COMMONWEALTH OF AUSTRALIA

Official Committee Hansard

HOUSE OF REPRESENTATIVES

STANDING COMMITTEE ON EMPLOYMENT, EDUCATION AND WORKPLACE RELATIONS

Reference: Employee share ownership in Australian enterprises

TUESDAY, 7 SEPTEMBER 1999

MELBOURNE

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HOUSE OF REPRESENTATIVES

STANDING COMMITTEE ON EMPLOYMENT, EDUCATION AND WORKPLACE RELATIONS

Tuesday, 7 September 1999

Members: Dr Nelson *(Chair)*, Mr Barresi, Mr Bartlett, Dr Emerson, Ms Gambaro, Mrs Gash, Ms Gillard, Mr Katter, Mr Sawford and Mr Wilkie

Members in attendance: Mr Bartlett, Dr Emerson, Ms Gillard, Dr Nelson, Mr Wilkie

Terms of reference for the inquiry:

The extent to which employee share ownership schemes have been established in Australian enterprises and the resultant effects on:

(a) workplace relations and productivity in enterprises; and

(b) the economy.

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Committee met at 10.06 a.m.

de BRETT, Mrs Marion Ruth, Compensation and Benefits Analyst, Esso Australia Ltd

McINTYRE, Mr John David, Tax Manager, Esso Australia Ltd

CHAIR—I would like to welcome witnesses and those in attendance who will be listening to this inquiry into employee share ownership plans and their impact on productivity in the workplace.

I should say to you that committee proceedings are recognised as proceedings of the parliament and warrant the same respect that proceedings of the House of Representatives itself demands. Witnesses are protected by parliamentary privilege in respect of the evidence that you give before the committee. You will not be asked to take an oath or make an affirmation. You are reminded, however, that false evidence given to a parliamentary committee may be regarded as contempt of the parliament. The committee prefers that all evidence be given in public, but should you at any stage wish to give any evidence in private, you may ask to do so and the committee will give consideration to your request. If you could please give us a precis of your submission, we will then ask you a few questions and explore the issues.

Mrs de Brett—We submitted a letter from Esso Australia Ltd and a submission, which was part of an MBA research paper that I completed as part of my MBA degree. The research paper was based partly on my experience in managing the implementation of the ESSO employee share plan, as well as on other research that I did. The research into the impact of share plan ownership in Australia is very limited and this is probably due to the newness of the concept. However, a Canadian study in 1987 suggested that companies experience greater productivity, net profit, return on equity and capital from operating share plans. Certainly, the Esso experience has been positive, with 67 per cent of employees participating in its first year of operation. This has increased to 70 per cent this year, with the second annual offer period finishing in July 1999. A remuneration survey that I have quoted in the 1998 report from Cullen Egan Dell also shows that the greatest percentage of companies which introduced a share plan did it to encourage employee involvement in the organisation.

However, there are some hurdles to overcome from the point of view of companies introducing share plans. There is complexity in the set up of share plans, particularly with the type of share plan that Esso Australia set up. This is the trustee type of phantom share plan, where we have a parent company based in the USA and we are buying shares on the New York Stock Exchange. So we had to set up a trustee company for that purpose. We also had to engage an expert in the taxation and share plan area to tell us what we needed to do. There is also ongoing administration involved in buying on the New York Stock Exchange and segregating the purchases into units for employees.

There is also complexity in the tax rules surrounding share plans, and I will ask John to give you an overview of some of them. One example from an administrative point of view is that, under the tax exempt scheme, the value of shares purchased for tax purposes is the weighted average over a week rather than the actual purchase value. This confuses

employees and also leads to greater administration costs because you have two sets of figures: you have the actual purchase cost and then you have the tax value. Sometimes the tax value differs from the actual purchase cost so that, in order to get under $1,000 for the tax exemption, you must make sure that the deduction from the employee salary in the final month is actually going to be less than $1,000. John might want to give a few more views on some of the tax issues.

Mr McIntyre—To follow that up, the five-day average pricing rule is probably more appropriate to a situation where new shares are issued by a company to employees, rather than where shares are purchased on the open market on behalf of employees. Where there is an actual purchase, I see no reason why the actual price should not be used to determine an employee's entitlement to the $1,000 exemption rather than this averaging arrangement. As Marion said, our books of account on behalf of employees now have two numbers associated with the acquisition of shares. One is the actual purchase price and the other is this deemed tax acquisition price. It leads to administrative complexity and a bit of confusion.

Another area of concern is the election available to employees in order to take advantage of the $1,000 exemption. The standard rule is that the employee will be taxable in the year of receipt unless the schemes are qualifying share schemes. Where they are qualifying schemes, the employee has a choice. He may go onto a tax deferred scheme, or he may take the $1,000 exemption arrangement. In order to take the $1,000 exemption arrangement, the employee must lodge an election, which is filed with the employee's tax return.

What can happen in practice, however—particularly for an organisation like our own that is multinational—is that we may have a share scheme arrangement here in Australia for our employees, but our head office may also be running employee share or option arrangements that cover the whole group of Exxon companies around the world. You can find a situation where an employee, say, at the start of a financial year in Australia may wish to elect to take the $1,000 exemption under the Australian scheme. He may or may not know whether he will be entitled at some stage throughout the year to receive shares or options—pursuant to, say, a head office or Exxon Corporation incentive or bonus arrangement that exists. This can leave a person not really knowing what they should be doing. We have found that to be an area of practical difficulty.

Another area of concern is the tax grouping rules—this is generally in the income tax area. In order for a company to benefit from the current group of, say, tax loss provisions or the capital gains rollover provisions, there must be 100 per cent commonality of ownership of entities within the group. For many companies operating in Australia with foreign parents, that commonality is traced back to the parent company—in our case, in the USA. It means that, in order to maintain that 100 per cent commonality of ownership between the elements of the Australian Exxon group, we cannot really issue shares to our employees out of the Australian companies. We have to issue shares in the parent company—Exxon Corporation of the USA.

That in itself is obviously not too bad, it is a chance for our employees to have shares on an international basis, but it does preclude them from taking advantage of the Australian tax imputation system and leaves them open, not only to the normal risk of shares going up or down, but also to the foreign exchange risk associated with those shares.

On the imputation side the difference is quite marked. Take as a simple example a dividend of, say, $64 paid by an Australian company—under our rules it is so-called fully franked—and a $64 dividend received from a US corporation. The effective rate of Australian tax on the $64 from the Australian company, due to our imputation system, is about 19 per cent, yet the tax rate applicable here in Australia on the $64 from the US company, for the same employee on the top marginal rate of tax, is 48.5 per cent.

In other words, the effective tax rate on the actual cash dividend paid is basically two and a half times as great in respect of a foreign share as it is in respect of an Australian share. But we are basically forced into that position because of the inability to issue shares in an Australian company without breaching the tax grouping rules. This issue has been raised as part of submissions made to the Ralph committee on business tax reform. They are the main areas of concern that we have had with our scheme at present in the tax area.

Mrs de Brett—We said in our letter that we would encourage this committee to look at the legislative requirements under which employee share plans operate. A reduction in employer costs of implementing and maintaining employee share plans would greatly enhance the opportunity for other companies to implement share plans. One of the major reasons for companies not providing share plans is the cost of setting them up and then the ongoing administration.

Additionally, we would encourage the government to provide greater tax incentives for employees under the tax exempt scheme, to increase the tax exempt level, or allow employees to participate in the tax exempt and the tax deferred schemes at the same time, rather than one or the other.

CHAIR—Thank you very much. On that last point about giving them the choice, can you explain in a bit more detail how you envisage that would work in a practical sense?

Mrs de Brett—If you were able to choose both you could choose the tax exempt and receive the $1,000 tax exempt, and then you could use the tax deferred to make extra contributions and buy extra shares.

CHAIR—Thank you. You said in your submission that overall you had a positive experience with employee share ownership schemes and that employees are now more aware of the business imperatives and performance. Apart from the reference to the Canadian research, have you got anything other than anecdotal evidence to support that view? It seems a self-evident hypothesis, I suppose, but it is hard to—

Mrs de Brett—Unfortunately, because the scheme has only been going for two years now—

Mr McIntyre—It is in its second year.

Mrs de Brett—We really were monitoring attrition levels and motivation of employees, a difficult thing to quantify. There was a lot of pent-up demand from employees for this. Our employees were aware of a number of US expatriates who had shares in the Exxon Corporation and our employees could see the positive attitude of the American expatriates

towards the company, towards production, towards productivity and efficiency. Our employees therefore wanted to participate in the company, wanted to take advantage of having shares in the company, because most of our employees are long-term employees and have an average length of service of around 15 years. So, to answer your question, anecdotally yes, but quantitatively, not at this stage.

CHAIR—So your scheme was put in place in response to employee demand, rather than the company having a series of objectives that it thought an employee ownership scheme might deliver?

Mrs de Brett—No, it was both, especially when the tax rules changed to exempt $1,000. The company then saw that it would be a viable proposition for employees. Also, our parent company had operated a share plan for many years and so they were not averse to affiliates providing share plans.

CHAIR—How does the share ownership spread throughout the company? Is it concentrated mainly at the white-collar end of the company?

Mrs de Brett—No, it is throughout the work force. All employees can participate in either the tax exempt or the tax deferred scheme. We have got offshore people, maintenance people, plant people, as well as executives and senior staff. They all have the choice of tax exempt or tax deferred.

CHAIR—Has it had any discernible impact on your employee workplace relations, for example?

Mrs de Brett—At this stage it would be difficult to assess. At the moment most employees would have about 8.2 Exxon shares. When you are looking at the tax exempt, the average cost of an Exxon share is between $A110 to $A120 for one share. So, it is not a lot of shares.

CHAIR—In terms of the $1,000 threshold, most people, other than the Taxation Office, have told us that they think the threshold should be raised. To what level do you think it ought to be raised?

Mr McIntyre—It is very difficult to say. The amount of tax forgone by the government is somewhere in the order of $485 downwards, depending on an individual tax rate, for the $1,000 exemption. That is not huge in relation to the number of participants in such a scheme. Probably somewhere in the order of $2,500 would make it more of an incentive for employees generally to take part. People do not have to go to the full extent of the $2,500, but that would be a significant incentive for people to take part.

Mr WILKIE—Do you use your employee share ownership scheme as a bargaining chip per se in relation to the negotiation of wages, or do you just have that as an extra?

Mr McIntyre—It is an extra.

Mrs de Brett—It was specifically taken out of the enterprise bargaining agreement. We did not want that to interfere at all, or it to be seen to be a bargaining chip. We wanted it across the whole organisation.

Mr McIntyre—Our scheme also is a salary sacrifice arrangement. It does not really impact on an employee's total package from the company, it is just a way of allocating that package.

Mr WILKIE—Do you have a separate system for executives, or is it all the same?

Mr McIntyre—It is the same. The employee share scheme in Australia is across the board. On the executive level there is a discretionary share or option arrangement that is managed totally by Exxon Corporation in the US.

Mr WILKIE—Right.

CHAIR—In dealing with the Taxation Office, a number of companies, and certainly the employee share ownership association, have suggested that it is very difficult to get draft rulings from the Taxation Office, that policy decisions are often pushed from ATO to Treasury and back again. What has your experience been, and is this an area that can be improved?

Mr McIntyre—I think in relation to our scheme we had very good service from the ATO. There is an inevitable delay it would appear in getting approval, particularly with schemes of this type. However, we did get our approval with what I would call a relative minimum of fuss compared to other rulings that we have gone for in relation to other areas of tax. At the time we applied we were aware that our scheme was on almost all-fours with another group here in Australia that had been to the tax office perhaps a year or so before ourselves. The tax office did have a precedent to follow. Maybe that helped smooth the way for us.

CHAIR—How long did it take you from application to approval roughly?

Mrs de Brett—I think it would be three months.

CHAIR—About three months. Okay, that is not too bad. Could you just tell us a bit more about the Canadian research please, Mrs de Brett?

Mrs de Brett—That is a while ago. I think it is referenced.

CHAIR—Toronto Stock Exchange 87, was it not?

Mrs de Brett—Yes. It was referenced in one of the books that I—

CHAIR—There seems to be a paucity of certainly national but also international research that confirms what, I think, people would generally believe in terms of productivity gains and efficiency.

Mrs de Brett—That was in a book called *Employee Share Planning in Australia* by Fitton and Price of 1990. There is a paucity. I had my husband go and research. He found the ACTU to be the best source of information on employee share plans but he went through all the libraries and it was very difficult to find anything quantitative with regard to motivation satisfaction levels.

CHAIR—Do you think that prospective research like that could be done in Australia?

Mrs de Brett—I think it could, yes. In fact, it is an area that I might explore a little bit further but it is very difficult, I think, because of the newness of it whereas, in the US, Canada and the UK, employee share plans have been existing for quite some time.

CHAIR—You said in your exhibit:

Companies introducing a share plan need to be aware of any industrial relations issues.

Are you able to tell us about your experience there? I presume you worked with unions in introducing it? Were there problems?

Mrs de Brett—There was one issue surrounding it. The unions tried to use it in enterprise bargaining. At that particular point in time we were in enterprise bargaining mode and the unions saw it as a tool with which they could delay the enterprise bargaining process. The company made it quite clear that that was not part of the negotiations but there was one group of employees—the operators offshore—who were not able to participate in the share plan because they had not approved the salary sacrifice clause within their agreement. Because they did not have that we could not let them participate. From a legal perspective we would be reducing their salary under the award in which they worked. From a legal perspective we could not allow them to join but subsequently they got the salary sacrifice written into their award and they participated as soon as that was done, which was eight months later.

CHAIR—From your research have you found that individual performance indicators are preferable to company performance indicators in terms of how share ownership affects employee behaviour?

Mrs de Brett—I would suggest probably both individual and company. I think you would need to look at both sets.

CHAIR—Thank you.

Dr EMERSON—In the documentation you describe a circumstance where a lot of other companies also had employee share ownership schemes. I was wondering if you can give a judgment as to what extent you were motivated by the fact that others had these schemes vis-a-vis some reasonably high expectation of direct benefits to the company itself. Did you feel, 'We had better get one of these because everyone else has got one' or 'That is irrelevant. The fact is we want an employee share ownership scheme because we think it is a terrific idea'?

Mr McIntyre—There is competitive pressure out there. It was certainly a consideration that other companies were also offering employee share arrangements at that time or had done so prior to ourselves doing it. It was a consideration. I would think the major consideration was to really get the employee involvement in an employee share scheme to gain the benefits from that rather than just to meet competitive pressure. Competitive pressure can be met in a number of different ways, not just by offering the same sorts of benefits as other organisations. It could be done differently.

Dr EMERSON—I probably missed it earlier, but to what extent is the value of the share linked to external factors beyond the control of the company?

Mr McIntyre—It is totally. It is market driven. It is Exxon Corporation and that is driven primarily by the price of crude oil around the world. That would seem to be the major generator of its share price.

Dr EMERSON—I think the oil price has been rising recently.

Mr McIntyre—Yes, it has been, thankfully.

Dr EMERSON—And they are probably pretty happy about that. Do you get circumstances or can you envisage circumstances where an external factor occurs—in this case, a very important one, such as an oil price fall—and the value of shares falls?

Mr McIntyre—We can have the worst of all worlds in relation to our scheme in the sense that, not only could the price of crude fall and therefore, say, the Exxon share price, but we may at the same time even have the Aussie dollar rising and therefore our employees carry not only the normal share price risk but a foreign exchange risk as well.

Dr EMERSON—What do you think their attitude in those circumstances would be? Would they say, 'That is fair enough. We are in an industry where we are a price taker and that is the way the cookie crumbles,' or would they say, 'We want some sort of insulation against this. Our shares have halved in value or fallen by a quarter. What is the company going to do about it?' Do you envisage those sorts of situations arising?

Mr McIntyre—I would think we do not really. We have advised employees before entering the scheme that they do carry these risks and also of the fact that the company does not guarantee what we might call the floor price for the shares. They have been advised of that. We think the majority of our employees do understand the environment in which they are working, particularly the pricing mechanisms for the shares in Exxon Corporation. We are a special industry, the oil industry, and I think that is well and truly understood by the majority of our employees. They may not like it if the share price falls, but I think they do understand it.

Dr EMERSON—Sure. Related to that is I do not have a really good feel as to how important the employee shares are as part of their total remuneration.

Mrs de Brett—From a total remuneration point of view, it does not impact their benefit whatsoever.

Dr EMERSON—What I am getting at is that maybe there is not much at stake from their point of view. They just say, 'This is just a little bit of extra money on the side of the plate.' Would that be the attitude or is everyone riveted to the oil price when they get up and eat their cornflakes in the morning, checking the price of West Texas Intermediate?

Mr McIntyre—As a percentage it is relatively small year by year. However, the shares acquired each year of course do grow in number. As Marion pointed out earlier, presently the average period of service of our employees is somewhere around 15 or so years. So whilst our scheme has only been running for a year, on the assumption that our average life of employees is 15-plus years into the future, they will have a significant number of shares come the latter period of their employment with us. I think then it could be of quite significant consequence to them what happens to the share price, as time goes on.

Dr EMERSON—It could become the subject of breakfast conversation. They will open up the *Financial Review* each morning and see how they are going.

Mr McIntyre—We do have a number of what we call expat employees. They come from maybe the US primarily but certainly from other countries around the world where Exxon has operations. The level of interest amongst those people in the Exxon share price is a lot greater than amongst Australians because they have been in employee share schemes for a long time and therefore have more invested in such schemes. It does grow as your overall investment in the corporation grows.

Mrs de Brett—The other issue, from an administrative point of view, is that we purchase on a monthly basis a percentage of the overall $1,000 for those in the exempt or the tax deferred. Essentially what we are doing by purchasing on that monthly basis is trying to even out the highs and the lows of the share purchase.

Dr EMERSON—I may have missed this because I was late but have you noticed any change in attitude or behaviour on the part of the work force as a result of participation in the scheme, or would it be far too early to say?

Mr McIntyre—Probably it is still early days. There has been a positive reaction—this is just from talking to people, just anecdotal, not from a study. Even the people in my own department do take more of an interest in what is happening with the share price.

Mr WILKIE—This may have been covered in the submission but I have not seen it. Are your shares portable—can people take them with them or do they have to sell them when they leave the company?

Mr McIntyre—They effectively have the choice. If they leave the company the tax liability under the tax deferred scheme hits them. Basically that means half the value of their shares at the time they leave would go in tax. They can certainly take the shares if they wish, but they have to come up with the money to pay the tax. We have not really had examples of that as yet, but I would assume some people would be in the position where if they left the company they would probably have to sell at least half the shares to pay the tax liability and take the remaining 50 per cent of the shares with them.

CHAIR—So, from Esso's point of view, the $1,000 threshold is an issue for you, as is, for tax purposes, the imputed as distinct from the real purchase value of the shares. You also made some comments about the five per cent rule and prospectus requirements for non-listed companies, but that does not affect Esso, obviously.

Mrs de Brett—That is right.

CHAIR—Are there any other things, from your point of view, that we should be addressing?

Mr McIntyre—Just the comment I made earlier about the general tax grouping provisions requiring 100 per cent commonality of ownership in order to participate, under the current law anyway, in the tax group relief and capital gains rollover relief. What that effectively does is preclude us from offering our employees shares in any of our Australian companies whereby they could participate under our imputation system, which is quite beneficial. We are really forced into having to offer them shares in Exxon Corporation in the US. It might be nice to have the opportunity to give employees a choice as to whether they want Australian shares or US shares. It would just open the flexibility of the scheme a bit more. As I say, the benefits of imputation are significant. The effective tax rate on a dividend is 2½ times greater on the US dividend than on, say, an Australian dividend that is fully franked.

CHAIR—Okay. As there are no further questions, thank you very much.

[10.43 a.m.]

CUMMIN, Mr Ian Ronald, Executive General Manager, Human Resources and Corporate Services, Southcorp Ltd

McWILLIAMS, Mr Michael Paul, Group Tax Manager, Southcorp Ltd

MORTON, Mr John Leonard, Company Secretary, Southcorp Ltd

CHAIR—Welcome. The committee proceedings are recognised as proceedings of the parliament and warrant the same respect that proceedings in the House of Representatives itself would expect. Witnesses are protected by parliamentary privilege in respect of the evidence that you give before the committee. You are reminded, however, that false evidence given to a parliamentary committee may be regarded as contempt of the parliament. The committee prefers that all evidence be given in public but if at any stage you want to provide anything in camera just ask us and the request will certainly be considered.

Thank you for providing a submission and coming to speak to us—it is very much appreciated. Would you give the committee a precis of the submission, which we will then discuss?

Mr Cummin—The committee has the submission so I will just provide a brief recall of it and then we can move into fielding any questions that you have on the detail. As you are aware, Southcorp is a diversified industrial company, with $2.8 billion in sales in 1998-99.

Let me give you a sense of familiarity in terms of what our 10,000 employees do. We have three divisions: wine, packaging and water heaters. The wine brands that I guess would be familiar to everyone would be Penfolds, Lindeman's, Seppelts, Seaview, Wynns, Queen Adelaide, Leo Buring, Coldstream Hills, Devil's Lair, Rouge Homme, Hungerford Hill, Kaiser Stuhl and others. We are the largest owner of vineyards in the world, so we are a genuine world player when it comes to premium wine.

In relation to packaging—again, to give you a sense of familiarity with what we do—we produce plastic bottles, anything from clear PET that you would see in, say, Schweppes soft drink bottles, through to cordial bottles et cetera, confectionery wraps, beverage and food cans—Lion Nathan is a major customer of Southcorp—milk and juice cartons, steel drums, from 44 gallon drums down to paint cans, and industrial textiles. That represents the kind of product range that our packaging division produces. Water heater brands that you would know would be Rheem, Vulcan and Solahart. In the US it is American Water Heater Company and in China it is Hot Stream. But we are also into manufacturing specialist valves for the clean air industry under Goyen.

Turning to the submission itself, the employee share plan in Southcorp is a major part of our employee relations program. It underpins our approach to our communication with employees about company financial performance, and it facilitates a focus between local management and employees at each of our sites—it facilitates their focus on local performance issues. It also generates rewards out of superior company shareholder value that

can go directly to employees without the need to go through a bargaining mechanism through the normal enterprise bargaining agreement negotiation process.

We have, as you know, a very high employee participation rate. With the divestment of white goods, it is now 99 per cent, and 100 per cent remains our aspirational target. Unlike some other companies, Southcorp is interested in the participation rate of employees under our share plan. We believe a high participation rate is critical for the success of the reasons underlying the company's introduction of the share plan. We do not believe you can have a communication program that we have without an atmosphere of goodwill and community of interest in order for that communication program to be a positive event. We believe this is served through the employee share plan.

While I guess our previous modern plan, which was structured using shares—that was the one that was introduced in 1995-96—was a step change improvement in the level of participation from previous times, achieving 75 per cent, the more recent introduction of the option plan in 1998 really took us to what we believe is the most outstanding of participation rates. The reasons for that introduction are in the submission. Principally it enabled us to go forward with a global program. We were unable to extend the same program using shares to all employees throughout the world in Southcorp, but we were able to structure a common program with only slight differences, really technical differences, but for all intents and purposes a common platform for all employees worldwide using options.

With the use of options, we took some risk because we were not aware of any other large companies that were using options for a general employee share plan. Previously we felt that to offer any kind of derivative would make the communication plan program more complicated as opposed to going forward with an ordinary share. We believe we overcame those communication problems—and clearly we did—when we looked at the response rate for employees.

I think the only issue for the company between the two plans—we would stick with the option plan—is that under the employee share plan, when employees had a loan to repay, they incurred interest on the loan if they resigned. There is no such mechanism that inherently assists in encouraging an employee to remain in Southcorp under the option plan. If they resign, they can still hold their options and exercise the options in three years, even though they are not an employee. That is an area that we are giving some more thought to.

Other than that area, we have just rolled through with our 1999 offer on the same terms, although on a lower amount. The reason we are offering 600 options instead of 1,000 options is that we are approaching our five per cent limit in relation to issued capital being in the hands of employees, which is being approached well in advance of what we anticipated. But that is the only change that we are making. We are open to any questions that the committee may have.

CHAIR—Does Southcorp have a view on the five per cent limit? Would you like to see that raised?

Mr Morton—It is a limit that exists under the rules of our plan. We would have to go to the shareholders to increase that limit. There is also a limit that is imposed by the ASIC.

They have a class order that allows companies to issue shares to employees without a formal prospectus. We would not go to the expense, I do not believe, of preparing a full prospectus to enable us to go above the five per cent limit.

CHAIR—One of the thematic views to put to us in relation to employee share ownership plans has been about the five per cent rule. The other has been about the prospectus requirements. Would Southcorp recommend some changes in both of those areas? Would you see that as advantageous to your employees?

Mr Morton—We certainly would. It would give us more flexibility in going forward and continuing to offer them the level of shares that we are currently offering. As Ian has just mentioned, we had to wind back our entitlement this year from 1,000 shares to 600 because of that five per cent limit. In addition, we would have to go to shareholders to increase the five per cent limit under our plan laws anyway.

CHAIR—That is an internal issue for you.

Mr Morton—That is correct. That is something that we can attend to internally.

CHAIR—If the committee were inclined to recommend raising the five per cent rule—it is not a universal view, but it seems to be a fairly common one—do you have an opinion as to what level it ought to go?

Mr Cummin—Our view is that the best judge would be the shareholders themselves. As the employee shares are issued, they have a dilutionary effect in relation to issued capital. They make the need to ever-increase and maintain earnings per share a bit harder. My feeling is that, on this kind of question, the shareholders are in a pretty good position to judge whether they are getting the value that they believe they should be getting from an employee share plan.

We have had a very successful plan and we have hit five per cent. We have hit five per cent early and the reason that we are not going over five per cent is principally because of the prospectus issues. But if that did not exist, you would have to say that 10 per cent would be a figure that would give the regulatory authority some sort of comfort but, at the same time, provide ample flexibility for shareholders to make a decision as to whether or not they felt they were getting what they needed out of a program.

CHAIR—In terms of the evolution of your plan, with the substantive changes in 1995-96 and then again in 1998, were unions involved in those changes?

Mr Cummin—No, they were not.

CHAIR—Did they seek to be involved?

Mr Cummin—No, they did not seek to be involved. It is fair to say that we see the employee share plan as something quite separate from the negotiated contract of employment on which, especially through the process of EBAs, unions have focused. We see this as something that is an entirely discretionary matter that the board and shareholders provide.

From the union perspective, there is obviously also some risk because shares can go up and down. I do not think that unions have necessarily sought to become involved because, in a negotiating sense, it is an area in which they would want to see a wage trade-off because of the high risk associated with fluctuations in share price.

CHAIR—Originally, though—and I would think with hot water packaging and wine that you are pretty safe at Southcorp—your scheme was a salary sacrifice kind of scheme, was it not?

Mr Cummin—It was.

CHAIR—I would have thought the unions would have some interest in that. It seems unusual that they would not.

Mr Morton—I do not know whether I would really describe it as a salary sacrifice scheme. Under our old scheme they had to pay a 10 per cent deposit to acquire the shares. That was until 1996. From and after 1996, in the two years in which we did issue shares, there was no cash outlay by the employee. They received an interest free loan from the company for the shares but that loan is being repaid by dividend income. There is no cash outlay by the employee in a salary sacrifice or any other sense.

CHAIR—You suggested in your submission that indicators perhaps of the success of your plan might be a fall in resignations rate in Australia from 7.7 to 6.7 per cent over the past three years; a lower level of industrial disputation since 1994-95; lower average days lost per employee due to workplace injury, down from 0.59 to 0.21 in the last four years; and company earnings per share growing at an average compound rate of eight per cent. How can we prove that? How do we know that it is the share ownership plan and perhaps not part of the general culture in terms of the way the company is managed?

Mr Cummin—It is hard to separate any of these elements. The previous witnesses indicated to the committee that it is extremely hard to hive off one element of an employee relations or an HR program. We would not be going forward with an employee share plan that has effectively diluted the shareholders base by approaching five per cent if we did not think that it was in the shareholders' interests to do so. We do see, on sites where there has been some threat in relation to the business or some recent industrial relations upheaval—not so much last year, but certainly in the two years before—a lower participation rate. But on sites where we have a high participation rate, we do not see a deterioration.

So, whilst the culture might be a cooperative culture on a particular site and you can ask, 'What comes first, the chicken or the egg?' once the employee share plan is in and there is a higher participation rate, it facilitates a management system on that site where there is a formal mechanism and a formal reason for interest in the financial performance of the site or of the company and, flowing on from that, the contribution that that particular site can make to it.

I guess, after a few years, if we feel that the employee share plan is something that is welcomed by employees as an event, which recedes in its importance after the shares or the options have been issued, then we would also expect to see, come EBA negotiation time, or

come a union campaign, for example, a protest against a legislative change. We would see a higher degree of activity across our sites in support of something that is really outside the company's agenda. I would have to say that, on a relative basis, we are happy with our employee relations.

Mr WILKIE—Do you have a separate scheme for executives, or other incentives?

Mr Cummin—Yes, every employee of Southcorp, with the exception of the managing director, participates in the employee share plan. In addition to that, we have an executive share and option plan.

Mr WILKIE—How does that differ?

Mr Cummin—Perhaps I might ask John to go into some of the details. It differs in a number of ways. For example, there is no discount on the exercise price. It is significantly greater in terms of quantum, and that depends on the level of the executive. When it was introduced, it was introduced into a company by a reduction in salary increase, if you like. So the executive share and option plan is very much seen as part of a remuneration package, and it is one that we compare in terms of an executive's total remuneration. We compare it with the market. The employee share plan is not seen as part of a remuneration trade-off. It is seen as a mechanism to foster the kinds of objectives that have been included in the submission.

Mr Morton—The other main difference—and a significant one—is that there is a performance hurdle built into the executive share plan.

CHAIR—Is that individual performance versus company performance?

Mr Morton—We have used a performance hurdle in a couple of ways in specific businesses. We have related to that business's individual performance where we have wanted a specific focus by the management on their business. Generally, it is a company-wide performance measure and it is earnings per share. We have traditionally used a 7.5 per cent annual compound growth in EPS which the company has achieved over the period.

Dr EMERSON—How significant in your overall decision to proceed with employee share ownership schemes is the tax treatment—the $1,000 threshold? Did you say, 'That's really important and that's why we'll do it,' or did you say, 'This is a good thing and, by the way, there's a little benefit on the side'?

Mr Cummin—It has not been significant in the reason to do it. I think it has been significant in the participation rate.

Dr EMERSON—In the take-up?

Mr Cummin—That is right.

Mr Morton—And the benefits to employees.

CHAIR—How have the general shareholders responded to the employee share ownership plan you run?

Mr Cummin—They have responded positively. At each of the annual general meetings where there has been a need to amend the share plan in some technical detail or, in fact, when it was introduced, it has been positively received. In relation to institutional investors, the people who might express a concern about company performance and share dilution issues, they do not do so and we have no reason to think that they do not believe that employee share plans positively impact the company's performance.

Mr WILKIE—Do they have the same rights as other shareholders? Can they vote, for example, at an AGM?

Mr Morton—They cannot in relation to options because votes only attach to fully paid shares. The shares are held by a trustee—this was under the 1996-97 issue—so the trustee can vote, but the employees get the right to direct the trustee how to vote in respect to their shares.

CHAIR—I want to ask about your relationship with the tax office. Some of the submissions we have received and people to whom we have spoken have said that communicating with the tax office—and it is probably difficult enough at the best of times—is not always easy. We have heard that there are often lengthy bureaucratic delays. Perhaps this does not apply to you so much, other than the two most recent changes that you have had, but we have heard that trying to get rulings is complex, that there are lengthy delays and that there does not seem to be any sort of general policy direction coming from either the ATO or, indeed, the Treasury. Have you got any comments on your relationship?

Mr McWilliams—Our relationship generally with the tax office is very positive. We have had a pretty good history of getting rulings from them on a fairly timely basis and we have a fairly open communication program. On the specific issue of share plans, though, we have had one difficulty with getting a ruling, but that was not so much the Australian aspect of the plan, it was in trying to broaden the scope of the plan to include our overseas employees. It was to do with the place of residency of the trust and a particular technical requirement of the Australian law that the tax office did not feel they could give a favourable ruling on. That resulted in us taking a different tack. But it was not for want of trying on the part of the tax office; it was just a technical flaw in the law that meant that they could not give us the ruling that we were after. By and large, we have not had any difficulties communicating with the tax office.

CHAIR—In summary, in relation to your company, if the government was to change the legislative requirements for any aspect of employee share ownership plans, the things that we should be looking at are the five per cent rule and the $1,000 threshold—I presume that is also an issue for your employees. Are there other things in particular you would like examined?

Mr McWilliams—On the issue of taxation, you have mentioned the $1,000 threshold. I have noticed from a few of the other submissions that the possibility of something closer to what the UK equivalent might be could be an alternative. We would support that as a

general proposition, and not just because other countries have it. We think it would allow Southcorp much more flexibility as to what it offers to employees and when. One of the constraints, I suppose, on maximising the productivity benefits is non-forfeiture of the shares and options. With the $1,000 limit that is not such a hook for the employees to stay. But if you were able to have a higher threshold, and have fewer issues but with a bigger discount, the ability to look forward to a bigger gain in two or three years time, with, say, a $5,000 exemption, might be a way to overcome that particular problem. That would be one thing that we would support.

We have mentioned that we use a trust for the shares and options. Other submissions have touched on this as well, but if the Ralph committee were to recommend any changes as to the tax treatment of trusts we would certainly support a carve-out for employee share trusts.

Finally, on the executive share and option plans that are tied to performance hurdles, one of the difficulties with option based plans is the tax treatment, in that you either pay a lot of tax up front when you get the options because of the valuation rules, or you pay tax at the time of exercise. What that tends to do is to induce exercise and immediate sale of shares to fund the payment of the tax. So, again, we would support any move that encouraged longer term retention of the shares under option based plans.

CHAIR—Is Southcorp disadvantaged in any way in the global marketplace for labour, particularly at the top end of the executive spectrum, because of our tax laws and particularly in relation to stock options?

Mr Cummin—No, in each of the countries that we operate, we operate in accordance with the competitive market of that country. Under our option plans, we structure our employment offers and benefits in accordance with the environment of the particular country. I think it just so happens that senior option plans now are a common feature across the world. For example, we would have managers in the US who, if you translated their base salaries at the rate of exchange, are being paid in some cases significantly more than the person that they report to back in Australia. But that is what you do to operate in a competitive market. We do not see it as an issue for us.

CHAIR—All right. Anything else you would like to add?

Mr Cummin—I think the only issue that I am not sure has come up is this one of retention. Certainly, what we see in the US with unemployment rates at 4½ per cent is a lot of churn between businesses and between companies. I think our employee turnover in the US is significantly higher than it is in Australia. It is starting to come down and part of the reason we, in fact, introduced our employee share option plan was directed at turnover.

Under the share plan, we were able to use the interest rate as, I guess, a mechanism to encourage employment stability. Under our existing option plan, we are not able to because there is no loan, which is great, and we have not seen an increase in employee turnover since it has been introduced. But, as unemployment rates in Australia hopefully do come down and the labour market begins to tighten, employee share plans are a great mechanism to reduce the level of churn and therefore encourage more employment from the unemployed

market as opposed to swapping between companies. We have not got the answer to it but it is something that the committee might consider.

CHAIR—Okay. It is a fairly reasonable hypothesis that, if the employees have got shares in the company, they would be less inclined to change employment. But, when you say consider it, is there something else we can do to help facilitate that in some way?

Mr Cummin—Yes, I think so.

Mr McWilliams—I suppose there is the issue of the non-forfeiture requirement. Perhaps that could be relaxed somewhat so that the shares or options could be forfeited in situations where an employee were to leave voluntarily. Obviously, you would not want a forfeiture in the event of termination of employment because of redundancy, retirement or death—those types of things. But, as a way of encouraging people to stay on whilst there is a restriction on disposal, there remains the potential for the share option to be forfeited during that period as well.

CHAIR—As a matter of interest, roughly what percentage of your work force is unionised?

Mr Cummin—All employees in an industrial situation—production or operational—through to the base level clerical group. You would probably say that in Australia it would be roughly 60 per cent or something like that. We are a typical company in that regard. We do not have white-collar unions but we have blue-collar unions. In the areas where you would expect to see blue-collar unions, they operate. Employees are members of the unions.

CHAIR—Would you say there is about 60 per cent penetration by unions of your blue-collar work force?

Mr Cummin—No. In relation to our blue-collar work force, you would probably say in the order of 80 or 90 per cent.

CHAIR—That is interesting. A high level of employee share ownership in your company has also been consistent with high levels of union membership?

Mr Cummin—In blue-collar areas, that is so.

CHAIR—But the unions have not been active players in the development of the plan.

Mr Cummin—They have not been active players and—

CHAIR—But they could have been if they had been concerned about something.

Mr Cummin—To be fair, we would not have seen the employee share plan as something that was appropriate in an enterprise bargaining arrangement. It is something we firmly see as not part of a remuneration strategy. It is part of the communication strategy.

CHAIR—I understand.

Mr WILKIE—It is probably why you have not had any great input from unions.

Mr Cummin—It is possibly why. I am sure if we had sent an invitation, we would have had the unions taking part.

CHAIR—But if the unions were upset or had concerns about your plan, whether it is a remuneration thing or not, I am sure they would have knocked on your door.

Mr Cummin—They would have. But with the move to enterprise focused employee relations, I think they take their lead on these sorts of matters from their delegates. If the delegates have not got a problem then they have got other things they need to look at.

CHAIR—Thank you very much for your time. We are very grateful to you.

[11.26 a.m.]

GRIFFITH, Mr Michael Llewellyn, General Manager, Taxation, North Ltd

CHAIR—Thank you very much, Mr Griffith, for coming along this morning and also for providing us with a written submission. There is just a formality that I need to go through. Firstly, committee proceedings are recognised as proceedings of the parliament and warrant the same respect as proceedings of the House of Representatives itself should demand. Witnesses are protected by parliamentary privilege in respect of the evidence that they give before the committee. You are reminded, however, that false evidence given to a parliamentary committee may be regarded as a contempt of parliament. If there is anything at all that you wish to provide in camera, then please feel free to ask us and we will certainly consider that request at any time.

You might now like to give us a precise of the submission and then we will talk about it.

Mr Griffith—Thank you. I have been with North Limited for almost 10 years and have been involved with the employee share plans from a taxation perspective over that whole period. Our HR people who run the employee share plans are all relatively new so it was felt that I would be the appropriate person to appear today because I can give a history of the results over that period of time.

North also runs, on a semi-regular basis, information sessions on the employee share plans for all employees. I have participated in all of the ones that have been run over the last 10 years, and they have included site visits and travel with the HR people to answer all the questions employees have. So, as I say, it was felt that I had a fairly extensive background.

North gave a relatively short submission which summarised the results of our employee share plan. Our share plan was a fairly traditional one in that the company provided shares—it started out at 500 and then it was increased to 2,000—on a fully paid basis with the company providing the loan funds on an interest-free basis to employees. The participation rates are detailed. They have always been, I suppose, a slight disappointment, and they have ranged from, in the last five years, 39 per cent up to 43 per cent. We would clearly like that to be higher but, unfortunately, that is the rate that has been accepted by employees.

We feel that the inhibiting factors have been the fact that employees have to take a loan and they have to bear the downside risks. Many employees have never participated in share ownership and, therefore, it is a psychological leap. That is why we run the information sessions for them. To actually fill in the paper and sign it, while it may only be a few minutes work, it is a big leap for many people and as such they just do not make it. They think about doing it but they just do not get on to it.

Also, the downside risk is a major concern with many employees. We find when our share price is high that employees are reluctant to look at the longer term. If you look at the North share price, it is fairly cyclical. Last year when our share price was $5, employees would say, ‘The share price is too high, I can’t see a short-term gain.’ Bearing in mind that we have a three-year restriction, they say, ‘It is just not there. I will wait until the price goes down in the cycle.’ This is something we try to educate employees in, but we cannot give

them financial advice. If you look over a 10-year period, which the loan funds were provided for, then the results are not outstanding, but they are not unreasonable.

It is worth adding that while there is a three-year period, employees watch the share price fairly closely, and even if it is two years before they can sell, if the share price goes down they get very distressed and if the share price goes up they feel quite comfortable. It is certainly a way of getting employees involved and interested. The scheme which we have covered here is the loan scheme.

Can I ask for an in camera hearing here because we are looking at introducing new arrangements.

Evidence was then taken in camera, but later resumed in public—

[12.05 p.m.]

HAMILTON, Mr Reginald, Manager, Labour Relations, Australian Chamber of Commerce and Industry

CHAIR—Welcome. I thank you and your staff and the chamber for providing a submission and taking the time to come to speak to us.

The committee proceedings are recognised as proceedings of the parliament and warrant the same respect that proceedings in the House of Representatives itself would demand. Witnesses are protected by parliamentary privilege in respect of the evidence given before the committee. You are reminded, however, that false evidence given to a parliamentary committee may be regarded as contempt of the parliament. If there is anything that you want to say in camera at any stage, please indicate to us that that is the case and we would almost certainly accede to that request. Could you give us a precis of the chamber's view of this issue in your submission and we will then discuss it.

Mr Hamilton—Through my position as Manager of Labour Relations at the Australian Chamber of Commerce and Industry, we deal with a broad range of employee relations and labour relations issues facing this country at a national level.

Before I came here I made the mistake of reading some of the transcript on the Internet and I am a bit cross-eyed, so you will have to forgive me. It was a big mistake—it was quite an interesting transcript, but unfortunately the print was very small. Our submission provides a slightly different angle to some of the discussion I have seen in other submissions. The information we can provide to this committee relates to the place of employee share ownership in ways of remunerating employees and involving them in the enterprise—a labour relations, employee relations perspective, if you like. On the other important issues which this committee is dealing with, such as tax issues, there are probably more skilled people who have appeared before you.

The submission we have made to you has a number of publications attached. We have sought to promote share ownership schemes over the years. We do see them as a very constructive option for employers and employees. You can look at it in a sense in two ways. One way is as another way of employer remuneration. Another way of looking at it is within the broader employee participation approach, as we would call it. Unions have a phrase 'industrial democracy' which we have never used and which we have difficulties with. Those are the two perspectives I would like to speak about.

First of all, in terms of another option for employee remuneration, the analysis we have provided does show that enterprise agreements—that is, agreements formally registered under the Workplace Relations Act, a Commonwealth act—do include, to some degree, share ownership as a subject. We think that is quite an interesting development. It is interesting because it does show that this form of remuneration is accepted as a legitimate part of labour relations, employer relations, by both employers, employees and their representative unions. It also shows that the schemes are spreading to some degree outside the traditional white-collar areas into what are often referred to as blue-collar areas.

This issue of legitimacy is a very important one because part of the process of reform of workplace relations has been a process of opening minds and a learning process for everybody—employers, employees and their representative unions, if they play a role in a workplace. Part of the learning process is looking at all the different financial participation approaches which can be used and accepting that they have a role on occasion. The old approach would have been to draw a line and say that those sorts of schemes have no role in this area and we will not have a company introducing them in our industry, or some such phrase.

Our enterprise agreement reports, which we produce on a quarterly basis, do show that financial participation schemes are not uncommon. Our latest report, for the first quarter of 1999, shows, for example, that performance appraisal schemes occur in about seven per cent of the agreements, and other performance pay provisions in about 13 per cent. Numbers of agreements with employee share ownership schemes are quite low—0.6 per cent—but, nevertheless, the point is that they are there and they are being looked at and used by managers and their employees. That is the sort of thing we want to promote. As the ACCI we want to promote an approach that people have open minds, that they look at all ways of remuneration and of rewarding employees and linking pay to performance and enterprise performance. We want an open-minded approach. I think the evidence is there that minds are opening—that comes from our enterprise agreement reports.

There is no formula for a good approach to labour relations or for a good approach to remuneration. Rather, there is a whole range of ways of approaching labour relations. This is one of them, it has a very important role to play and we hope it will be more important in the future. That is what I want to say on the remuneration aspect. I will not bother to list all the other types of financial performance linkages—it is all there in the documentation.

The second way of looking at our share ownership schemes is in the broad, employee participation approach, what unions call industrial democracy. There are commonalities between the two terms but there are also differences. I have noticed in one or two union submissions that the term industrial democracy is used. I have brought along a short position paper that we have developed on the issue of industrial democracy/employee participation, if I can tender it.

CHAIR—Thank you.

Mr Hamilton—The term industrial democracy/employee participation is not a new one. It has been around for a long time, since the 1960s and 1970s. We looked at these issues quite recently in a meeting of our employment and labour relations committee and we developed this sort of approach. We do see that the term industrial democracy is not an appropriate one. It has a whole range of implications and associations which are not particularly helpful. But in terms of employee participation—you will see that is the second bold heading on page 2—there is a lot to be gained by both employers and employees from involving employees more in decision making, from making them more aware of the performance of a company, from being more open-minded and listening to employee views and concerns and from seeking out employee views and concerns. Again, there is no one way of doing that, there is no formula, but there is a lot to be gained from it. This is a longstanding position that we have always taken.

As part of that involvement process of employee share ownership schemes, other financial participation schemes have a role. One suggestion that has been put to us is that often employee share ownership schemes work best when they are associated with that sort of consultative approach. I must say, I think there is a lot in that. We would generally agree with that proposition that that sort of approach, which is a different way of remuneration, probably often involves a process of building trust and mutual exchange of information so that both employers and employees know where they stand and act on a solid basis of information and understanding.

The final point I would make is that I have had a look at the Department of Employment, Workplace Relations and Small Business submission and I find their analysis of the benefits of employee share ownership schemes at page 21—drawn from AWIRS, the Australian Workplace Industrial Relations Survey—quite interesting and impressive. It does confirm the sorts of impressions we have of dealing with labour relations and of providing advice. We do see that they generally provide benefit to enterprises. So those are the sorts of views we would seek to put to the committee. If there are any questions or additional information which the committee would be interested in, we would be happy to provide it. We have provided a lot of information, so it may not be necessary.

CHAIR—Thank you very much. Has the chamber turned its attention to how we could more objectively assess the benefits or otherwise of employee share ownership plans? I think almost every company that has come before the committee has spoken highly of the plans, although they have had some concerns about tax or Corporations Law in relation to them. However, there does not seem to be any objective evidence. Southcorp, for example, looked at employee participation, resignation rates, industrial disputation, occupational health and safety, and company earnings per share—all of which had improved in the last three or four years. Can you shed any light on this one?

Mr Hamilton—It is a very hard question to answer. In our sort of area, virtually nothing is provable according to strict standards of proof. Really this is one factor among many: you could have a very good employee share ownership scheme associated with very poor other aspects of the workplace, which would mean the results of the workplace do not reflect the performance of the employee share ownership scheme. So the only way you can really assess these sorts of schemes at a macro level is by using a combination of anecdotal data—companies reporting what they think—and objective data such as AWIRS.

There have been two AWIRS surveys. They are comprehensive surveys of a full range of employee labour relations issues in Australian workplaces. I think the last one was done in 1995. That was when the surveys went out. If you look at AWIRS data, you can analyse it as the Commonwealth has done at page 21 of the Department of Employment, Workplace Relations and Small Business submission. It does seem to indicate a positive correlation between those schemes and various aspects of performance such as absenteeism, turnover and dismissals. Interestingly, industrial action seems to be more prevalent in firms with employee share ownership schemes, but the answer to that may be that there is a correlation between trade union activity and employee share ownership schemes. So that may deal with that particular, if you like, negative indicator, but the other indicators seem to be quite positive.

In terms of other data, I think there have been some studies done in this area which have been put to this committee. There is overseas evidence, which is generally positive. I think that is all you can do—look at all the sources of data and make an assessment using that.

CHAIR—Are there any changes in the taxation treatment of employee share ownership plans that the chamber would recommend the committee to consider?

Mr Hamilton—That issue is probably best dealt with by others. I am unfortunately not able to do so; I am not a tax expert.

CHAIR—It is interesting that the chamber sends to us its manager of labour relations in the context of employee share ownership. I presume, in doing so, the chamber is saying that it more or less sees the benefits of this in terms of employee relations rather than workplace relations. Is that right?

Mr Hamilton—Yes, it is essentially. If you put the tax issues in context, provided there is an appropriate tax regime which encourages these schemes, the benefits are to be gained by employee relations. That is how I would answer that. In other words, the role that these schemes play is part of the employment relationship. It is a positive role as far as we can tell. All the information I have available to me indicates it is positive, but the issue of changes to tax laws is a very difficult issue. It is simply a question of whether the laws provide appropriate encouragement and an appropriate role for these schemes or whether they are barriers. They do seem to be barriers. I would hope this committee would be able to look at those barriers and make an assessment on them.

Ms GILLARD—We have had one example before this committee where an employee share ownership scheme was entered into as part of a rescue package for a company that was in difficulty, so it was used in part for a fundraising objective. That obviously raises a whole lot of public policy questions, particularly when we are inundated at the moment by examples of employees losing entitlements in corporate failures. Are you aware of any examples of that happening, or does the chamber have a view about employee share ownership being used in those sorts of circumstances?

Mr Hamilton—I think it would be a rarity. I have not heard of any, although there would be some. You have mentioned one. I think that would be a rarity; it would be an unusual case. The examples I provided from enterprise agreements are all examples from ongoing enterprises where they are part of the general building up of employee relations and developing an effective workplace approach—it is not that specific issue. I would say that would be a rarity, but it does raise one issue which is the extent to which employee remuneration should be put at risk, if you like, under these and other schemes.

We have an award safety net, and these schemes operate on top of that award safety net and, generally speaking, not in substitution for them. I have not seen any cases where the award wage rates have been displaced by one of these share ownership schemes. Overwhelmingly, they must be over awards, if you like—additions to the award safety net. In those circumstances, some of the schemes involve interest free loans and that sort of thing, which could involve employee assets being put at risk. Those are obviously issues

which would have to be discussed between the employer and the employees at the time in which offers are made. I do not think there is a firm rule either way.

In these performance related schemes generally, there is often an element of risk and it can help the scheme. Obviously, you want it to operate in a fair and equitable way and you want to make sure that people are aware of any risks that exist. I do not think you can say there should never be any risk to employee assets. If employees enter into a very beneficial arrangement where there is some risk and do very well out of it, that is all to the good. I do not think you can have a firm rule which says, 'In no circumstances shall there be no risk to employee assets.' It should be a matter of full information.

Mr WILKIE—Most companies use employee share ownership schemes as a way of getting employees involved in the company, feeling part of it, et cetera. One company actually uses it as an enterprise bargaining tool in negotiating salaries. Does the ACCI have an opinion about the use of share ownership schemes as an enterprise bargaining tool?

Mr Hamilton—Yes. If you look at our submission at page 4, we have attached and summarised a range of enterprise agreements dealing with employee share ownership, and they deal with it in a number of ways. What that says is just what you have raised, that for whatever reason, either employer offer or union/employee demand, these schemes have become part of the bargaining process. It is hard to say who would have initiated it. These schemes do not have to be part of bargaining, but it is quite constructive that they are now seen as potentially part of the bargaining process, that a range of unions and industry sectors do bargain about these issues. It does show that there is more of an open-minded approach, that it is not just about the traditional 'we want a 10 per cent wage increase now' sort of approach. It does show an open-mindedness and a willingness on both sides, I suppose, to look at issues of workplace performance and to involve employees in it.

It is very constructive that there are those signs that people are looking at a wider range of issues than the traditional industrial relations claims. That does not mean that every agreement should contain these provisions or that the sorts of claims made are desirable. Obviously in some cases they are probably not. Those are our views on the role of the bargaining process and employee ownership schemes. These schemes are part of workplace relations. They have a role to play in workplace relations. The tax issue is essentially one of whether the tax system provides an appropriate underpinning for workplaces to use them for their own purposes. Perhaps I can put it in that context.

Mr WILKIE—You then say that the primary objective should be increased productivity in the enterprise bargaining or reducing wages.

Mr Hamilton—On the second issue—reducing wages—I guess that, in part, these schemes could be a substitute for a wage increase or might displace to some extent some existing form of remuneration. I do not think you can rule that out. For example, a lot of workplaces operate on contract of employment overaward payments, and the share scheme might displace some of that. You cannot rule that out. It is unlikely to displace much of the award rates but, again, if the parties agree, and they satisfy the Industrial Relations Commission that it is appropriate, then so be it.

Generally, the scheme will be there to increase productivity and employee commitment to the company. It might do so as a substitute for a wage increase or by displacing some existing wage arrangements or by adding to them. There is a whole range of ways in which that could be done.

CHAIR—In the ACTU submission—and we have not yet spoken to Mr Mansfield, who will be here this afternoon—they have suggested that the tax concessions to employee share ownership participants should not be encouraged and would not be needed if such plans promoted enterprise performance, as it is claimed. The ACTU submission goes on to say that these schemes only benefit a small minority of employees whose companies are able to operate such schemes, therefore it is suggested that it is perhaps inequitable to promote tax concessions for those relatively fewer numbers of employees. I presume the chamber has a view of that. What might it be?

Mr Hamilton—That involves an issue of the extent of tax concessions and the benefit that can be achieved from these schemes. We do see that these schemes can provide a lot of benefit to workplaces. They are not confined to white-collar employees, although I assume most would be so-called white- collar employees. If these schemes do benefit workplaces, and therefore job prospects and prosperity, then there is a very good case for tax concessions. We think the evidence shows that they can play quite a positive role.

CHAIR—I presume that the chamber's support for employee share ownership is for all employees; we are not just talking about white-collar management?

Mr Hamilton—Not at all. We strongly support these schemes being looked at by employers and involving all sections of the work force.

CHAIR—Does the chamber give any assistance to employers who are considering establishing an employee share ownership program?

Mr Hamilton—Yes, we do. The chamber structure is that we are the peak council of employer associations. Our employer association members in every state and territory, in every industry sector, would provide that assistance, sometimes using some of the publications that we have attached, and sometimes using their own publications and their own legal and other advice. So we do a lot of promotion in that way.

Ms GILLARD—On the question of employee share ownership schemes being possible for all the work force, we have considered, during the course of this inquiry, the position of proprietary limited companies. I note that one of the enterprise agreements which you cite is for a proprietary limited company, Multigroup Distribution. One of the intellectual difficulties with employee share ownership schemes in proprietary limited companies is that you are really getting employees to buy, however the scheme is structured, an asset for which there is no market. You cannot go out and flog shares in a proprietary limited company; you can only transfer them under very limited conditions authorised by the board. Often, in your very small proprietary limited companies, your mum and dad style proprietary limited companies, it is almost impossible to put a value on the share, because, say, two directors control all the accounting, control the payments to themselves—all of that sort of stuff. So in terms of dividend streams, et cetera, they are able to control that absolutely. In that sort of

circumstance, if you envisage a furniture store, for example, that is run by ABC Proprietary Limited, mum and dad are the directors and you have got two or three employees, I am struggling to see what the role of an employee share ownership scheme is in that kind of business. If I am right, and it is very hard to define a role, really, when we are talking about employee share ownership, we are not talking about the whole work force, are we?

Mr Hamilton—I take it that you are referring to the Greenhalge cases on Corporations Law and so on. It is very easy to try to erect rules to the effect that 'You can't have these schemes here,' or 'You can't have them there.' We are rather reluctant to do that because if there is a proper information process, people would know what they are getting into. I would hope that the information process would include providing employees with the information that is relevant, including those sorts of issues. I do not think you can rule out the use of these schemes even in those places. The group that you mentioned, and perhaps some of the others, would obviously have looked at those issues. I am certainly not going to say that they made the wrong decision. You are right: there may be additional issues that need to be looked at, but I would hope that those companies and others who are already doing this would have worked through some of those issues and reached some sort of agreed solution.

Ms GILLARD—I suppose it is not a question of whether you make rules to prevent it; it is more a question of whether, as a government, you forgo tax revenue in order to encourage it in those circumstances. Given that you have got to think about national savings, the current account, financing hospitals, schools, the Defence Force and everything else, you have to consider whether that is a wise public policy decision.

Mr Hamilton—The evidence suggests to us that there are a lot of benefits to be gained from improving our performance in the workplace, and that benefits everybody on these schemes. A lot of proprietary limited companies already seem to be using these schemes and, for good reason, that is assisting them. You are right to point out that there are additional complications. I would agree with you on that point, but I do not think they are insoluble. The tax treatment should be the same for them if the companies—and therefore, jobs and the economy—are benefiting in the same way. If that is the case, and I think it is, there would be a case for the same sort of tax encouragement.

Ms GILLARD—I am still concerned because, whilst it seems right intuitively that it should increase productivity, as far as the state of the evidence before this committee goes, it is generally true to say that we are being asked to take a leap of faith about that. There is no objective trial that says, 'This is how we were before we introduced an employee share ownership scheme; this is how we were afterwards. Everybody who took shares was more productive, stayed longer and went on sick leave less.' No-one has actually done that study, as far as we are aware.

Mr Hamilton—No-one has ever proved anything, virtually, in the labour relations area. All you can ever do is act on the sort of evidence that I have heard about AWIRS and the like. There is no proof. Take the junior rates example: we spent six years arguing about the junior rates system, and some people still do not accept that removing junior rates for a large section of existing juniors would have devastating employment consequences for those juniors. Some people still do not accept that, despite the fact that there has been a Productivity Commission study which came to that conclusion and confirmed an earlier

study by an institution whose name I have temporarily forgotten. Two institutional studies came to the same conclusions. Those are the only Australian studies, and they came to the same conclusions. The *OECD Employment Outlook* found that juniors were particularly susceptible to disemployment effects of movements in wages. The UK Blair government report from the Low Pay Commission found that you needed a discount rate until age 21 for juniors. That is a Blair Labour government report, tripartite in nature, by unions, employers and government.

It is always the same in all the debates we have. There are people who adopt different positions and refuse to accept all those sorts of studies and still say, 'No, we disagree.' I find that extraordinary myself. In this area, if you put all the evidence together—

Ms GILLARD—We do not even need the studies.

Mr Hamilton—from AWIRS, the anecdotal evidence from us and from the companies, that would certainly be as good a basis on which any other decision has been made by federal parliament on labour relations issues in recent years, if I can put it that way.

Dr EMERSON—In the area of wages policy, a lot of objective work has been done about elasticities of demand for labour. No individual is then forced to accept that evidence, and that is why you get different interpretations of it and some people rejecting it and other people embracing it. In the area of wages policy, there has been a lot of empirical testing of the arguments. As Julia said, based on the information that has been presented to this committee, there has not been that sort of objective evidence in the area of employee share ownership schemes. It is not a matter of, 'Here it is, it's staring you in the face. Why are you not accepting it?' It is just not there, except to the extent of businesses speaking anecdotally. That is why there is a qualitative difference between the wages argument and the share ownership one.

Mr Hamilton—On the wages argument, there was not that much evidence. There were two Australian studies—one by the Productivity Commission and an earlier study which I cannot remember the name of—and I suppose there are international studies which back that up. In this area, we have this analysis from AWIRS data, which I suppose you are right to say is not a study on that issue by the Productivity Commission or whatever—I suppose that is correct—but it is drawn from objective or survey data. It does show correlations between positive features of workplaces and employee share ownership schemes. So unless there is some difficulty with that analysis which I am not aware of, AWIRS is used in every area and it generally seems to correlate with other data sources.

Dr EMERSON—On this point about a leap of faith, I think it is right that—I am sure it is—in determining or deciding whether we need to expand concessionary taxation treatment to a particular sector or activity, it is our responsibility to at least look at what the next best alternative is. It may well be that that money would be better put into education, for example, which is really by definition available to all young people coming through, or it may be better put in the defence of the nation in the current circumstances.

Ms GILLARD—In the current circumstances, yes.

Dr EMERSON—One of the jobs of parliamentarians is to weigh these things up rather than to simply say, 'It sounds like a good idea. People say it is really good, so let us allocate X million dollars extra of taxpayers' money to that,' without confronting the reality that that X million dollars is not available for some other purpose. This seems, at least to my mind, to go to the heart of the issue which is not the question of whether employee share ownership schemes are a good or bad idea—they are obviously a good idea—but the question of that investment decision. Just as private businesses have to make investment decisions and look at their next best alternatives or range of options, so parliamentarians have to look at the alternatives in terms of taxpayers' dollars.

Mr Hamilton—When you come down to priorities for government spending, that is a very difficult question to answer. I guess what we would say about that is that we find the evidence quite convincing. It does accord with what we know of the area. There is a good case for this area receiving some priority. Obviously, there is a balance about how much and what are the current tax concessions and whether they should be increased. On that issue, there do seem to be some problems with tax treatment of these schemes, which do need to be looked at. There are impediments, if you like, in the tax area and we would hope they would be looked at, because we do think that these schemes should be encouraged. They are not the answer to everything but they do play a positive role where they are used. We would hope that more companies would use them. I think that is all I can say. It is a very difficult question.

Dr EMERSON—I know.

CHAIR—Is there any evidence that Australian companies are having difficulty attracting and retaining employees in a global labour market because of our approach to stock options and/or employee share ownership?

Mr Hamilton—There are other ways in which employees can be attracted and retained. The trades area is quite notorious for the extent to which some of the over-award payments are made just for that reason. I suppose there might be a case for—

CHAIR—Is Australian industry having a problem, for example, if somebody says, 'I would rather work in the US than work in Australia because I am disadvantaged in relation to stock options,' for example?

Mr Hamilton—Yes, I am sure that is the case in some of the executive areas. I was focusing more on the blue-collar areas, which I have been speaking about before. In the executive area, I think that would be the case.

CHAIR—Thank you very much, Mr Hamilton. We appreciate that.

Resolved (on motion by **Mr Wilkie**):

That the committee receive as evidence and include in its record as an exhibit for the inquiry on employee share ownership a document received from Mr Reginald Hamilton titled 'ACCI position on employee participation and industrial democracy'.

Proceedings suspended from 12.45 p.m. to 2.08 p.m.

MANSFIELD, Mr William Clements, Assistant Secretary, Australian Council of Trade Unions

CHAIR—We will reconvene the hearings into employee share ownership. I welcome Mr Mansfield, who is here on behalf of the ACTU. Committee proceedings are recognised as proceedings of the parliament and warrant the same respect that proceedings in the House of Representatives might demand. Witnesses are protected by parliamentary privilege in respect of the evidence they give before the committee. You are reminded, however, that false evidence given to a parliamentary committee may be regarded as contempt of the parliament. The committee prefers that all evidence be given in public but if there is anything you wish to provide in camera, simply ask and we will certainly agree to that. Would you give us a precis of the ACTU's submission which we can then discuss?

Mr Mansfield—As the committee would be aware, the ACTU represents around two million employees in Australia who are trade unionists. A number of those are participants in employee share ownership schemes. We have had an interest in the issue of employee share ownership for a number of years. We have undertaken work in the area over the past few years. In 1989 we developed a reasonably comprehensive policy on employee share ownership which is included in our submission. In 1993 we issued a publication, copies of which have been made available to the committee, on employee share ownership, with the general title of *Handle with care.* That publication was developed in collaboration with the Remuneration Planning Corporation, an organisation which has a level of expertise in the design and implementation of remuneration packages including employee share ownership.

In summary of our submission, which broadly canvasses the issue of employee share ownership, I should say at the outset that the ACTU has a policy which favours employee share ownership but favours it with a number of conditions attached to it. Perhaps I can go through those a little later. But broadly our attitude towards employee share ownership is positive. We see it as an approach which can be of benefit to employees in those companies which offer good employee share ownership schemes.

However, our submission draws out two areas of concern in relation to employee share ownership generally. Firstly, we put it to the committee that it needs to be careful in assessing propositions that employee share ownership in isolation from other factors at the enterprise level will generate significantly higher levels of productivity or profitability in the companies that introduce it. The evidence that we have seen, which includes surveys in the United States and the United Kingdom, which were referred to in our submission, and a recent publication of the International Labour Organisation which is reasonably comprehensive and authoritative, indicates to us that companies that introduce employee share ownership and do not change the style of management in the company will not achieve significant benefits by way of improved productivity and/or improved profitability.

The areas that are referred to most commonly in regard to the need for changes at company level to company employee share ownership go to issues of the style of management, particularly communication issues. Management in many cases tends to be authoritarian, not in an extreme sense but in a general sense. It is, 'You will do it this way,' 'We do not need your ideas,' 'We do not need your suggestions'. It is a top down management style.

The more appropriate style in our view, which I think is borne out by the literature in this area, is one which is collaborative, which encourages employees to put forward their own suggestions and ideas, which is a flatter management style which delegates more authority to people at lower levels in a skills hierarchy and one which, as I said before, communicates regularly and thoroughly with employees as to how the enterprise is performing and the way employees can be involved in improving the operation of the enterprise.

As our policy points out too, we would look for a change in the approach of management in regard to career opportunities for employees. One of the problems of many employees in Australia and elsewhere is they are put into jobs which have no real future, which basically are dead-end in terms of career opportunities—jobs on production lines and jobs in various areas of the service sector which do not have career structures attached to them and do not have skill development paths. So we stress the need for employment structures to be developed to offer careers to individuals, to offer opportunities for skill development, to offer the individuals who wish to fully extend their potential the chance to do so.

They are the issues that have to be taken account of in terms of the rationale for the public purse subsidising the introduction of employee share ownership schemes. It should not be accepted that employee share ownership schemes, in isolation from the other management changes that I have mentioned and which are brought out more thoroughly in our submission, will generate those high levels of productivity, profitability and competitiveness which are of benefit to the economy and to the overall wellbeing of this country. It should not be assumed that employee share ownership in isolation will achieve that objective. The committee should, in our view, examine that proposition cautiously and thoroughly.

The second point we wish to make—we have made it in our submission—is that we have a serious question mark on the equity issues that go to offering tax concessions to companies and individuals who are involved in employee share ownership schemes. If they are of benefit to enterprises by way of improved productivity and profitability that outcome in isolation should be sufficient for enterprises to become involved in offering employee share ownership schemes and there should not be a need for scarce taxpayer's funds to be added as an incentive to enterprises to get involved in this area of activity.

Employee share ownership is still only available to a minority of employees. The most recent figures I saw were that something in the order of 400,000 to 500,000 employees in Australia were in employee share ownership arrangements in the early 1990s. The work force has grown substantially since then and no doubt employee share ownership has as well, particularly with the privatisation of a number of public enterprises and the offering of shares to employees in those enterprises. I would concede that although the number of 400,000 to 500,000 has probably grown since the early 1990s, it is still very much a minority of employees. We have something like 8.5 million people in the work force in Australia at present. Perhaps 1 million to 1.5 million are involved in employee share ownership schemes.

In addition, most of the work force growth at present is coming from small to medium sized private companies—not from the Telstras or the Commonwealth Banks or the BHPs. It is coming from those small to medium sized private companies which are not in a position to offer their employees participation in employee share ownership. In addition, you have the

non-profit sector—hospitals and other non-profit type organisations. The public sector is still a major employer in Australia but is obviously not in a position to offer employee share ownership arrangements. In the future only a minority of employees, quite probably, will have access to employee share ownership arrangements. The question should therefore be asked—in addition to the points I made earlier—why should the public purse offer an incentive and a subsidy for employees to become involved in employee share ownership when that opportunity is only available to a portion of the total employment in the country?

Our proposition is that, if the committee is concerned to assist national savings through employee share ownership as well as other objectives, it would be far better to look at areas such as the universal superannuation arrangements for employees. It should be remembered, of course, that superannuation funds are largely invested in the share market in this country, so it is a matter of indirect employee share ownership in the national share market through superannuation funds. It would be far better, and more equitable, if we are talking about providing greater incentives for savings and benefits to the country through that mechanism, to look at the superannuation area rather than at employee share ownership. Broadly, that is a summary of our submission.

CHAIR—You said in your opening remarks that the ACTU was generally in favour of employee share ownership plans, although with some conditions attached to them. What is the basis of your support for them? Why does the union movement support employee share ownership generally?

Mr Mansfield—Our view is that they do provide a mechanism for allowing employees to have a part ownership of the enterprise that they are involved in and, in turn, provided that the enterprise is successful and growing and that the share price is increasing, it provides a benefit to the employees. There is a very basic reason, which is the second of the two I have just mentioned—that is, it does provide an opportunity for employees to get higher levels of remuneration in a broad sense from their employment, the remuneration coming from both their wage and their participation in a share ownership scheme, particularly where that share ownership scheme is put forward in the manner of the schemes that are advocated in our submission and which are advocated also by the Remuneration Planning Corporation, where they are employer-funded schemes rather than employee-funded schemes, which are the new generation schemes advocated by the RPC.

Broadly, when a company comes along to its employees and says, 'We wish to introduce an employee share ownership scheme,' and the scheme is generally consistent with the approach that we believe is desirable and can lead to benefits to employees, we have no objection to that scheme going ahead. But there is a distinction between that broad support for employee share ownership that I have just described and support for policies that say, 'In addition to a company offering employee share ownership, the public purse should be opened and there should be incentives given to either the company or individuals to become involved in employee share ownership.' The reasons for that are the ones I outlined earlier.

CHAIR—A number of employer organisations have said that they believe, although they are having difficulty providing us with evidence to this effect, that employee share ownership results in increased levels of productivity and a general interest in the performance of the company by employees, although a number have obviously recognised

that it is often part of a spectrum of culture in the workplace of which employee share ownership is but one.

Southcorp, for example, suggested that their employee share ownership had contributed to a significant fall in the resignation rate, a lower level of industrial disputation, lower average days lost per employee due to workplace injury, and company earnings per share growing at an average compound rate of about eight per cent since 1995. Does the ACTU see benefits of a productivity/ workplace nature other than just direct employee benefits from these plans?

Mr Mansfield—Sure. Our position is sometimes misunderstood. It is not a position of favouring unproductive, uncompetitive enterprises. Our position is that we want to see Australian companies successful, productive, competitive and enjoying improved productivity year by year. We know that we have to do that if we are going to remain competitive and in business. It is pretty silly to say anything else, quite frankly.

Sometimes there is a notion that the trade union movement is somehow opposed to successful companies in this country. We are not opposed to it at all; in fact, we are very much supportive of it. We have arguments about who should get the benefits and what proportion of the benefits ought to go to owners/shareholders as opposed to employees, but we are not advocating that companies ought to be anything other than what I have described.

Yes, we do see that some of the advantages of employee share ownership can influence those sorts of outcomes. I was looking at a survey—which is admittedly a little old now—conducted in 1998, which was a very comprehensive one undertaken in the United Kingdom in regard to employee share ownership. It showed that, in regard to an increased level of productivity—and this was referred to, unfortunately I now notice, on an unnumbered page in the ACTU submission; I am a big one on paragraph numbers as well, but I see that they are not there either—only nine per cent of the companies surveyed in this major survey in the UK reported a significant effect. Certainly, 37 per cent recorded a small effect, but 54 per cent recorded no effect in regard to improved labour productivity. In regard to facilitating recruitment, which I would imagine would include not only actual recruitment but also retention, 13 per cent recorded a significant effect, 48 per cent a small effect, with 39 per cent recording no effect whatsoever.

So, as I said earlier, there is a range of evidence in regard to the effect of employee share ownership in these areas. You will see above that table, which is on that page, the other listing for the US General Accounting Office survey. This was undertaken probably in the seventies; I have not actually recorded the year. In that survey, reduced labour turnover amounted to 33 per cent in regard to it being reported as a consequence of employee share ownership. So that is a significant effect, I think—33 per cent reporting reduced labour turnover.

All of these things are desirable, but I go back to the point in regard to public funding: if these things are positive for companies, why is it that we need public funds to encourage them to occur? If people say that employee share ownership achieves all of these advantages—and I am not denying that it does—the advantages will vary depending on the share ownership plan itself, how it is introduced and the changes in the management style, et

cetera, that accompany it. But if all of these advantages are there, why do we need to apply public funding as an additional incentive? We should simply publicise better the advantages and rational managers should then set about making the changes that will bring about these effects.

CHAIR—Presumably, there should be some sort of cost-benefit analysis to that effect.

Ms GILLARD—We have had evidence before the committee that there are some enterprise agreements where employee share ownership schemes have been one of the matters bargained upon and are present in the agreement. What is the ACTU's view about whether it should be a bargaining matter or whether it should be done alongside, rather than directly within, the industrial relations system?

Mr Mansfield—I do not think we have a fixed view on whether it is desirable to include it in enterprise bargaining or do it separately. We certainly have a view that when it is done there should be opportunity for consultation between the representatives of employees and employers as part of the process—meaning that the unions should have an opportunity to participate in the development of an employee share ownership scheme to ensure that the scheme is one which provides reasonable benefits to employees as well as benefits to the employer.

Employee share ownership is not a thing which is without complexity. The point that is brought out in this report is that there are some dangers involved in employee share ownership. There are some traps, for example, for people in partly paid share schemes which have burnt people in the past. There is a need for some good advice in relation to the design and development of employee share ownership arrangements.

Ms GILLARD—We have had one example raised with this committee of where an employee share ownership scheme was entered into when a company was in a crisis situation, consequently the employees were in part being used to provide an emergency source of funds to keep the business trading. In the example that was raised with us that ultimately worked and the business is still trading, but it obviously raises a very big issue about the security of employees' funds. Could you address us generally on the issue of the security of employees' funds? Also, are you aware of any specific examples of where that has been done and the company has gone on to fail, so that employees have effectively been used for emergency revenue raising and it has not worked?

Mr Mansfield—In terms of any guarantees once employees invest their money in an employee share ownership arrangement as a means of raising capital for a firm, there is obviously a lot of moral pressure and a lot of real pressure on employees to participate in such a scheme. We can all understand the circumstances in which employees are basically told, 'Unless the company can raise X million dollars in 30 days, the doors will be shut. You have all of this money here in these sorts of benefits. What about putting some of it forward and investing it in the company?' If it is a choice of losing your job and perhaps having to move home, if you are in a country based enterprise, there is a lot of pressure on individuals to do that. But, as we all know, there is absolutely no guarantee that that is going to be successful—not one single iota of guarantee—and the money is very much at risk.

There have been examples of people investing in employee share ownership schemes in the circumstance that you have outlined and the rescue not being successful. I cannot give you particular examples this afternoon but I am certainly willing to get some evidence of that and come back to you on it. As you have also said, there is a number of examples where, as a result of the capital injection and the willingness of employees to risk their money, plus the other changes that hopefully have been made, it has been successful and there has been a positive outcome.

Ms GILLARD—The example that was raised with us was an enterprise agreement where a wage increase was traded against an employee share arrangement in circumstances where the company was in trouble. The employees effectively traded a high priority payout in a company liquidation for a no payout. Fortunately, it did not come to that—we were advised the company kept trading. But, obviously, there are some real policy issues and risks in those sorts of agreements.

Mr WILKIE—This follows on from Julie's earlier question. I see the ACTU policy says in point i):

Wage levels and conditions of employment are independent of share ownership. Award standards, including wages should not be discounted in return for rewards from financial participation—

We have had a company come to this committee and say that they deliberately used share ownership as a bargaining chip in enterprise bargaining so that they can reduce wages and conditions of employees. How would the ACTU respond to that?

Mr Mansfield—Our position is that they are two separate areas of employee benefit and they should be regarded as such. We would look to companies like Lend Lease, by way of example, as positive examples of companies that quite clearly separate their remuneration package from employee share ownership and, in this particular case, profit sharing, because Lend Lease operates profit sharing and an employee share ownership scheme as well as having good, progressive remuneration levels.

Our view is that they should not be mixed together. An individual's remuneration is what you need to live for today; employee share ownership should be regarded probably as a longer term investment which you will use later in life. There are quite good arguments to make that employers should not try to trade off wage increases for employee share ownership benefits, along the lines which I have just mentioned, but also there is the risk factor that is involved.

A colleague of mine who worked for a bank on one occasion, who is referred to in this document as 'Mr D', went into employee share ownership as part of his remuneration package. At the time, bank shares were quite high. You will recall there was a period not so long ago when they crashed to much lower levels. Fortunately, he was able to hold on to most, but not all, of his shares and the share price has increased to a much more attractive level. That is an example of how individuals can get burnt by going down that track.

Mr EMERSON—I want to focus on the taxation issues that you raised. Are you able to give us a judgment as to the current degree of concessionality, if you like, in the tax

treatment of employee share ownership schemes? Would you argue that the current treatment is about right or that there should be an extension of tax concessions or a tightening of tax concessions?

Mr Mansfield—Our view is based on the points I was endeavouring to make earlier—about the fact that employee share ownership schemes are available only to a minority of employees in this country. No matter how attractive it is made, no matter how positive it is in regard to outcomes for employers, if you are employed by a private company, if you are employed in a public enterprise, if you are employed in a non-profit company, employee share ownership is not applicable to your area of employment. I believe that significantly less than half of the work force in this country is employed in a public company, which is where shares are traded on the stock market. For that reason, we would say there is a big question mark about whether you should have any tax concessions where they can only apply to a minority of employees.

We would not support an extension of existing tax concessional arrangements for encouraging employee share ownership. If there is a public interest—and there is—in ensuring that companies are productive, profitable, well managed—outcomes of that kind—those matters ought to be addressed in ways other than employee share ownership.

There is certainly a case to be made for improving the quality of management in this country. If there is one issue, in our view, which would bear on improvements in productivity, profitability and competitiveness in Australian enterprises, it is improving the quality of management. Without being critical of management overall, there are many things in Australia that can be improved. One of them is the quality of management. We had a report several years ago on management skills in Australia, which highlighted that very starkly. That is one issue, and others are mentioned in our submission that ought to be paid attention to. We would not support an extension of public funds in this area. We would say: leave it as it is; certainly do not take it any further.

Dr EMERSON—Can I get a summary from you, Bill? You are representing the view of the ACTU here. To what extent does the ACTU represent the views of its constituent unions in this position that you are putting?

Mr Mansfield—We have circulated the submission to executive members of the ACTU and also to affiliates and asked for their views. We have not met any substantial disagreement with our propositions. You will find that some affiliates can take a different view to the ACTU. If I were, for example, an official of the Finance Sector Union, which largely represents the employees of private banks, I might well come to this committee and say, 'In our view, there should be more encouragement given to employee share ownership schemes,' because the vast majority of members of that organisation would have those schemes available to them. If I were an official of the liquor and hospitality union, where virtually none of its members have the opportunity to get into employee share ownership, I would probably come along here and say, 'As far as we are concerned, there should be no tax concessions given to employee share ownership.' So there is a variety of views inside the ACTU, but the position I am outlining here today is broadly accepted by the ACTU affiliate organisations.

Dr EMERSON—Following on from that, has this issue ever been discussed at an ACTU congress?

Mr Mansfield—It has, but not of late. It would probably last have been discussed in 1993 when this publication was issued, and there was an associated discussion at the ACTU congress of that year. It certainly has been discussed in the past but not in recent times.

Dr EMERSON—Do you see any merit in the general concept of moving away now from the tax treatment of people on the schemes? If people put a proposition to the committee that there is scope for simplifying the rules that apply to employees—some sort of streamlining or simplification—removing those impediments that do not necessarily serve a particular public purpose, would you be more inclined to move in that direction or not?

Mr Mansfield—My understanding is that the rules at present are rather complex and cumbersome, and there is a case to be made for simplification. The trick in simplifying, of course, would be to make sure they are not simplified to the point where they are abused.

Dr EMERSON—Sure, and where the public interest is then damaged.

Mr Mansfield—Yes.

Dr EMERSON—I said at an earlier hearing that maybe one approach to this would be to simplify and not to subsidise.

Mr Mansfield—As a general statement, I would agree with that.

CHAIR—The last thing I want to ask is: why does the ACTU prefer employee shares to be in group holdings rather than have individuals holding their own shares?

Mr Mansfield—It is actually a recommendation of the Remuneration Planning Corporation; it is the feature of their new generation share schemes. They argue that, first of all, it gives them an opportunity to deal with the shares collectively rather than individually, and you can have more of an influence on the company, I expect. It is held through an employee share ownership trust. It does not in any way affect the ownership rights of individuals. The individuals still own the shares; the individuals still receive the dividends. They argue—and you will see it in the *Handle with care* document—that it also encourages individuals to hold their shares for a longer time. It encourages retaining ownership rather than exiting the scheme just to make a quick profit.

CHAIR—Does the ACTU have a view about the extension of employee share ownership plans into non-publicly listed companies?

Mr Mansfield—The document does actually cover that as well. In our view there is no difference in principle in terms of it being available to non-listed public companies. There are examples in the document about how it can be done. I would suggest that, in many cases, it is not practicable to do so, particularly in the smaller companies.

Dr EMERSON—Chair, do you see a potential for that to occur?

CHAIR—I do. One of the things we are looking at is whether it ought to occur and, if so, how it might be done. One of the issues is the transfer of ownership in smaller companies often from the family who owns it to the employees, if that is what they choose to do.

Mr WILKIE—The submission we have been talking about is contained here. Is the document you have there separate?

Mr Mansfield—Yes, *Handle with care* is separate and you have copies.

CHAIR—Thank you very much, Mr Mansfield.

[2.49 p.m.]

LANG, Mr Iain Bruce, Federal President, Australian Licensed Aircraft Engineers Association

SPRING, Captain Gavan, Chair, Employee Share Ownership Plan Subcommittee, Ansett Pilots Association

CHAIR—Welcome. Thank you for coming along today and providing us with a submission. The committee proceedings are recognised as proceedings of the parliament and warrant the same respect that proceedings in the House of Representatives itself would demand. Witnesses are protected by parliamentary privilege in respect of the evidence that they give before the committee. You are reminded, however, that false evidence given to a parliamentary committee may be regarded as a contempt of the parliament. The committee prefers that all evidence be given in public, but if at any stage you want to provide evidence in camera simply ask and we will be happy to accommodate that. Could you give us a precis of the submission, and then we will have a chat about it.

Capt. Spring—Thank you, Mr Chairman and honourable members, for the opportunity to present today. I am here basically as a simple Ansett employee who has facilitated this initiative. However, the jobs that I do perform for Ansett include being a Boeing 737 captain and being chairman of the pilots' accumulation superannuation plan and principal pilot lecturer for the national Fear of Flying program. I am also on the committee of the Ansett Pilots Association ESOP subcommittee.

Mr Lang—As well as being Federal President of the Australian Licensed Aircraft Engineers Association, I am also a director on Ansett's ground staff superannuation fund and I work for Ansett Airlines as a licensed aircraft engineer in Brisbane. My involvement with this inquiry is, hopefully, to progress an ESOP proposal for employees of Ansett Airlines.

Capt. Spring—Perhaps I should refer to the history of this proposal. Two years ago a colleague, Captain Les Vidler, had the view that an ESOP proposal in Ansett could be a solution to some of the concerns which were: a resolution of the ownership issue, addressing the morale situation and the financial viability of the airline.

Twelve months ago I also formed the same view, and from that point we proceeded to investigate who were the best people to assist us in moving this forward. I went to New York and had discussions with a leading New York investment bank, Keilin & Co. They described to me the process and the activities necessary to carry out a sophisticated ESOP—perhaps better termed an employee buyout. They were the leading investment bank that did the United Airlines transaction.

Following that discussion in New York, I came back to Australia and organised a meeting with the 13 unions in Ansett. The view was that, to progress this further, we really needed to get the support of the union leadership and obviously the employees and management so we proceeded to organise a meeting at ACTU House with the Ansett unions being present. That occurred on 3 March this year. Present at that meeting was the Managing

Director of Grant Samuel Private Equity and the New York Investment Bank CEO was on the telephone line from New York.

Following that meeting, there was the announcement that Singapore Airlines had arranged a transaction with News Ltd and that they were going to proceed with the acquisition of the 50 per cent stake of News Ltd. At that point in time, it was felt that that transaction should be given the opportunity to progress, as it appeared that the Ansett employees were supportive of that proposal. So time passed until another window of opportunity occurred.

That, of course, occurred when the transaction broke down. At that stage, more of the unions had come on board by giving their written support for the proposal in principle and, following the increased support, a letter was formed by the New York Investment Bank. They sent that letter to Ansett on 23 June this year. I believe you have a copy of that letter. It basically outlined a proposal which was a sophisticated ESOP which had the objective of retaining significant Australian ownership in Ansett Airlines. The events from there have included getting 11 of the 13 unions on board in principle to the proposal and, during the last nine to 12 months, canvassing all the employee groups and getting a feel for their receptivity to this proposal.

It is my view and the view of a number of colleagues that that interest is great, and increasing. So we are basically here today to seek your support to assist this transaction in terms of what the Australian government could do in two areas. One is the relaxation of ESOP legislation to facilitate a transaction of this nature and make it more appealing to employees of small and larger corporates in taking a stake in the corporation. The second is to make public the concern about the potential possibility of having Air New Zealand acquire the other 50 per cent stake and therefore have 100 per cent of a great Australian airline. There would be concerns about whether the Foreign Investment Review Board issues would be resolved in terms of Australian management, Australian headquarters and the national interest. Through having an employee buy out a sophisticated ESOP arrangement, we believe that those issues would be resolved, and there is great interest in the potential to restructure Ansett from that perspective.

Mr Lang—I am here because I believe the government and the members here have some very important roles to play in employee share ownership both generally for ESOPs and specifically for the proposal that Gavan and I are trying to progress. If we step back and look at the proposal in terms of an employee share ownership buy-out of Ansett Australia, there are three main players here. One, you have to convince News Corp to sell to us. Two, there is Air New Zealand, which have pre-emptive rights and which have already sunk a Singaporean bid through their want to acquire 100 per cent of Ansett Airlines. Three, there is the final stage of making the employees comfortable that this is the best thing for their future in terms of making the sacrifices needed to establish an ESOP.

With respect to Air New Zealand, there is a pre-emptive right. News Corp could sell out. That is one thing we have to consider about Ansett. Ansett has been a national icon. Originally, with the sale from Mr Reg Ansett to TNT, TNT and News Corp were both Australian companies. Over the passage of time News Corp has obviously become an American entity, TNT has exited and Air New Zealand has come on board. But overall

News Corp is still viewed generally by the public as part of the Australian picture. It is still very much Australian content.

Here we have Air New Zealand wishing to acquire 100 per cent. The employees have grave concerns about that in terms of what that would mean for consolidation of the company, in terms of shutting down administrative back office facilities in Australia and moving that work to New Zealand and in terms of what it means for the Air New Zealand ethic. Currently within Ansett there is the BA idea that you can create a virtual airline and that means chopping off parts of the organisation and contracting it out. One of those parts that has already been foreshadowed is engineering.

We find ourselves in a very similar position to the ESOP that we have modelled this one on, which is United Airlines. United Airlines back in 1992-93 was looking at outsourcing their kitchens and engineering. That created the impetus for employees to grasp hold of an employee share ownership scheme. Why would they want to do that? There are obvious reasons. People do not like being transferred through a transmission of business to another organisation. We have feelings of loyalty. Many people in Ansett are long-term employees. Gavan has been there for over 10 years. I have been there 18 years. Many engineers spend their whole career with one airline. Many pilots do, as well. Many people have strong attachments to the employer.

Outsourcing creates low esteem, low productivity and low loyalty. That certainly was the BA experience when they outsourced their engineering. They have now brought it back in-house. Once you dismantle those sorts of arrangements the capacity to bring them back is very limited. An ESOP helps employer workers. It makes them feel part of the productive process, part of getting some control and stability over their employment. It has that very positive aspect for employees.

There are also benefits for Australia in the way ESOPs engender national savings. That comes down to the way you structure ESOPs. The sort of ESOP we would be considering is where the shares are held in a trust. People receive their benefit when they either retire or leave the company. Then there would be access to their investment. The sort of ESOP we are considering is about getting some control, getting some ownership, of a company and retaining Australian ownership of what is a national icon. Those are some of the considerations.

An ESOP is not an easy thing to get off the ground. There are currently provisions which make our job all the more difficult. One of those is in terms of creating a large trust structure. We are talking about deferred tax arrangements. Where you have a complying or a qualified 13A division plan there is only a 10 year deferment. If someone is going to be there for longer than 10 years how do they pay that tax? They are going to have to borrow to pay that tax. It would be preferable if at the point of sale of the shares or the actual liquidising of that investment you take the tax component rather than in the course of employment.

One of the other issues that goes to the creation of an ESOP—because we have an idea of prescribed interest with investments—is that there is potential for us in the arrangement we are proposing to have to produce a prospectus for employees to know what they are

buying into. That creates a lot of additional expense in assessing whether this a viable option for employees. So it creates the hurdles which makes this sort of proposal much more difficult. It is the role of government to look at those issues and to come up with other solutions.

Capt. Spring—There may also be concern on the government's behalf about the taxation impact of an ESOP. I would suggest that if some analysis is done on a large corporate ESOP scenario there may well be some tax gains to be made from the government's perspective when they look at the receipts they currently get from large corporates from taxation, given corporate structures and their deductible arrangements and their creative accounting arrangements. If one compares the tax receipts from the existing arrangements with having a large number of employees under this scheme who, down the track, would obviously have to pay tax on the capital gain from their share involvement, I question whether the former would achieve a greater gain for the government. It is reasonably common knowledge that certain corporations in this country pay minimal tax. That is the sort of comparison I am looking at. A large corporate with a large employee base may well, down the track, return greater tax to the Australian Taxation Office through this arrangement.

CHAIR—Gavan, you said there are 13 unions involved in the deal which you discussed at ACTU House. They are all supportive of the employee share ownership proposal you are putting up?

Capt. Spring—Eleven of those unions are supportive of it now and, of the other two, I believe the AMWU has a philosophical opposition to the concept. However, I think they are relatively small in number, perhaps 240 members, and they have had a recent leadership change. I am of the belief that once they are more knowledgeable about the issues they will also be receptive to the proposal.

The other union is the Miscellaneous Workers and Hospitality Union. I have not been able to make contact with them due to time and resources. Also at the back of my mind was the fact that that component of the Ansett business, the kitchens basically, are being sold off. So it became less of an imperative to get them involved. I believe that with the current interest that is being shown by the other unions—and not just the union leadership but the employees; that is essentially what it is about—all would come on board.

CHAIR—If the government were to withdraw all the tax concessions for employee share ownership would that sink your plan?

Capt. Spring—I do not think it would sink the plan but I would not like to think that would happen. I hope that the government would not be relaxing its concessions.

CHAIR—We have just been told by the ACTU that we should not be providing tax concessions for employee share ownership plans because you are providing a tax concession—or 'public fund money' as the ACTU put it—to a relatively small section of the work force.

Capt. Spring—I would not question that gentleman's commentary, but with a bigger picture perspective potentially there is going to be a larger number of groups coming into

this arrangement. If we could get this Ansett initiative off the ground that would be a precedent for other large corporates taking on this type of concept. In this country there is a lack of knowledge and understanding about how ESOPs can not only contribute to improved corporate performance but how they can contribute to the macro-economic development of countries.

Mr WILKIE—It is a slightly different scenario, though.

CHAIR—In your case it is a question of who owns and controls the company as much as it is a productivity issue—in fact probably more so.

Capt. Spring—Yes.

CHAIR—Your submission is fairly consistent with a number of others in relation to 13(a) changes?

Capt. Spring—Yes.

Mr Lang—I think the issue of 13(a) is tax deferment and having to pay tax while you liquidise the shares.

Capt. Spring—Which is in line with other share transactions. Also, a broad cross-section of income is received by Ansett employees. You have a great range there. You have certain people on less income than others. They would face more of a challenge accommodating that 10-year rule and sale and having to provide for that capital gains tax.

CHAIR—Do you have a view about the $1,000 tax-free threshold?

Mr Lang—The $1,000 threshold may be a good mark; I do not know. You might want to increase it slightly. But obviously that is more of value, say, to people whom I represent at Qantas who are getting a portion of shares as part of their enterprise agreement and their arrangement with the organisation. That is a different sort of ESOP to the one we are considering here. So I think there is a place for that. Whether the sum is correct or not is a matter for debate.

Capt. Spring—We are certainly not advocating a mechanism where there is going to be tax relief or tax minimisation. That is not the fundamentals of this initiative. If there can be some encouragement through concessions then that would be welcome, but the impetus is not to use potential public funds to drive an initiative like this at all.

CHAIR—It is interesting that you had to go to the US to get help here. There is no expertise here in Australia?

Capt. Spring—There is, but Keilin & Co. are the leading investment bank in the world to do these large transactions. As they had done United Airlines, which is the largest employee-owned corporation in the world, and an airline, it was reasoned that they would be an excellent first stop. Also you gain with that New York Wall Street credibility and access to perhaps capital markets in the US as well.

However, we have consulted with buyout specialists here in Australia, Grant Samuel Private Equity. They were very supportive throughout the process until three weeks ago, when I was advised that a conflict of interest was evident because of Air New Zealand's intention to take the other 50 per cent. We are now in consultations with Deutsche Bank; their mergers and acquisitions director has been assisting us greatly.

CHAIR—Are you aware of any other precedents for what you are doing in Australia?

Capt. Spring—Not in Australia. This would be a first on this scale. We have done some research about some of the smaller ESOPs buyouts. So this would be a first.

CHAIR—Is there something that the government, for example, could consider supporting or establishing, or is there anything that might help employees in other companies who might choose to take the road that you have chosen to follow?

Capt. Spring—One of the critical things is education. At this point in time in Australia, there is not a great deal of awareness about ESOPs. Perhaps they could consider putting some information out there into all-sized companies to make people aware that there is a mechanism there to at least enjoy some benefit. But, more importantly, apart from the taxation concessions, I think once you have gone through this committee inquiry, you will have determined some of the larger issues which are evident. If they could be marketed, I think there might be some gains there.

Obviously, on the industrial front, I certainly see that there would be benefits. There would be presumably fewer adversarial activities and more empowerment between the groups, and that would have to be directly reflected in the bottom line in terms of less expense with litigation. In those sorts of areas, I think there is enormous potential.

Mr WILKIE—I see this as really totally different from the ESOPs that we have been looking at. This is more of a takeover bid by a consortium of employees, rather than what we have been generally looking at, which is to be encouraged, I would have thought. What have they done in the US in the case of United? What has the government done to help? Is there anything that we can learn from them that we could use here and make recommendations about?

Capt. Spring—I assume that you are aware of the current US government's legislation with regard to ESOPs? Has anybody produced a submission on that?

CHAIR—I am flat out trying to look at Australia.

Capt. Spring—I have a copy of the current US government legislation on ESOPs and I can leave that with you, but they have a much more flexible taxation arrangement.

CHAIR—We did get a profile of the American situation from the Employee Share Ownership Association and I think from one other submission.

Capt. Spring—I would have nothing more to add to that.

CHAIR—Compared to Australia, it is much more attuned to it.

Capt. Spring—It is much more relaxed.

CHAIR—In fact, one of the issues that has been raised, not so much to our committee at this stage, but something on which I have actively been seeking some advice from people in the sector, is the problem with stock options in emerging small biotech and IT companies. So we will be talking to some of them shortly.

Mr Lang—One item on that issue—and do not take me for an expert on these matters—was that it came up in conversation around these arrangements as to how such a deal could be structured. I mentioned the requirements in Australia for prospectuses and all the liabilities and additional work that that requires. I believe that it is possible in the States to hold the shares within a trust, and the trust then essentially owns the shares on behalf of the employees. The employees obviously have an allocation, but they do not, in and of themselves, own the shares. But when they terminate or retire, they get the value of whatever that portion is. That gets around the provision of having to individually provide prospectuses to all the employees, because it is the trust that vests the ownership.

I know this is not specifically on the question, but it relates to the earlier question that the chair proposed in terms of what the government can do in advancing ESOPs. Certainly, from this perspective, one point I wanted to make today was that I believe the government has a very clear role, with respect to our proposal, in the national interest to not allow Air New Zealand to own 100 per cent of Ansett Airlines. I do not think that is in the national interest. If Air New Zealand were to understand that, our potential to get this ESOP off the ground and to make it a viable option would be greatly assisted.

CHAIR—I do not think the government will be buying it, anyway! Thank you very much. I must say that I admire what you are doing. When I read about it in the *Financial Review*, I thought 'This is a gutsy effort.' I hope that it is successful from your point of view. Thank you for taking the time to come and speak to us. I am very grateful to you.

Mr Lang—Thank you for the opportunity.

Proceedings suspended from 3.16 p.m. to 3.26 p.m.

MYTTON, Mr Alistair, Group Taxation Projects Manager, The Broken Hill Proprietary Co. Ltd

PATULLO, Mr William, Corporate Manager, Compensation and Benefits, The Broken Hill Proprietary Co. Ltd

WONG, Mr Adrian, Counsel, The Broken Hill Proprietary Co. Ltd

CHAIR—Welcome, gentlemen. Thank you so much for taking the time to come along today and talk to us about this important issue. I have to go through a couple of formalities before we start. Committee proceedings are recognised as proceedings of the parliament and warrant the same respect that proceedings in the House of Representatives itself demand. Witnesses are protected by parliamentary privilege in respect of the evidence that they give before the committee. You are reminded, however, that false evidence given to a parliamentary committee may be regarded as contempt of the parliament. The committee prefers that all evidence be given in public but if at any stage you want to give evidence in private you may ask to do so and that request will be given consideration. Would you like now to give us a precis of your submission that we will then discuss.

Mr Patullo—Thank you, Mr Chairman. In our presentation today we would like to simply make some observations on our submission that you already have. We would like also, subject to your approval, to comment on some other submissions. We would also like to presume what we see to be the outlook for Australia in terms of the employee share plan environment into the future. We would, of course, naturally be willing to answer any questions of a tax or legal nature—not myself personally, but my colleagues—either in relation to our submission or any other aspect that you wish.

Firstly, we acknowledge and appreciate the interest and commitment of the federal government to employee share plans. When I use the term ESOPs, I mean that as being all forms of employee equity programs—shares, options, general participation, executive programs, et cetera. We appreciate the opportunity to present our views, particularly as we can present them to you rather than via Treasury bureaucracy.

Our submission that you already have has demonstrated BHP's longstanding active involvement in ESOPs. In fact, it has been going for over 15 years, and that involvement is indicated by the substantial stake that employees already hold—some 7.6 per cent of capital. There are not too many public companies that would have that sort of employee equity holding.

Our submission recognises the multifaceted benefits of ESOPs both in a social and economic perspective. We recognise that ESOPs have various legitimate purposes and objectives. We contend that ESOPs can only flourish in a supportive and concessional tax environment. We believe that we have identified scope for some sensible and not radical amendments to the Corporations Law and the income tax law that will improve the conduct and efficiency of employee equity programs.

Concerning our comments in relation to other submissions that have been made or those that we have seen, we generally support the views that have been expressed in the written

submissions. There were submissions by a Mr Taig in relation to his Siddons experience, by North Ltd, by Ernst and Young, by KPMG, and by the corporations Lend Lease, Commonwealth Bank, Southcorp, Telstra and Woodside. Many of their recommendations are similar to our own perceptions and proposals.

We noted the comments on BHP by the AMWU in its submission. We would like to make an observation or two on those if we can. There was a reference to a claim that shares are like a form of superannuation. We take that comment more as a compliment than anything else, although I am not sure exactly what was meant by that comment in the AMWU's submission.

By way of example, I might just reflect upon an employee who has 15 years service and who may be leaving the company now either voluntarily or perhaps, unfortunately, as part of a restructuring event such as the closure of the Newcastle steelworks. If he or she had participated to the extent possible in every employee share purchase issue since 1984—he or she would have a growing asset that had been financed mostly through interest-free loans and repayable by application of dividends—that employee would hold 10,638 shares with a current market value of $191,484, if I use $18 as a indicator share price; that is, every employee would have not less than that sort of portfolio if they held their shares and the bonus shares as well.

Of course, from that has to be deducted the remaining balance of any ESOP loans which, if they were paid off according to the scale that is permitted, would be about $70,000. That would leave a net—admittedly, mostly assessable—gain of $121,439. We think that is a pretty good long-term saving supplement to superannuation. So we are pleased with our share plan as a long-term investment program. There is a slight error of fact in the AMWU's submission when it says that the BHP shares have to be sold back to the company when an employee leaves. That is not correct. The shares are actually sold on the market.

Last year, shareholders at the annual general meeting approved a loss protection process. The process allowed employees to continue to be in the program and continue to hold their shares under loan after they leave the company if they are in a situation where they would suffer a loss if they had to repay their loans immediately on leaving. That was a program put in place only last year, but we think it meets the current requirements.

BHP does not hold that workplace relations are changed solely by ESOPs of any sort. Our response is that ESOPs have never been, and never will be, a substitute or a panacea for sound employee relations practices. There are a whole range of employee relations circumstances, including ethics, respect, fair pay and conditions, proper on-the-job training, appropriate supervision, career development, and performance reward management. All those things go towards a sound employee relations environment. No one thing of its own will create an instant ideal workplace environment.

There are some inferences that superannuation is better than shares. Yes, there is a similarity in the sense that both involve investments for the future and those investments hold some market risk, but they are different in many ways, of course. Superannuation is compulsory and almost universal, and that is understandable and applauded.

ESOPs, though, are at the discretion of the existing shareholding owners through their board's recommendations and they exist mainly in public companies. Superannuation has diverse investments and portability of accounts. ESOPs are limited to the employer shares and usually only continue while a person is a current employee. So superannuation and ESOPs are different. One should not take the place of the other—there is room for both.

We noticed some of the other submissions were of a rather different tenor. They fall into what I call the social re-engineering, or 'ESOPs fables', category. They sometimes recommend a forced transfer of asset ownership to employees as part of their argument. In our view, such a process would undermine Australia's democratic and legal institutions and would effectively seek to replace them with another form of system altogether. We hope you will recognise those submissions for what they represent.

At this stage, would you like us to continue and talk about what we see for the future, or would you prefer to address our own particular submission?

CHAIR—We might just address those issues now, but we will ensure that we have some time to talk about the future. I can also assure you that Mr Cameron's submission from the AMWU also had an impact on us—at least I remember him speaking to us. Could you elaborate on the loss protection program? Is this something that is unique to BHP?

Mr Patullo—It is not unique to BHP. It usually arises when a share plan involves the issue of shares to employees in which employees contract to pay the full market price. At the same time, there is usually an offer by the company of interest free, or low interest, finance, so that, at the time the employee subscribes for the shares, it is a cashless transaction. Most of the arrangements that I know of, and certainly BHP's, involve repayments progressively of those loans, but they are done in such a way that the repayments are timed and set at the value of the dividend that an individual will receive. So, again, there is a cashless repayment of the loan outstanding.

When an employee leaves the company, it seems to me there are three alternatives. One is that the company forgives the loan or waives any loss which the individual might sustain after those shares are sold. That particular alternative has been applied by some major companies. It has found disfavour amongst investment representatives, investment funds and even shareholder associations on the grounds that a debt is a debt and so why should it be waived for employees.

The second method is to say that the employee enters into the contract and, thereafter, becomes a shareholder—the same as anybody else—and is exposed to risk in the same way as anybody else. So when he or she leaves his or her employment, the balance of that loan is due and repayable immediately. Of course, if the shares involved have to be sold, they are sold, and if the proceeds from those sales are inadequate and there is a deficit or a deficiency, the employee has to make that up from other means.

The third approach is the current BHP approach whereby, if there is a loss situation as mentioned under scenario 2, the arrangement is that the employee can elect to have the shares continue under the plan—even though it is really only a plan for current employees—until the outstanding balance of the loan and the market price of the shares converge.

For example: the BHP share price is $18. If the loan were $19 for the share at the time the employee left, the employee would keep the share in the system, and, at dividends of 50c a year, subject to annual reviews by the board, it would take two years for the loan balance to sink from $19 to $18. Assuming an unchanging share price, there would then be a break-even point where the company would initiate the sale of the shares. As I recall, I think that at the moment there are no share issues in BHP which are under water in that way at this time, and that is particularly important for those people at Newcastle who will be leaving the company at the end of the month.

With share options, of course, there is not the same sort of consideration, because there is no contract to buy and no loan to repay. Options are simply let lapse when a person leaves the company—usually. Does that clarify the situation in relation to loan obligations on termination?

Mr BARTLETT—For employees who have held the shares over a longer period of time, presumably it is less likely that that will be an issue for them because the dividends that they receive are more than enough to offset any temporary downturn in share price.

Mr Patullo—Absolutely. If you go back to 1985, a share issue was priced at $5. There have been two bonus issues since.

Mr BARTLETT—And even over a reasonably short period of time—two or three years—it would generally be unlikely that this requirement would be effected for most employees.

Mr Patullo—It could happen, because share prices have declined. The last issue that we made to employees was at $15.80. It would not take a lot for a share price to sink below that, but the break-even price, of course, would be down around the sort of $14 mark, as you would deduce.

Mr Mytton—On that point, the share price was, even as short a time ago as 12 months, at $11 or $12 for BHP, so those shares were under water, but with the effluxion of time and the share price where it is now, they are no longer under water.

CHAIR—Thanks very much. You alluded in your opening remarks to dealing with, I presume, the bureaucratic processes of the Taxation Office and/or Treasury, perhaps. On the suggestions you make in relation to tax treatment of employee ownership plans, are there things that you have discussed or sought to discuss with the Taxation Office, and if so what sort of reaction have you had?

Mr Mytton—I think it is fair to say that, when division 13A was introduced by parliament in 1995, it was a completely new regime to what had been there, and there was a long period of consultation with industry and many submissions were put forward. Some points were taken on by both Treasury and the tax office, and some points were not taken on. It is some of the points that were not taken on that we feel could improve the operation of the law without changing the intent of the policy, and they are the sorts of things we have sought to outline in our submission. Indeed, we note that some of the large accounting firms such as KPMG have also made submissions along those lines—that the proposals are more

in the nature of correcting what we perceive to be deficiencies rather than changing the intent or policy of the legislation. However, it is fair to say that we raised all those issues both with Treasury and the Australian Taxation Office back in 1995, and again in 1996, but nothing has happened yet.

Dr EMERSON—You talked earlier about democratic processes or institutions. You have 51,000 employees holding shares or options representing 7.6 per cent of the company's capital. Do those employees potentially or in reality get the option of a representative on the board of directors?

Mr Patullo—Those employees are treated in the same way as other shareholders. Any shareholder can nominate for directorship for a vacant board position. There is not a block entitlement in those shares. Those shares are ranked pari passu with all other shares. It is one vote.

Dr EMERSON—So each share is one vote. Is that how it works?

Mr Patullo—Yes.

Dr EMERSON—Let us say that they were all very like-minded people, would that be enough to give them a representative on the board? Let us say that the 51,000 employees hypothetically said, 'Yes, we like so and so; we think he or she should be on the board.' Would that be enough? Does anyone know?

Mr Wong—The election of directors needs to go to a general meeting, so it would need to be approved by shareholders at a general meeting before a director would be elected to the board. That requires an ordinary resolution, which is a simple majority.

Dr EMERSON—So, potentially they could if they—

Mr Wong—If they hold 50 per cent of voting rights in the company, then potentially they could. But, given that it is only 7.6 per cent of the total shareholding of the company, that alone would not be enough to elect a director. They would need support from other shareholders.

Dr EMERSON—And that is true of all shareholders?

Mr Wong—Yes. They are just ordinary shares in the company.

Mr Patullo—There is certainly enough for an individual to nominate, or be nominated, for a seat on the board. And then it is a question of all shareholders having an opportunity to vote either directly or through a proxy on the nominees.

I know there is sometimes a misguided view that the institutions are faceless and that perhaps they have an overweighting in terms of voting, but it needs to be remembered that the investment funds—the AMPs and the like of the world—are really investing the funds of hundreds of thousands, maybe millions, of mums and dads. They are actually voting on their behalf in the way that they consider best. They can vote in terms of one nominee or another,

but it requires a majority of votes cast at the meeting directly or by proxy for someone to be successful.

Dr EMERSON—I was exploring a hypothetical model or an extension to ESOPs where the employees themselves may say, 'We have got something in common—that is, we are all employees—and so we will seek to get representation in the management structure of the company,' which is not necessarily a bad thing by any means. You could create a situation where there are blurred distinctions between managers and employees that may even be a good thing at the time.

Mr Patullo—I certainly believe that all executives and managers are all employees. There is no doubt about that. The board is a little different. The board is a custodian of shareholders' assets and a steward of those assets and seeks to assure the viability of a corporation into the future. It is not an actual operating day-to-day manager. So different skills are required.

Mr Wong—I think, generally, the board is there to represent the company. They have a duty of care to the company, not to the employees. The stakeholders in the company are the shareholders. So their duty is—

Dr EMERSON—But, if the employees are the shareholders, they have a duty of care to the employees.

Mr Wong—They do—if they are shareholders.

Mr Patullo—We recognise that stakeholding is much broader than what used to be thought in the past. Stakeholding was once thought of as ownership. The stakeholders that BHP sees are the community, the governments, the customers, the suppliers, the employees and the shareholders. I have probably left a couple out. But the whole community of interactive forces is part of the stakeholding community that we recognise.

Dr EMERSON—Are you aware of any examples—they would probably be overseas examples if there were any—where that distinction becomes so blurred that the employees, the management and the board of directors all become part of one whole, if you like, and that the employees effectively have, if not a management role—I accept your point that the board of directors are not the day-to-day managers—some sort of decision making role by virtue of the proportion of shares they hold? Do you know of any European examples of that?

Mr Patullo—The Mondragon model has been cited, but I am not an expert in that. I think it was a brave experiment in its day. Basically, we are familiar with major corporations that live in a competitive, regulated environment, and the accountabilities of the various pieces of that environment are relatively defined. We live within what the government defines as the framework in which we operate. To be honest, we do not go looking for other models that might not work in our environment.

Dr EMERSON—I was wondering if, in your travels, you had come across any. That is all. I seem to recall 20-odd years ago that people used to say Volvo was a really good

example of the workers having a strong interest in the company. I do not know the mechanism by which they had that interest—whether they were in some sort of profit sharing arrangement. I suppose the ultimate aim of an employee share ownership is that they have a financial stake in the success of the company.

Mr Patullo—I remember that Volvo was renowned for setting up quite different operations from its traditional methods. There was a plant in one area with fairly semiautonomous work groups, which was novel at the time you are talking about. There are of course forms of reward other than shares in any major corporation.

Dr EMERSON—Particularly annual bonuses.

Mr Patullo—There are productivity payments. There is the question of group incentive programs. Rewards in that form are moving more toward specific goal based incentives rather than discretionary bonuses. The trend is clearly in that direction.

Mr BARTLETT—What is BHP's principal objective in encouraging participation in the ESOP?

Mr Patullo—I cannot answer it on one particular basis. I have to quote a number of reasons for it. Firstly, to be a good corporate citizen, we believe that society now requires of us to offer equity to employees; secondly, the opportunity for employees to gain a capital stake in the company affords them an opportunity to have a perspective as a shareholder. Alongside that, there is the information employees receive as shareholders. So there is educational information about the financial progress of the company. Thirdly, it also affords the employees the opportunity to understand the purpose of the greater organisation as distinct from the particular plant where they are operating at the moment.

In our submission, we refer to a number of other reasons: we want to be an attractive employer; we need equity as a basis for providing certain incentive programs. I think it is important for employees to understand the justification of the profit motive, the nature of risk return for investors and the notion of retaining profits for future growth.

Mr BARTLETT—Was it anticipated that those sorts of factors would have led to—via greater commitment, a feeling of belonging and so on—improvements to the workplace in terms of commitment to the organisation, productivity, fewer sickies, greater long-term employment, et cetera?

Mr Patullo—No.

Mr BARTLETT—None of those were part of the thinking?

Mr Patullo—No. There are so many factors that impact upon a person in their workplace.

Mr BARTLETT—I note in your submission you say that the evidence is inconclusive, but I was wondering whether that, in fact, was a surprise or disappointment to the company in terms of what had been anticipated.

Mr Patullo—No. Our expectation is as I have stated. We firmly believe that an employee share program, or a number of employee share programs, contribute to a constructive and productive workplace environment. It certainly does that. Of its own, it does not create it. It is hard to say that an employee program or, indeed, any other single thing, will make employees more committed to an organisation, particularly in a time of turbulence and change.

There is some statistical evidence that corporations with ESOPs of one sort or another seem to be financially more successful than others. We are not entirely sure about the cause and effect relationship of all that, but there is no doubt that a profitable and successful organisation generally means greater stability, greater chance of higher pay for people, greater chance of security of jobs. It is a long trail, but I think it does lead constructively and positively towards better employee relations.

Mr BARTLETT—I note in your submission that you mentioned that employee attitudes towards ESOP do vary according to the market price of BHP shares. Does that fluctuating attitude show itself in any way in terms of those other variables, such as commitment, productivity, et cetera?

Mr Patullo—Not that we have measured.

Mr WILKIE—You have got 51,000 employees involved in this scheme; how many employees have you got in total?

Mr Patullo—Fifty-one thousand.

Mr WILKIE—So there is 100 per cent involvement?

Mr Patullo—Yes. I have to explain that most of our overseas employees have options and not the share purchase program that I explained in some detail earlier. We did offer only options in our last issue in April-May this year. Thanks to our legal colleagues, we were able to, in most cases, grant them, rather than go through the arduous and mistake ridden procedure of invitation, acceptance, offer, issue procedures. So we have a lot of employees with options. They are 10-year options. They have performance hurdles—the same performance hurdles as for the managing director. The company has to deliver in its total shareholder return against some comparators, both national and international. We believe it is a unifying thing to have the managing director, the executives and all management and staff—other employees, howsoever described—all in the one program. We are happy with that particular issue. We want the price to be higher, of course, but that is another thing.

Mr WILKIE—You do not offer a different scheme for your executives as opposed to average employees?

Mr Patullo—The long-term incentive program that we have takes the form of the options that I described. It is under the umbrella of the employee share plan. There are a number of strands, and that incentive program applies to all employees. There are different numbers of options to meet market competitive circumstances, but with the same vehicle and the same standards.

Mr WILKIE—How do you base that? Do you base it on salary?

Mr Patullo—No, it is somewhat hierarchical.

CHAIR—To what extent have the unions been involved in the development of your employee share ownership plan?

Mr Patullo—This is going back a long way because the share purchase program was developed in 1983-84. There was an education program but the unions were not invited to develop the program. I do have to say, though, that we had a very constructive input from what was called the transition steering team at Newcastle. You gentlemen may recall that the announcement to close the front end of the Newcastle operations was made some two years ago. There was a working party drawn from amongst union representatives, management on site and others. One of their concerns was the prospect of facing a loss when individuals leave a company in the way I explained earlier. Through discussions with that transition steering team, a solution was found which was acceptable to the board and, ultimately, to the shareholders in September last year, which resulted in the loan extension program.

CHAIR—You mentioned earlier that tax concessions are critically important to the development and maintenance of the employee share ownership program. Is that a view that is shared by your employees? The reason I ask is that Mr Mansfield from the ACTU told us this afternoon that there should not be tax concessions provided by government for employee share ownership. I just wonder to what extent your work force would share that view.

Mr Patullo—We have not asked them that question specifically. We do consider, as we indicate in our submission, in some respects, the employee to be a somewhat disadvantaged investor. The employee is offered an opportunity to subscribe for shares or options at a time of choosing of the company, not of the employee. The offer is in respect of that company's equity only, on what is sometimes a favourable terms basis, but which does not always bear a relationship to an independent and free investor. There are restrictions, such as performance hurdles on options. There can be vesting restrictions. When an employee leaves the company, they usually leave the program. So, in that respect, an employee is not like an ordinary voluntary investor. It is voluntary, but they are not like a normal discretionary investor. Sometimes they are influenced by their peers, positively or negatively, in terms of the decisions they make. So we believe that there need to be some concessions.

Clearly, if you accept the views that corporations that have employee share programs are more productive and more successful—again, I am not labouring the cause and effect point—then that must deliver greater returns to the country as a whole and to Treasury as a whole, too. So the concessions are relatively minor, relative to the potential for gain that is there. The potential for gain is that if a corporation issues a large number of shares or options and gains are made, they are subject to tax, of course.

CHAIR—Would you like to tell us a little bit about the future?

Mr Patullo—We know all about the future! No, we do not, but we presume to speak just briefly about what we hope might be the outlook in terms of ESOPs. We hope that the future that you will allow will see ESOPs continue to be diverse in nature; shares and

options to proliferate. They can be used as a means of building a capital base for employees; also for another purpose altogether: as a substitute for both ordinary remuneration and what would otherwise be cash incentives. Companies will approach these objectives in different ways, and we hope that such variety will be permitted and, indeed, encouraged.

We see that performance hurdles will increasingly feature in ESOPs—certainly for executives, but possibly for all employees. They will most likely, we believe, be applied more to share options and will take the form of either absolute financial goals or comparative index standards.

We have the view that shareholders, investment companies and company boards will continue to expect that the sponsor of each ESOP proposal should be free to design the ESOP to suit each company's individual circumstances. There may be cases where, for example in high-growth companies, ESOPs will use new capital raising to deliver their equity participation while other companies may make greater use of on market share purchases for that purpose. We, of course, acknowledge that there are trends in corporate governance which will also influence the practices of public companies in particular.

Overall, we hope that the government will provide, as it has done substantially in the past, a stable and supportive legislative framework for ESOPs into the future. We support the finetuning which we have advocated in our submission, but we do not propose that the whole thing be torn up and started again on a blank sheet of paper. That is our daring look into the future.

CHAIR—It is pretty modest really. Just one other thing: the forfeiture rules. You touched on that in your submission. What changes are you specifically interested in there? You wanted removal of or, I think, exemption from 139CE.

Mr Mytton—Yes, 139CE(2). At the moment, to avail the exemption—the $1,000 threshold—to the extent that there is a discount, parliament places certain conditions on the issue of the shares under the employee share plan, and one of those conditions is that there be no forfeiture rules. However, in our view, there are situations where employees betray their loyalty to the company through fraud. It would be appropriate in circumstances such as those to allow forfeiture rules to be included in the legislation but not to prevent the threshold still applying. It would only be in situations like that—as in fraud—that we think there should be an exemption to the exemption, if you like.

CHAIR—I understand. Mr Wilkie reminds me that we have had a number of submissions that have pointed that out.

Mr Patullo—It does not go to the heart of the whole nature of the legislative program but it is an issue.

CHAIR—Yes, it is on the fringe. Thank you very much for letting us know that employee share ownership extends beyond the CEO, and for putting all that effort into it. We are grateful that, particularly with such busy working lives, you have all taken an hour of your day to come along here.

Mr Patullo—Thank you. We do appreciate the opportunity to make this submission. We reaffirm our appreciation of your commitment to and interest in employee equity programs.

[4.14 p.m.]

BALTINS, Mr Edgar Martin, Partner, KPMG

PURDON, Mr Andrew, Tax Partner, KPMG

CHAIR—Welcome. Thank you for taking the trouble to provide a submission and for putting aside an hour or two of your busy day to come along and speak to us.

The committee proceedings are recognised as proceedings of the parliament and warrant the same respect that proceedings in the House of Representatives itself would demand. Witnesses are protected by parliamentary privilege in respect of the evidence they give before the committee. You are reminded, however, that false evidence given to a parliamentary committee may be regarded as contempt of the parliament. The committee prefers that all evidence be given in public but if at any stage you want to give anything in camera simply ask and we will organise for that to be done.

I invite you now to give a precis of your submission, which we can then discuss.

Mr Purdon—We have put in two submissions. Edgar will talk to the one that was put in most recently, on the basis of the extreme view—for want of a better word—that we get rid of the current legislation and have capital gains apply, and I will go through the problems we see in the current legislation that need to be addressed.

Mr Baltins—The big picture view is that the current legislation is fairly complex. Since the various submissions have come through, a number of our clients have come to us and said, 'Wouldn't it wonderful if we could actually get rid of this legislation and just bring it within the normal capital gains tax regime so that we don't have all the different calculations that are required and decisions for taxation at different points in time, and the employee pays tax at the time he ultimately disposes of the shares—pure and simple.' That is the first proposal.

CHAIR—Just treat them like any other kind of share purchased by an individual?

Mr Baltins—That is right, and your cost base is what you paid for them, basically. That is very simple.

The second issue that I want to talk to you about—and I have given each of you a handout with a worked example—is an anomaly under the existing legislation. The employee share scheme provisions are wonderful if the employer is a company and it is shares in a company that are being provided as the benefit. They are not so good if the employer is a trust or has a stapled structure.

There are quite a few stapled structures listed on the Australian Stock Exchange already. I will explain what that is. You could have a unit in a unit trust and a share in a company where the unit trust and the company are both listed but the units and the shares are stapled, contractually bound, so that you can only trade them together, you cannot trade them separately. There is Stockland, there is Thakral, there are quite a few listed entities in that

situation. These entities have a particular problem in trying to provide a traditional employee share scheme benefit because the current legislative rules apply to the shares in the stapled structure but they do not apply to the units.

The example I have given you is based on one of our clients. It is the calculations that were done which caused them to decide not to go ahead with an employee share scheme. I will take you through it very quickly. It was a typical example: 10,000 options, the option term was five years, the current market value on the Stock Exchange was 75c, and the idea was that they could exercise the option at 75c but they had to meet various performance hurdles. At some later stage, they eventually exercised the options, and the stapled securities at that time were worth 85c. So we know that the overall benefit that they got was 10c per stapled security, which is $1,000. Equity would say that tax should only be paid on $1,000 because that was the benefit. We have shown a split of the value of the trust versus the company—34 to 66.

On granting of the trust unit option there is fringe benefits tax payable. That is based on the fact that the fringe benefits tax legislation says, 'I am giving you property. That property has a value.' That value that is calculated here is using the same valuation rules under the employer share scheme rules and you pay fringe benefits tax to the extent that nothing is paid for that option. That is point one. In the example, we have got a taxable value of $295.80. When the option is exercised, you then look at the value of the shares that are given—in the example: 85c, we pay 75c per unit. And in that example the allocation to the units is subject to FBT, so you pay FBT on the $340. There is nothing taken into account at that stage for the fact that tax was paid on a notional value of the option, so already we have got double tax. Then, when the whole thing is sold by the employee, he will have a cost base in the units aspect equal to what he paid for it, so if he sells it straight away he pays tax on the difference between the market value and the unit there.

It is a complex example but, in simple terms, tax is paid overall on $1,635.80, the real benefit is $1,000, the total tax paid is $1,114.68, which means you have got an effective tax rate of 111.468 per cent. The problem part is on the unit part, where $975.80 of the $1,635.80 taxable value relates to trust units and is basically 2.87 times the actual gain of $340.

There is a very simple recommendation to fix this, and that is that the definition of share in the employee share scheme provisions should be amended to include stapled securities and units in unit trusts, and the FBT legislation should be amended so that nothing is taxed under FBT under the current regime and everything is taxed under the income tax regime. That is the recommendation to avoid this multiple taxation problem. We have only found it amongst a few of our clients who are in this. I think there are about 10 or 11 listed at this stage. These are listed organisations very keen to institute an employee share scheme arrangement. Employees want it and the management want it to keep their key people. This is probably something that is not well known, but we felt it had to be brought to your attention.

CHAIR—So stapled securities and units in unit trusts?

Mr Baltins—Yes.

CHAIR—Have you done any estimate of the tax expenditures involved in that?

Mr Baltins—No. But just think of it this way: there are quite a few listed trusts out there and their employees cannot participate in this arrangement.

Mr BARTLETT—Has this problem been put to the tax office?

Mr Baltins—This problem was put to the Treasurer in 1997. Part of the attachment to this submission is a copy of the letter that we put to him. The tax office recognise that there is this problem, but the legislation has a problem and their duty is to administer the legislation.

Mr WILKIE—Did they get back to you at all about what they were doing with it?

Mr Baltins—What they are doing with it?

Mr WILKIE—You had written pointing it out. Did they suggest that they would—

Mr Baltins—We have spoken to them and we have, within KPMG, employed people who previously worked in this area and they just say it is a recognised problem.

CHAIR—Your letter sets out the problem and what you see as the solution to it?

Mr Baltins—Yes.

CHAIR—Okay. We will pay particular attention to that. But we will also send that to Treasury and ask them for some estimates. As will always be the case, Treasury will give us a worst-case scenario on that.

Mr Baltins—Okay. That is all I wanted to say.

Mr Purdon—We have already stated that many of our clients prefer the capital gains tax provisions to apply to share schemes. On the basis that the legislation, as is, is to remain, there are certain problems in that legislation that we see need to be fixed.

One is that under the current legislation an employee must make an election under section 139E to be taxed on receipt of the shares or options up front to get the $1,000 exemption. If an employee receives any other shares or options during that year, they are also taxed on receipt. So you get the situation where, if you have more than one issue, they are all treated the same way and the employee cannot take the benefit of the $1,000 exemption without having other share or option issues assessed up front. This can create the situation where they say, ‘I don’t want to participate any further because I don’t have the ready funds to pay the tax on any further issues up front.’ Or they may not make the election if they know they are going to have more than $1,000 worth of shares or options, because they do not have the ready funds and they would rather be taxed down the line when any restrictions are removed.

Also, that $1,000 exemption seems to create an artificial ceiling in that both employers and employees look to that $1,000. The question is: was the legislation intended to create an artificial ceiling? In a share survey we did last year of 750 Australian companies, ranging from public companies down to private companies, 35 per cent said that they did not have a share scheme but that if that threshold were increased to $2,000 they would certainly participate. So a fairly high number saw that $1,000 as a very low threshold in today's economy.

CHAIR—Can I get that right: thirty-five per cent of companies said that they were not involved—

Mr Purdon—That they did not have a share scheme.

CHAIR—Right. And of that 35 per cent who said they did not have a share scheme, 100 per cent then said—

Mr Purdon—No. Of the 750 that were surveyed, 35 per cent said that they did not have a share scheme but that, if the threshold had been $2,000, they would have participated. There were others that said that they did not have a share scheme but that they probably would not have one if the threshold were raised or indifferent.

CHAIR—So all of the 215 who said, 'We do not have a share scheme,' said—

Mr Purdon—No. There were others that said that they did not have a share scheme but would not change their minds if there were an increased threshold.

CHAIR—Let us say that there are 215 who do not have a share scheme. Of those, how many said, 'We would have one if the threshold were increased?'

Mr Purdon—For those who said that they would not, I am not quite sure of the actual number. I do not have the figures here.

CHAIR—That is all right. But most of them? Is that what you are saying?

Mr Purdon—A large majority of those that said that they did not have one said that they would. I do not know if the figure was actually 40 per cent or whatever of the total, but it was a substantial number of those that said that they did not have one that said that they would. That was 35 per cent of the total that were queried.

Mr Baltins—We can get you those numbers.

CHAIR—Yes, that would be useful. It sounds as though you should pursue a career in politics!

Mr Baltins—Is that a compliment?

CHAIR—Please continue, Mr Purdon.

Mr Purdon—That creates a disincentive for further shares to be issued in the one year. There is also the disadvantage that was mentioned by the people who were before us of this idea of the forfeiture of shares and the fact that there are those restrictions on forfeiture. There is a provision in the legislation that says that, where the forfeiture conditions apply and employees are taxed up front to get the $1,000 election and the shares are forfeited, there is no refund of any tax paid up front. But the legislation specifically provides for a refund of tax where options lapse. Where you actually lose the shares, you cannot get a refund if you have paid up front; but where the options lapse and you lose them, you can get a refund up front. So there is an anomaly in the legislation between shares and options, and there does not seem to be a logic for that.

Notwithstanding that options do have their problems, currently the cessation time for options can be when the employee leaves the employment of the employer. They may not be able to exercise the options for several years, but it is still a taxing point. An employee who is retrenched, made redundant or dismissed will be required to pay tax on those benefits but may not be able to realise the sale of those shares for several years when the share price may have fallen and they may have paid the tax, et cetera. It may even be that these people who have been required to pay tax have been retrenched, they may have got a very minimal payout and they may be on unemployment benefits yet they cannot sell the shares to pay the tax liability. So in some cases it could create a problem.

CHAIR—What happens in that situation? As I said earlier, we are doing a parallel inquiry into problems of the over-45s being unemployed.

Mr Purdon—What would happen in those institutions is that either the employee would have to borrow money to pay or deplete what reserves they have of savings to pay their tax. This was a very serious problem back in the year ended 30 June 1988, after the stock market crash in Australia, when there were a lot of share plans out there. Employees had taken shares and were being taxed up front, and suddenly the stock market collapsed and the shares were worth only a small amount. Some people did have severe financial problems at that time.

CHAIR—What is your solution to that?

Mr Purdon—The solution would be that the cessation of employment does not create a taxing point.

CHAIR—Just tax at disposal?

Mr Purdon—Just tax at disposal or, alternatively, when the shares are able to be realised, when the time period is up for the employee to be able to dispose of their shares. At the moment, under the issue requirements they may have another two years to go before they can actually dispose of the shares but, because they have been retrenched, the legislation says that they must now pay the tax.

Mr WILKIE—Have you had the situation where someone is in that position but they then cannot get unemployment benefits because they have assets that are too great? They

cannot sell their shares but, because they own them, they cannot get benefits. It might be worth checking.

Mr Purdon—I do not know with the legislation regarding the payment of unemployment benefits whether an asset which you do not have any rights to dispose of can actually be taken into account in deciding whether or not you qualify for unemployment benefits. That is something I do not know.

Mr WILKIE—There are all sorts of new provisions now, so it would be worth checking.

Mr Purdon—We also have a similar position on restructure. You may have shares in a company and the company may be bought out. As part of the buy out you are required to exchange your shares for shares in the takeover company. A change in the ownership of the company creates a taxing point, notwithstanding the employee cannot realise those new shares for a few years into the future. So if there has been a buy-out at the holding company level and the employee is holding the new shares, that creates a taxing point with no ability for the employee to actually dispose of the new shares to pay the tax. Again, it is an area which could cause some financial hardships.

The Ralph report looks at replacing script for script in respect of takeovers by saying that you can have your original cost price for the new script. It would simply be a case of allowing those provisions to apply. You could just roll over if the employer was replaced, et cetera. That would not create any cost anywhere, just the fact that a taxing point would not be created.

We also see another problem in respect of the move towards global companies and the global economy. The example I have here is the UK, but I believe it also applies in Canada and may apply in other countries. Where you have a non-approved share scheme, you can have the situation where an employee in the UK parent company receives options in the parent company and, let us say, four years down the track is seconded to Australia for two years. It could just so happen that the time when those options would be exercised falls during those two years. Under our legislation we would say, 'You have exercised those options whilst you were working in Australia as either a resident or a non-resident, and we will have tax on 100 per cent of the gain made on that exercise of the options.'

In the UK legislation, it is taxed pro rata for the time that they were in the UK, so they would have a tax liability in the UK of 80 per cent of the gain on exercise of the options. Effectively, you are getting taxed on 180 per cent of the gain, not even on 100 per cent of the gain. There is no clear evidence in the legislation and the double tax agreement that you would even get a tax credit allowed between countries. We have spoken to the tax office about it; some say, 'We think you should get one,' and others have said, 'The legislation doesn't allow it, so you don't get one.'

If it happens the other way, and an Australian is granted options in Australia and is seconded to the UK and exercises the options in the UK, then the UK says, 'They were issued in Australia, they are Australian options, we don't tax it.' So it only relates to 100 per

cent. It is only a problem for secondees coming into Australia and exercising options while they are here, even if they are back in their parent company.

CHAIR—Without breaching confidentiality, can you nominate any specific companies that might have been affected by this?

Mr Purdon—I am aware of it actually happening on three occasions.

Mr BARTLETT—You said that you have taken that up with the tax office; has that been taken up with the Treasury as well?

Mr Purdon—No.

Mr BARTLETT—The tax office said it is a legislation problem?

Mr Purdon—Yes. They are aware of the problem, but we are not aware of anything being done to resolve the problem.

Mr BARTLETT—That issue needs to be raised with Treasury as well then, in order to have the legislation changed, I take it?

Mr Purdon—Yes.

Mr Baltins—Not just legislation, it could be a double tax treaty issue as part of the negotiations on the revamping of some of these treaties.

Mr Purdon—The other major issue that I would like to put forward today relates to the formula for assessing the valuation of options. To most of our clients, it is extremely confusing; their main comment was, 'Could you make it a lot simpler to understand?'

Mr Baltins—Hence the original recommendation: scrap it all.

CHAIR—What you are suggesting is very attractive. In fact, I was saying to our secretary that just about every recommendation you have put in here is one that I would look at very carefully. My colleagues may feel differently. Are there any other points that you would like to make?

Mr Purdon—We have got some other minor points in our submission, but they were the main ones that we wanted to raise today.

Mr BARTLETT—I have a more general question, not one to do with specific tax issues. In your submission you give an overview of the percentage of employees involved in ESOPs in different industries. I notice there is quite a range—83 per cent in R&D companies, down to 25 per cent in telecommunications, 26 per cent in retail. Have you given any thought as to the reason for the differences?

Mr Baltins—I was not actually involved in the survey; Andrew was. In start-up operations, like an R&D operation or a venture capital organisation, where there is little cash to fund employees, the incentive that you give them is an equity stake.

Mr BARTLETT—I notice that the percentage even for banking and finance companies is 78 per cent.

Mr Purdon—Banking and finance companies traditionally do have the share schemes. A lot of the larger banks have the $1,000 schemes and variations thereof for their employees. In most industries, once one company does it, there tends to be a trend to follow it for employee relations and to retain employees. Once they find out that two or three competitors have got a benefit like a share plan, then they tend to say, 'Well, we'll follow suit.'

Mr BARTLETT—Any indications as to why it is so low in retail, for instance?

Mr Purdon—The only thing that I can think of in retail is that it probably has a greater turnover of staff and, therefore, there is not the same longevity of employee that they are trying to maintain. That is the only possible explanation that I can think of.

CHAIR—Did you read the Ernst and Young submission?

Mr Purdon—No, I have not read the Ernst and Young submission.

CHAIR—If you are agreeable, I might ask our secretariat to provide you with a copy of the Ernst and Young submission. They made quite a long series of suggestions and put to us a range of practical problems they had had with employee share ownership programs and, more specifically, with the tax office. I would be interested to hear any comment that you would like to make—points of agreement or even disagreement. It would add weight to what is coming from administering the technical aspects of the current act. It would help us at least if we could see where KPMG lines up with one of the other big accounting firms.

Mr Purdon—I think we will have a copy of that in the office. I will have a look at it and we will respond to those issues for you.

CHAIR—There is a lot of stuff particularly in relation to 13A, but there are some things you have suggested that cross paths there. It adds some weight to our deliberations if you are on the same—

Mr Baltins—What is the time frame in which you would like a response to that, given everything else that you are trying to do?

CHAIR—Another month or so.

Mr Purdon—We will impose a time limit on ourselves of early October.

CHAIR—That would be very good. Are you identifying with your clients a problem with our treatment of stock options in terms of attracting and retaining staff from other countries? We talked about non-residents but—

Mr Purdon—It is not an issue of not attracting people; it is just a result of what happens. Most people who are seconded to Australia do not find they have a problem until they exercise their options when they are here. Quite a few employees who come to Australia on secondments will be involved in any stock options or share schemes they have in their home country, anyway, whilst they are away. It is only a problem when you have got an option and the option is exercised whilst they are here. That creates a problem. Otherwise it does not, if it is not exercised whilst they are here.

CHAIR—I have been speaking to some venture capitalists and some principals in small but emerging IT businesses. Apparently, there is a problem where you have got a relatively poor cashflow in a company that has got enormous potential and what the employees want is a stake in the company as distinct from necessarily a high income. Because our tax treatment here is quite different from, say, the US, I am told that it is difficult to attract and retain this sort of staff. I wonder whether you are coming across that at this stage.

Mr Purdon—I am aware that the issuing of shares or stocks or options in IT companies is extremely prevalent and most employees want it, but I was not aware of the difference between the countries causing a problem.

Mr Baltins—They generally find that it is easier, especially in IT, to do their work offshore, in any event. It is a matter of wherever the computer is, so it is just as easy for them to do that work and transmit it across here, if need be. They will not necessarily stay in the US, either; they might go to a haven.

CHAIR—Thank you very much. I really appreciate your putting the effort into this. As I said, just about every recommendation that you put there is one that we will look at earnestly. If you would have a look at that Ernst and Young submission, that would be helpful, and if you have a chance to look at any of the other submissions that have been put in, and if you have any disagreements or anything like that, feel free to let us know.

Resolved (on motion by **Ms Gillard**):

That this committee authorises publication, including publication on the parliamentary database, of the proof transcript of the evidence given before it at the public hearing this day.

Committee adjourned at 4.46 p.m.