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Appendix F – Employee share plans in other countries

Introduction

This appendix outlines employee share plans in other developed countries. It is not intended to be exhaustive, detailed or comprehensive but to provide an indication of the nature and extent of employee share plans for comparison purposes.

United States of America

The United States leads the world in the number of employee share plans on offer, the number of employees involved, the number of employers offering plans and the value of equities in plans.

In the United States there are three dominant forms of employee share plan: employee stock ownership plans or ESOPs, the so called 401(k) plans, named after the section of the legislation that provides for them, and stock option plans.

ESOPS[1]

An ESOP (employee stock ownership plan) is a retirement-type plan, in which a trust holds stock in the employee-participants' names. It usually covers all full-time adult employees. After they leave the company the equity they have amassed and which is held by the trust is paid to them.

ESOPs are subject to the Employee Retirement Security Income Act of 1974 (ERISA) and are highly regulated. They are never 'key executive' plans; rather, the applicable rules ensure a broad base of participation.

In an ESOP the employer makes defined yearly contributions that accumulate to produce a benefit. The size of the benefit is not defined in advance.

In return for meeting certain legislated requirements, ESOPs offer special tax benefits. These benefits include:

- The company can deduct contributions to the ESOP, including payments on loans the ESOP takes to buy company stock;
- The company can deduct dividends paid on ESOP-held stock; and
- Owners of closely held companies who sell to an ESOP can avoid paying capital gains taxes on the sale proceeds by reinvesting them in securities of U.S. operating companies.

To establish an ESOP, an employer creates a trust fund. The employer contributes company stock and/or cash to buy either new or existing shares for the trust. Employees do not own the stock directly; rather, the ESOP trustee holds it in their names. With a few minor exceptions, only after a participant retires or otherwise leaves the company does he or she receive the stock or the fair value of the stock.

Of all the benefit plans that receive tax exemptions, only an ESOP may borrow money to buy stock, and it may do so on the employer's credit. Also, almost all contributions to ESOPs come from the employers, not the employees themselves.

Lenders will often make the loan to the company instead of the trust, with the company relending the proceeds to the ESOP. In return for doing this the company gets a number of tax benefits, provided it follows the rules to ensure that employees are treated fairly. These include

- The company can deduct the entire loan contribution it makes to the ESOP, within certain payroll-based limits. In effect, it can deduct interest and principal on the loan, not just interest; and

1 Scott Rodrick, 'A Tale of Two Acronyms: An "Employee Stock Option Plan" Is Not an ESOP!' August 1997, available at http://www.nceo.org/columns/sr6.html. Downloaded 2 August, 2000.

- The company can deduct dividends paid on the shares acquired to repay the loan itself; that is to say, the earnings of the stock go to pay for the stock itself. There are limits to the deductions that may be claimed.[2]

Since ESOPs may borrow funds and given their tax advantages, they are often used to buy out all or part of an owner's interest in an established, profitable, closely held company. They are also used to acquire blocks of stock in public companies.

It is not usual to find ESOPs in recently established companies. Owners may not be interested in selling their interest or diluting their control, or the costs of setting up an ESOP in a small company may outweigh any advantage, such as the tax and other benefits. Such disincentives may be increased if the company is not profitable and is therefore not paying taxes in the first place. It can cost, for example, $20,000 to establish an ESOP in a small company.

401(k) Plans[3]

401(k) plans allow employees to save for their own retirement. Named after section 401(k) of the Internal Revenue Code, 401(k) plans permit employees of qualifying companies to set aside tax-deferred funds.

A 401(k) plan is established by a person’s employer. The employee elects to contribute to the plan from pre-tax salary or wages a specified amount. The employee also specifies how the contribution will be invested, from a range of options. Employers usually offer at least four alternative investment vehicles.

The contributions can be withdrawn for certain emergencies or in some cases may be borrowed against. However, the money invested is intended to remain in the employee’s account until the employee is at least 59 $^{1}/_{2}$.

While the investment is growing the employee does not pay any taxes on it. When it is withdrawn at retirement, tax is paid as sums are withdrawn from the account, so the taxpayer pays tax over time instead of as a lump sum.

Employers may make contributions to an employee’s 401(k) plan. This is because the law requires that participation in the plans is not too heavily skewed towards more highly paid people. This contribution takes the form of an employer match on the employee’s contribution. Usually the employer matches a certain percentage of the employee’s contribution.

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2 ‘An Overview of ESOPs, Stock Options, and Employee Ownership: Why Set Up an Employee Stock Ownership Plan (ESOP) or a Stock Option Plan?’ http://www.nceo.org/library/overview.html. Downloaded 2 August, 2000.

3 Drawn from:’ 401(k) Defined’, http://www.401kafe.com/education/abc/abc_def.html and ‘An Overview of ESOPs, Stock Options, and Employee Ownership: Why Set Up an Employee Stock Ownership Plan (ESOP) or a Stock Option Plan?’ http://www.nceo.org/library/overview.html. Downloaded 2 August, 2000.

401(k) plans also have a number of other features:

- Contributions can be matched in any investment the company chooses, including company stock;
- There is a combined limit of 15% of taxable pay that the company and the employee together can contribute to the plan;
- 401(k) plans and ESOPs can be combined, with the ESOP contribution being used as the 401(k) match. This can work on either a nonleveraged or leveraged basis; and
- 401(k) contributions cannot be leveraged.

Stock Option Plans

An employee stock option is a right to buy a given amount of company stock at a given price. The right may be exercised for a given period of time. Employee stock option plans are not governed by ERISA. They are not retirement plans.

Employees do not possess the stock until they ‘exercise’ their options. When the options are exercised, employees must buy the stock. At this point, many sell the stock immediately. A stock option plan is designed for employees to buy the stock and also to hold it directly, unlike an ESOP, in which the trust holds the stock until the employee is eligible to receive it.

In general, a stock option plan can be offered to any number of employees as determined by the company. Employee stock option plans are usually referred to as incentive stock option plans or ‘ISOP’ (or ISO). However, employee stock purchase plans that receive concessional taxation treatment are sometimes classified with stock options; these ‘ESPPs’ or ‘423 plans’ (after the relevant section of the Internal Revenue Code) must be offered to all employees, with certain exceptions such as part-time workers.

Stock option plans do not receive as generous tax incentives as ESOPs. Provided certain taxation requirements are met, stock option plans allow employees to defer taxation until they sell the shares and also to pay tax at the capital gains rate rather than at the ordinary income tax rate. Employees are generally not taxed until they sell the stock. At that point they pay tax on the difference between the sale price and what they paid for it. The company does not receive a tax deduction.

In stock option plans that do not enjoy concessional taxation treatment employees receive no tax benefits and initially pay ordinary income tax on the difference between the price they pay for the stock when they exercise their options and the fair market value at that time. At this time, the company receives a corresponding tax deduction for this amount. If the employee holds the stock instead of selling it immediately, any additional gain is taxed as capital gain. Most broad-based stock option plans do not enjoy concessional taxation treatment. Such plans are simpler than those stock option plans that do receive a concessional taxation treatment.

Stock option plans are often used in start-up companies, such as high-tech firms that intend to go public within a few years.

Value of, and participation in, employee equity plans in the United States

401(k) plan assets stood at an estimated $1.41 trillion at the end of 1998. They made up approximately 13 per cent of the $10.9 trillion U.S. retirement market. Assets in 401(k) plans have grown an average of 18 percent per year, from $385 billion in 1990. There were 273,485 401(k) plans with 36.7 million participants at the end of 1998. Since 1990, the number of 401(k) plans has increased from 97,614 and the number of active participants from 19.5 million. On average, 78 percent of eligible employees participate in their employer-sponsored 401(k) plan. At the end of 1998, the average 401(k) account balance was $US 47,004. This represented a 26 per cent increase over the average account balance at the end of 1996. ($US 37,323).[4]

Information on the other equity plans used in the United States is summarised in the following table:

Table 1 Number of plans and participants, and value of plan assets

Type of plan	Number of plans (as of 2000)	Number of participants (as of 2000)	Value of plan assets (as of 2000)
ESOPs and stock bonus plans	11,500	8.5 million	400 billion +
Broad stock option plans	3,000	7 to 10 million	Several hundred billion (not realistic to estimate)
Stock purchase plans	4,000	15.7 million	(not realistic to estimate)

Source: 'A statistical profile of employee ownership', http://www.nceo.org/library/eo_stat.html. Downloaded: 2 August, 2000.

The authors of this table provide these qualifying comments:

- The estimates here are roughly accurate as of the February 2000 update, but for ESOPs, there is no solid, up-to-date data to work from, so the figures for 2000 are the same as the figures we gave for 1998 and 1999; at any rate, the number of ESOPs has not grown very much in recent years because although there are many new plans put into place each year, other plans are terminated because the company is sold, etc.

4 'Frequently asked questions about 401(k) plans ', http://www.ici.org/retirement/401k_faqs.html. Downloaded 2 August, 2000.

- ESOPs (employee stock ownership plans) are stock bonus plans qualified to borrow money; otherwise, the two types of plans are very similar. Estimates for this category are based on data gathered by the U.S. Department of Labor (DOL) for 1994 (Form 5500[5]) and by the Internal Revenue Service for 1997 (letters of determination). To carry estimates forward to the present, we have made conservative extrapolations based on anecdotal data. These figures replace prior estimates of 11 million or employee-participants for prior years. Those estimates were less precise and less narrowly focused on ESOPs. The stock bonus plans included here are similar to nonleveraged ESOPs (they are primarily invested in employer stock and offer distributions in employer stock).
- Most companies with ESOPs are closely held. However, because public companies have, on average, many more employees than private companies (for example, there are tens of thousands of ESOP participants at United Airlines), most ESOP participants are in public companies.
- ‘Broad stock option plans’ are those that grant stock options to 50% or more of full-time employees. Estimates are based on surveys by NCEO, ShareData, Inc., and media reports. It is not realistic to estimate the value of the stock represented by these options, although it might be a few hundred billion or more. Broadly granted stock option plans are found both in smaller, closely held companies (often in entrepreneurial high-growth firms) and in large public companies.
- Employee stock purchase plans (ESPPs) include both tax-qualified ‘423 plans’, which are offered by about 2,400 companies, and nonqualified plans, which are offered by about 1,500 companies. Our estimates are based on data from ShareData's *Equity Compensation Trends in America* (1991), Hewitt Associates' *On Employee Stock Ownership* (1996), Hewitt Associates' *Survey Findings: Employee Stock Purchase Plans* (1998), and the National Association for Stock Plan Professionals' *Stock Plan Design and Administration Survey* (1998), especially the more recent studies. To estimate the number of employees covered under the plans, we took the total number of companies offering plans, multiplied those numbers by the average number of employees in the companies (13,207 for 423 plans and 17,790 for nonqualified

5 A tax form that companies sponsoring an ESOP or other such plan file with the Internal Revenue Service each year.

plans), and multiplied that number by the average percentage of participation in the plans (34% for 423 plans and 17% for nonqualified ESPPs). Almost all companies with ESPPs are public.

- Many companies offer multiple plans, and many employees participate in more than one plan. For example, many ESPP participants are also in 401(k), stock option, or other equity compensation plans. Hence, the total number of participants in all these plans is definitely *not* the total of the numbers in the 'Number of participants' column.

European Community

Employee participation in profit and enterprise is strongly encouraged in the European Community. The European Council issued a recommendation on 27 July, 1992[6] which called on member states to 'acknowledge the potential benefits of a wider use…of a broad variety of schemes to increase participation of employed persons in profits and enterprise results by means of profit-sharing, employee share-ownership or a combination of both…'[7] To a great extent this recommendation has been based on the European Commission's PEPPER Reports (Promotion of Employee Participation in Profits and Enterprise Results). The motivation for the recommendation is to increase profit sharing. It is based on replies received from Member States. The Report states that in all cases, profit-sharing is associated with higher productivity levels.[8]

Information collected by the Committee indicates that employee share plans are operating in the United Kingdom, Germany, Austria, Ireland, Belgium, Italy, France, Spain and Denmark. In a document published on the internet, the European Commission stated that:

> The positive effects of PEPPER schemes (promoting participation by workers in profits and enterprise results) on profitability are widely recognised. Profit-sharing invariably goes hand in hand with increased productivity.
>
> The divergence of policies adopted by Member States must be seen in the light of their traditions and practices with regard to financial participation.

6 Council Recommendation 92/443/EEC.

7 'Employee Profit-Sharing Arrangements – Germany', http://www.europa.eu.int/scadplus/citizens/en/de/0127.htm; downloaded 23 June, 2000.

8 'Employee Profit-Sharing Arrangements – Germany', http://www.europa.eu.int/scadplus/citizens/en/de/0127.htm; downloaded 23 June, 2000.

- France and the United Kingdom have a long tradition of encouraging financial participation.
- Ireland, the Netherlands, Finland, Germany, Spain and Italy have started to promote the establishing of PEPPER schemes.
- In the other Member States, PEPPER schemes have been discussed, but official government support has been limited.

> Most legislation on promoting financial participation schemes involves incentives such as fiscal or other financial advantages: tax-free issue of shares or bonds to employees, tax-free allowances on distributed profits, exemption from social security contributions, etc. Some countries offer these incentives to both employers and workers. Legislation in some Member States makes tax concessions subject to certain conditions: minimum percentage of personnel covered by the scheme, eligibility criteria, retention periods, etc.[9]

In a report published in December 1999,[10] the European Commission set out its view of the place of employee share plans in the European economy. The Commission views employee share plans as essential tools in increasing the motivation of employees, in increasing productivity, decreasing labour-management conflicts and encouraging information sharing and cooperation. The Commission also considers that employee share plans have an important role to play in the development of 'entrepreneurship' and small enterprises, especially in the sunrise sector. Employee share plans provide added wealth to employees, which contributes to the development of household investments in equities and the development of entrepreneurship. According to the Commission, 'Stock option and employee ownership plans can play a role in the social dialogue in Europe through the development of more participatory forms of work organisation'[11] However, employee share plans have not expanded throughout the Union as quickly as the Commission believes is desirable. The Commission noted in its report that:

> Several member states have been considering developing a more favourable taxation of stock options than the present often complicated and expensive taxation regimes (e.g. taxation at sale of the underlying shares, taxation as capital gains, etc…) However besides the schemes already in place or under consideration in the

9 'Information, consultation and participation of employees: Shareholding and financial participation of employees', Available at: http://europa.eu.int/scadplus/leg/en/cha/c10806.htm; downloaded 25 October, 1999.

10 European Commission directorate-General for Economic and Financial Affairs, 'European Economy: Supplement A: Economic trends', no 12 – December 1999. Downloaded 23 June, 2000 from: http://www.europa.eu.int/comm/economy_finance/document/eesuppa/a1999_12_en.pdf

11 'European Economy: Supplement A: Economic trends', p. 12.

> UK, and the new Belgium law (rather controversial: taxation at issue of the options, but at a low rate), little has been done. Beginning 1999, the French government withdrew its law proposal on this subject (the law proposal in favour of innovation and research is however taking some positive steps in this area); the issue was discussed in Denmark in 1998 but never led to a reform; some steps were taken in Italy, but the situation remains complex. The American example of Silicon Valley shows the significant role that stock options can have in the development of innovative companies.
>
> The Commission considers both these issues [i.e. the development of employee share schemes and reform of insolvency and bankruptcy laws] as essential elements for encouraging a fresh entrepreneurial culture in the Union[12]

Information concerning the arrangements in various countries of the European Community is reviewed briefly in the following paragraphs.

Austria

Plans to promote employee share ownership or profit sharing in the form of shares operate only to a limited extent in Austria.[13] In general, Austrian law allows employee share plans only in the context of collective agreements. It has been legally permissible to distribute shares at a discounted price to employees since 1994. The discount is treated as a tax deduction up to a maximum of ÖS 10,000 per annum (about AUD$1,150).[14] The plan must be open to all staff or a specific group. About 18,000 employees are involved in share-owning plans in major companies, concentrated in the metal working industry. In Austria stock options are, in principle, possible, but it is not planned to give them favourable treatment.[15]

Belgium

Employee share plans exist across the economy, but are more common in large industrial and commercial firms, the financial sector and multinational companies. The Department of Employment, Workplace Relations and Small Business advised the Committee that in Belgium and France, employee participation arrangements tend to act as a supplement to normal wage increases.[16]

12 'European Economy: Supplement A: Economic trends', p. 18.

13 'Employee profit-sharing arrangements', downloaded from http://europa.eu.int/scadplus/citizens/en/at/0127.htm; downloaded on 23 June, 2000.

14 At June, 2000 exchange rates.

15 'European Economy: Supplement A: Economic trends', p. 31.

16 Submission no. 38, p. 6.

New shares acquired by an employee from his or her employer are tax deductible. Such shares may not be sold for five years. Employee share plan legislation also regulates the issue of new shares at a discount to employees and employee stock option plans.[17]

Denmark

According to information listed on the European Community's internet site, no statistics are available on the number of employees benefiting from employee profit sharing plans. Employers must have plans approved by the Danish Taxation Department, and the number of approved plans would suggest that their use is relatively stable but not very extensive.

There are three share-based plans (two in the form of profit-sharing via distribution of shares and one in the form of bonds). Subscription to any of these plans is on a voluntary basis. Firms have the option of requesting authorisation to apply them. As there are certain tax benefits attached to the plans, they must be approved by the Danish Tax Department.

There are two separate share-ownership plans. The first enables employees to buy shares at a discount, up to a value equivalent to 10 per cent of their salary. Employees are not taxed on these shares but, if they dispose of them, the usual regulations on capital gains tax apply.

In 1987 a second type of plan was introduced. It enables employees to be given free shares up to the value of DKR 6 000 per year [about AUD$1270[18]] The number of shares given may not:

- exceed 10 per cent of the employee's salary; and
- be disposed of for seven years.

While the shares are not taxable upon initial allocation, the rules on capital gains tax apply if they are transferred.

Since 1958, it has been possible to issue bonds to employees. These bonds are cost- and tax- free to the employee. Tax is paid on any dividends. Since 1 January 1996, the employer does not pay tax on the value of the bonds, up to a ceiling of DKR 1800 per employee (about AUD$380[19]). If the value of the bonds exceeds this figure, the employer is liable to a levy of 45 per cent. In compensation, the total cost, i.e. the value of the bonds plus the 45 per cent levy and the dividends, can be claimed against tax by the employer.

17 'Employee Profit-Sharing Arrangements – Belgium, http://www.europa.eu.int/scadplus/citizens/en/be/0127.htm; 23 June, 2000.

18 At June 2000 exchange rates.

19 At June 2000 exchange rates.

Such plans must be approved by the Danish Tax Department. The plans must meet certain criteria in order to obtain approval. The criteria include:

- the plans must be open to all employees;
- the value of the bonds plus the 45 per cent levy must not exceed 10 per cent of the employee's annual salary; and
- The bonds are not transferable for the first five years.[20]

France [21]

France is the only European country where all companies, including unquoted companies, which have at least 50 employees are legally required to establish a company savings plan, although employee participation remains optional. Companies with fewer than 50 employees may also apply a saving plan on a voluntary basis.

This policy goes back to the 1950s, and as a result, France now has an extensive legal framework to provide for profit sharing plans. Profit sharing plans take a number of forms, including, profit-sharing plans based on cash payment, deferred profit-sharing plans, employee share ownership plans and company savings plans. These plans enjoy considerable tax advantages. About six million employees (around 23 per cent of the workforce) participate in employee share plans. According to Professor Andrew Pendleton (Professor of Human Resources Management at Manchester Metropolitan University), and referred to by DEWRSB, France has the second highest incidence of employee participation in share plans in the European Union.[22]

Employees have no access to accumulated profits for 5 years. After this time, the assets of the plan are exempt from income tax and (partially) from social security contributions. Employee share plans must be open to all employees. By 1994, there were almost 16,000 profit-sharing agreements covering over 19,000 companies, employing over 5 million workers.

To encourage the plans, the French Ministry of Labour publishes leaflets on profit-sharing plans.

20 'Employee profit-sharing arrangements – Denmark', http://www.europa.eu.int/scadplus/citizens/en/dk/0127.htm; downloaded 23 June, 2000.

21 'Employee Profit-Sharing Arrangements – France', http://www.europa.eu.int/scadplus/citizens/en/fr/0127.htm; 23 June, 2000 and, the Rt Hon. Gordon Brown MP, *Consultation on Share Ownership*, 1999, p. 5.

22 Submission no. 38, pp. 14-15.

Germany [23]

In Germany, there is no profit-sharing incentive in legislation but there are regulations in place that are designed to encourage employee share ownership and accumulation of capital. Recently the government has been promoting the creation of PEPPER schemes.

DEWRSB advised the Committee that there are only small tax concessions for plans, and eligibility for the concessions requires benefits to be held for at least 6 years. In 1994 about 0.5 per cent of firms covering around 4 per cent of employees had either an employee share plan or a deferred profit sharing plan.[24]

Under the income tax legislation, employees receiving reduced-price shares from their employers are exempt from tax and social security contributions on them, up to a maximum of DM 300 (about $A240), provided they are subsidised by the employer up to a maximum of 50 per cent of the interest and the shares are frozen for a period of six years. In addition, under the tax laws an option is not considered for tax purposes as income derived from employment or as a pecuniary benefit at the time it is granted, but only when exercised. There are exceptions to this rule, such as when the option granted is tradeable at any moment on the open market. In such cases, the option is considered as income from the moment it is granted.[25]

In 1995, the German Government proposed that employers, trade unions and employees consider employee share-ownership and similar plans as an element in wage agreements.

The situation in the former East Germany is causing considerable concern. According to the Government, there is a need for the social partners to take new initiatives:

- to create the conditions likely to lead to more private investment by employees with a view to promoting growth in employment;
- to encourage equity participation by employees; and
- to develop employee participation in the company.

Ireland

Various legislative provisions have been introduced that provide tax benefits to employers and employees if certain types of share plans are implemented. In order to obtain these benefits, share plans in Ireland must obtain the prior

23 *Germany, Employee Profit-Sharing Arrangements*, http://www.europa.eu.int/scadplus/gui/en.de/0127.htm; downloaded 25 October, 1999.

24 Submission no. 38, p. 15.

25 'European Economy: Supplement A: Economic trends', p. 31.

approval of the Revenue Commissioner. They must include certain features, including allowing participation by all employees, subject to specified objective criteria. [26]

There are seven types of Revenue Commissioner approved share plan: [27]

- **Approved Profit Sharing Scheme (APSS)** A company sets up a trust for its employees and invites them to pay their cash bonuses, along with a specified percentage of their after-tax salaries, to the trustees for the purchase of shares in the company up to a maximum value of £10,000 per year [about AUD$ 20,000 [28]]. Provided that these shares are held by the trustees for at least three years, there is no tax payable by the employees when the shares are transferred by the trustees to them. The employees benefit from any increase in the value of the shares over the three year period, although they may be liable for capital gains tax on any gain made on the sub-sequent disposal of the shares. The company can claim tax relief on the costs of setting up and administering the scheme.
- **'Save As You Earn' Share Option Scheme (SAYE)** Employees agree to save between £10 [about AUD$20[29]] and £250 [about AUD$500 [30]] of their after-tax salaries each month for a period of either three or five years. After the relevant period they may use the savings in exercising options to purchase shares in the employer company at a price which is fixed at the beginning of the period. Rules have been drawn up by the Department of Finance as to the level of interest and bonus payments which can be made on these savings and the payments are tax-free. The benefit of the scheme is that the shares will hopefully increase in value over the relevant period and no tax is paid by the employee on the exercise of the options. The company may claim tax relief on the costs of establishing and running the scheme.
- **Employee Share Ownership Trust (ESOT)** This scheme generally combines the APSS with a trust established by a company. The trust receives funds from the company for qualifying purposes, including obtaining shares in the company on behalf of the employees. If these shares are then routed to the employees through the APSS, the employees will enjoy the tax benefits of an APSS as outlined above. As with APSS and SAYE, the company receives tax relief on the costs of establishing and running the scheme and on all payments made to the trustees of the ESOT which are used for qualifying purposes.
- **Restricted Stock Scheme** Employees are given shares in their company which have a restriction or 'clog' on disposal placed on them, thereby reducing their value for income tax purposes. The level of tax abatement

26 Derived from: B Connolly, 'Employee share schemes: Giving workers their fair share', KPMG Ireland, 1997, available at: http://www.kpmg.ie/clas/shareschemes.pdf; downloaded 22 June, 2000.

27 B Connolly, 'Employee share schemes: Giving workers their fair share', KPMG Ireland, 1997.

28 At June, 2000 exchange rates.

29 At June, 2000 exchange rates.

30 At June, 2000 exchange rates.

available depends on the length of the 'clog' period, with the maximum abatement being 55 per cent of the market value of the share where disposal is prohibited for more than five years.

- **Share Subscription Scheme** Where an employee subscribes for shares in the employer company, any subscription amount of up to £5,000 [about AUD$10,000[31]] paid by him over his lifetime will be deductible for the purposes of income tax, provided he holds the shares for at least three years before disposing of them. The company must be incorporated and resident in Ireland and must be a trading or holding company and the shares must be ordinary, fully paid up and non-redeemable and the employee must pay market value for the shares. In practice, in order to avail of the tax relief, the Revenue Commissioners will need to be satisfied that all the above criteria are met.

In addition to the above 'approved' schemes, there are other plans which may be used as incentives to employees and which currently do not require express Revenue Commissioner approval:

- **Share Option Scheme:** An employee is granted an 'option' to purchase shares in his company during a specified future period and at a specified price. The exercise of the option to purchase the shares may also be made subject to the fulfilment of certain conditions, e.g. performance targets being met by the employee. When the employee exercises the option, he will be taxed on the difference between the price he pays for the shares and the market value of those shares at that time. If the period within which he is allowed to exercise the option exceeds seven years after the date the option is granted, tax will be payable at the time the option is granted on the difference between the exercise price and the market value of the shares. In addition, CGT may arise on disposal of the shares.[32]

In addition to these plans, other types of performance-related share plans may be established to suit the requirements of individual companies.

The rationale for establishing and operating employee share plans is that they act as motivating factors and enable employers to attract and retain staff:

> The experience in all countries where employee share schemes are widely used is that they are a useful tool for employers facing staff shortages or lack of motivation. By becoming 'stakeholders' in the company, employees feel that they have a central role in building the company's performance and can benefit directly from that improved performance. Employers can facilitate this at a relatively low cost and without losing competitiveness. In short, it can be argued that everyone gains…[33]

31 At June, 2000 exchange rates.

32 B Connolly, 'Employee share schemes: Giving workers their fair share', KPMG Ireland, 1997.

33 B Connolly, 'Employee share schemes: Giving workers their fair share', KPMG Ireland, 1997.

Italy

Employee share plans have increased in number over the past decade, particularly in the financial, banking and insurance sectors of the economy. The plans most widely promoted have been in public companies undergoing privatisation, where employees have been offered the opportunity to acquire shares as part of the privatisation process. Employee share plans, in such cases, take three forms:

- reservation for employees at a discounted price, a proportion of the shares that are placed on the market. in such cases, the majority share holders may decide to deny voting rights to such shares;
- reservation for employees of a set percentage of shares going on public sale;
- employee investment plans, as part of a shares package reserved for employees.[34]

Under present arrangements in Italy the value of shares, not necessarily newly issued, granted to employees is exempt from taxes and social security tax up to the yearly individual amount of 4,000,000 Lire (about 200,000 Euro or AUD$3,250). The eventual contribution made by the employee correspondingly reduces the amount of the benefit.

The exemption is granted provided that the shares:

- are offered to all employees of the company;
- are issued either by the employer or by other companies that, directly or indirectly, control or are controlled by the employer;
- are not, after assignment, purchased by the issuing company or by the employer; and
- are not sold within three years.

If the latter requirements are not met, taxes, including social security taxes, are levied upon the sale.

In the case that the shares are offered to a single employee the difference between the value of the shares at the time of the assignment and the price paid by the employee is exempt from taxes and social securities. The exemptions are granted provided that the employee does not own more than 10 per cent of the issuing company.[35]

34 'Employee profit-sharing arrangements – Italy', http://www.europa.eu.int/scadplus/citizens/en/it/0127.htm; downloaded 25 October, 1999.

35 This information was obtained from the Global Equity Organization internet site, http://www.globalequity.org/#ITALY. Downloaded 22 June, 2000.

Portugal [36]

Labour law governs the participation of employees in enterprise results. Since 1969 participation has not been considered to be part of remuneration.

Equity participation is closely linked to the policy of privatising the public sector. This began in 1989. The law on privatisation stipulates that a proportion of the capital to be privatised must be reserved for small applicants and for employees of the enterprise being privatised. The most has been done in the finance and insurance sector to promote the application of the principle of participation and redistribution.

A number of equity participation incentives operate. These comprise

- plans involving the option to apply for or buy shares under agreements concluded between enterprises and their employees; and,
- buying shares put on public sale by the State.

Various tax concessions apply to these plans. These are:

- An employee may deduct from his or her total taxable income 50 per cent of an amount set in 1991 and applicable to option plans established by employers. The maximum that may be deducted is ESC 250 000 [about AUD$1970[37]). The amount is deducted from total taxable income;
- Enterprises may deduct from their tax an amount corresponding to the losses and other expenses resulting from employees exercising their right to apply for or purchase shares.
- 30 per cent of the amount spent on the purchase of shares put on public sale by the State may be deducted from taxable income. The deduction rate for individual taxpayers is doubled in the case of married couples who are not legally separated.

United Kingdom

Employee share plans in the United Kingdom fall into two broad classes: those that have Inland Revenue approval and those that do not. In this section the approved plans are reviewed. The UK Inland Revenue approved share plans are:

- Company Share Option Plans;

36 'Employee profit-sharing arrangements – Portugal' http://www.europa.eu.int/scadplus/citizens/en/pt/0127.htm; downloaded 23 June, 2000.

37 At June 2000 exchange rates.

- Approved Profit Sharing Share Schemes (or PSS); (to be phased out after 5 April 2002);
- Savings-related Share Option Schemes;
- New All Employee Share Ownership Plans;
- Enterprise Management Incentives; and
- QUESTs

Company Share Option Plan (CSOP)

The Company Share Option Plan was originally introduced in 1984 and is the most popular of the three types of Inland Revenue approved employee share schemes.

Employees are granted options to acquire shares at the market price at the time of grant. Employees may be granted options over shares worth up to £30,000 at any one time. There is no tax or National Insurance charged on the gain made when the option is exercised, provided that the options are held for at least 3 years and there is a gap of at least 3 years between each tax-relieved exercise. Around 3,750 companies have a CSOP with some 450,000 employees holding options. CSOP costs in the region of £130 million a year.38 Specific details of the plan are:39

- Options may be granted to any employee or full-time director of a participating company.
- Options may be exercised at any time thereafter, subject to certain tax conditions.
- The exercise price must not be less than the market value of a share at the date of grant.
- The aggregate exercise price of options granted under all Inland Revenue approved Schemes established by the relevant company and its associated companies which may be held by an individual at any one time must not exceed £30,000 (current limit).
- Shares used are ordinary shares. Preference shares and redeemable shares are not acceptable for the purposes of an approved Scheme.
- Shares used must not carry restrictions on transfer which are not attached to other shares of the same class. Restrictions imposed in accordance with the

38 Inland Revenue Rev 3: Budget Day Press Notice, 'Boosting Productivity and Fairness: Employee Share Ownership', 'Boosting Productivity and Fairness: Employee Share Ownership'. Available at: http://www.inlandrevenue.gov.uk/news/budgetreleases/rev3.doc. Downloaded: 1 May, 2000.

39 'UK inland revenue approved company share option plan', http://www.btinternet.com/~essconsultantsltd/esos.html. Downloaded: 27 June, 2000.

model code for securities transactions of a recognised stock exchange or other regulatory bodies are generally excepted.

- Options are not transferable although the personal representative of a deceased optionee may exercise the deceased's option within a period not exceeding 12 months from the date of death.

The following conditions must be satisfied if an option granted under the Inland Revenue approved Scheme is to receive favourable tax treatment:-

- The option must not be exercised less than three years and not more than ten years after the date on which the option is granted; and
- The option must not be exercised within three years of a previous tax relieved exercise. All options exercised on the same day will count as one exercise.

Approved Profit Sharing Share Schemes [40]

The Inland Revenue Approved Profit Sharing Share Scheme was introduced in 1978. It is a restricted share bonus plan and is designed to provide free shares to employees, free of tax.

Under the APS (also known as PSS) Scheme a trust is set up. The trustees then acquire shares of the company with funds provided by the company and allocate the shares in accordance with the PSS Scheme. The shares are not actually transferred to the employee at this time but are held in the trust for two years (a shorter period in certain circumstances).

The scheme must be open to all eligible employees on similar terms. A minimum length of service can be set for eligibility to participate, but it may not be more than five years. Most companies operating a Share Save Scheme operate on a much shorter eligibility period. It is not uncommon to include all those employed as at the date of invitation and who continue to be employed to the grant date.

During the period the shares are held in trust any dividends paid in respect of shares allocated to an employee are passed to that employee. Employees are awarded free shares up to the value of £3,000 a year or up to 10% of salary up to a maximum of £8,000, whichever is greater. The shares must be left in a trust for 2 years but can be taken out after 3 years free of tax and National Insurance.

Fewer than 900 companies have an APS with some 1.25 million participants. It is expected that the vast majority of companies with APS schemes will replace this with the new plan.

40 Inland Revenue Rev 3: Budget Day Press Notice, ‘Boosting Productivity and Fairness: Employee Share Ownership’,. Available at: http://www.inlandrevenue.gov.uk/news/budgetreleases/rev3.doc. Downloaded 1 May, 2000; Proshare, ‘Profit Sharing Scheme Fact Sheet’, http://www.proshare.org/eso/profotfacts.asp; Downloaded 27 June, 2000.

No further tax free awards can be made under the Approved Profit Sharing (APS) from April 2002.

The Share Save Scheme [41]

The ShareSave scheme is also known as the Save As You Earn (SAYE) or Savings-Related Share Option Scheme. This type of scheme was introduced under the 1980 Finance Act. The Share Save scheme is the most popular of the all employee share schemes.

According to the Inland Revenue, over 1,200 companies operate approved Share Save Schemes. About 1.75 million employees participate and the cost to revenue is approximately £600 million per annum in tax relief.

Employees are granted options at a discount of up to 20% at the start of a savings contract. Employees may save a fixed monthly amount of between £5 and £250 for 3, 5 or 7 years. At the end of the savings contract a tax-free bonus is payable. Employees use the proceeds of the savings contract, including the bonus, if they want to exercise the option. If they do not, the proceeds are repaid in cash, tax free. There is no tax or National Insurance Charge (NIC) on the discount or on the gain made when the option is exercised.

The scheme must be open to all eligible employees of the company. A qualifying period of employment can be set but this must be no greater than 5 years. Most companies operating a Share Save scheme operate on a much shorter eligibility period. It is not uncommon to include all those employed as at the date of invitation and who continue to be employed to the grant date.

There is a minimum savings amount of £5 per month, and a maximum of £250 per month across all existing SAYE contracts. At maturity (the 3, 5 or 7 year anniversary from the contract start date if no payments have been missed) a tax-free bonus is paid.

New All Employee Share Ownership Plan [42]

This plan was introduced in the 2000 UK budget. It is intended to replace the Approved Profit Sharing Share Scheme.

41 Proshare, 'The Share Save Scheme', http://www.proshare.org/eso/sharesavefacts.asp; Downloaded 27 June, 2000. Inland Revenue Rev 3: Budget Day Press Notice, 'Boosting Productivity and Fairness: Employee Share Ownership', 'Boosting Productivity and Fairness: Employee Share Ownership'. Available at: http://www.inlandrevenue.gov.uk/news/budgetreleases/rev3.doc. Downloaded: 1 May, 2000.

42 Inland Revenue Rev 3: Budget Day Press Notice, 'Boosting Productivity and Fairness: Employee Share Ownership'. Available at: http://www.inlandrevenue.gov.uk/news/budgetreleases/rev3.doc. Downloaded 1 May, 2000; 'UK Inland Revenue approved employee share ownership plans', http://www.btinternet.com/~essconsultantsltd/esos.html.

The Inland Revenue estimated that the New All-Employee Share Plan will eventually cost around £400 million per annum. The Inland Revenue anticipated that around 450 employers would use the plan to establish their first all employee share scheme. This would result in more than 500,000 employees owning shares in their company for the first time.

The Inland Revenue also estimated that the total number of employees with shares in a new plan would reach 2.5 million in the next 3 to 5 years.

The New All Employee Share Ownership Plan will involve the setting up of a trust which will acquire and award shares in accordance with the rules of the plan. Participation by employees in the plan is not compulsory although all qualifying employees must be given an opportunity to do so.

The plan provides for three types of share:

- Partnership Shares;
- Matching Shares; and
- Free Shares

Companies may choose to adopt ESOPs, which provide:

- Partnership Shares only;
- Free Shares only;
- Partnership Shares with Matching Shares;
- Partnership Shares and Free Shares; and
- Partnership Shares with Matching Shares and Free Shares.

Up to £1500 worth of Partnership Shares (more in certain circumstances) each tax year may be acquired out of pre-taxed salary (i.e. before tax and NIC) of the participating employee. Subject to a cap of 10% of salary, employees make regular contributions from salary of between £10 and £125 per month. Partnership Shares can be acquired on a weekly or monthly basis or over an accumulation period not exceeding 12 months. At the end of each accumulation period Partnership Shares may be purchased at the lower of its market value at the beginning and end of the period.

Partnership Shares which are removed from the ESOP before three years from the date of award will attract income tax and NIC on the market value of the shares on the date the shares are removed from the ESOP. Partnership Shares which are removed from the ESOP after three years but before five years from the date of the award will attract income tax and NIC on the lesser of the salary used to buy the shares and the market value of the shares on the date the shares are removed from the ESOP.

Employees may acquire Partnership Shares and participate in a PSS Scheme in the same tax year. Partnership Shares cannot be subject to performance criteria or forfeiture. Partnership Shares may be withdrawn from the ESOP at any time.

Matching Shares of up to £3000 may be awarded in any tax year to a participating employee. Matching Shares may be awarded at a rate of up to 200% of Partnership Shares. The rate at which Matching Shares are awarded must be the same for all participants on any share allocation. Matching Shares must be of the same class, carry the same rights and must be awarded on the same day Partnership Shares are acquired. Except in certain circumstances Matching Shares will be subject to a holding period of between 3 years and 5 years depending upon the rules of the ESOP. Matching Shares may be subject to forfeiture in certain circumstances.

Free Shares of up to £3000 may be awarded in any tax year to a participating employee. Free Shares may be awarded on the same terms or by reference to performance or a mixture of both. Performance measures must be based on business results or objective criteria. Awards on the same terms include awards by reference to salary, length of service or hours worked. Except in certain circumstances Free Shares will be subject to a holding period of between of between 3 years and 5 years depending on the rules of the ESOP. Free Shares may be subject to forfeiture in certain circumstances. Up to £1500 dividends received in any tax year in respect of shares held in the ESOP can be re-invested in shares and held tax free in the ESOP.

Free and Matching Shares held in the ESOP for five years will not attract income tax or NIC. Free and Matching Shares which are removed from the ESOP after three years but before five years after the date of award will attract income tax and NIC on the lesser of the market value of the shares on the date of award and the market value of the shares on the date the shares are removed from the ESOP.

Free and Matching Shares will be subject to a minimum holding period of three years and cannot be removed unless the employee ceases employment and the shares are not forfeited under the ESOP. Except in certain circumstances income tax and NIC will be chargeable on the market value of the shares on the date the shares are removed from the ESOP.

Any increase in the value of the shares whilst held in the ESOP will be free from capital gains tax. For capital gains tax purposes the base cost of shares will be the market value of the shares at the date on which they are taken out of the ESOP. Additionally shares acquired under the ESOP will be treated as business assets and will attract accelerated taper relief (i.e. a rate of tax of 35% after one year, 30% after two years, 20% after three years and 10% after four years).

The employer will be entitled to a deduction in respect of the cost of establishing the ESOP except where the ESOP is used before the Inland Revenue approves it. The cost of administering the ESOP will be deductible. The cost of providing Free and Matching Shares to employees, other than those not chargeable to tax in certain circumstances, will be deductible. The excess cost of providing Partnership Shares will be deductible.

Enterprise management incentives [43]

These schemes were introduced in the UK 2000 Budget to provide assistance to smaller companies with potential for growth so that they can recruit and retain high calibre employees, and to reward employees for taking a risk by investing their time and skills the company.

In the EMI scheme, EMI options can be offered by independent trading companies with gross assets not exceeding £15 million. Eligible employees must work for a minimum of 25 hours per week or 75% of his working time, whichever is less. An eligible employee must not have a material interest (more than 30%) in the qualifying company. EMI options must be restricted to 15 eligible employees. When the number of employees holding EMI options is reduced to less than 15, the company must wait 6 months before further EMI options may be granted.

Options over shares worth up to £100,000 at the time of grant can be granted to up to 15 key employees in the company. In calculating the limit of £100,000 unexercised options already granted under an Inland Revenue approved Company Share Option Plan must be included. Options granted under the Sharesave Scheme, however, are excluded. Employees are restricted to £100,000 of EMI options in any three year period.

There will normally be no income tax or NICs when the options are exercised, and when the shares are sold, CGT taper relief will normally start from the date the options are granted.

There is no approvals or clearance mechanism for EMI, but a simple requirement on Employing Companies to notify the Inland Revenue when an EMI option is granted. Qualifying companies must carry on a qualifying trade wholly or mainly in the UK throughout the life of the EMI option and gross assets of the company must not exceed £15 million.

An EMI option may be exercised at any time but the exercise period must not exceed 10 years. EMI options may be granted at any price but the market value of the shares at the date of grant will be taken into account in calculating the limit.

Shares must be ordinary shares, fully paid up when issued and be non-redeemable. Shares may be subject to restrictions or the risk of forfeiture but these conditions are not taken into account in determining the market value of a share for the purposes of the EMI option.

43 'Enterprise management Incentives', http://www.inlandrevenue.gov.uk/shareschemes/emi.htm. Downloaded 1 April, 2000; 'Enterprise Management Incentives', http://www.btinternet.com/~essconsultantsltd/esos.html.

Qualifying Employee Share Trust (QUEST) [44]

This is a trust set up to acquire shares in a company. The trust holds the shares on behalf of employees. The QUEST can be funded by the company (pre-corporation tax) or a bank. Shares must be distributed to employees within 20 years. This can be by sale or the QUEST can route shares through a profit-sharing trust (enabling it to give them to employees without triggering an income tax charge) or it can provide shares under Save-As-You-Earn Share Options. The QUEST could simply give shares directly to employees, but that would trigger an income tax charge on those employees.

The tax incentives for establishing a QUEST include

- for the company: payments to the QUEST are corporation tax deductible; and
- for sellers to the QUEST: Capital Gains Tax can be deferred by reinvesting sale proceeds in any other investment.

Japan

The Department of Employment, Workplace Relations and Small Business advised the Committee that while employee share ownership is widespread in Japan, there has been no legislation actively to encourage it.[45] Citing a study conducted in 1988, DEWRSB advised that 90 per cent of Japan's publicly traded firms provide mechanisms for employees to buy company stock. This same study, DEWRSB said, estimated that in 1985 close to 60 per cent of all firms had employee share schemes. In most cases, around one half of a company's employees participated in a plan. Japanese firms often provide generous subsidies to their employees to encourage participation in such schemes.

According to the US based National Centre for Employee Ownership, participation in these plans extends to most employees and the average per-employee holding is $16,000. In general, employees own only about 2-3 per cent of their firms.[46] DEWRSB reported that employee share schemes only make up a fairly small proportion of total ownership of a Japanese company: the average for listed companies is less than 1 per cent and holdings over 5 per cent are rare.[47]

44 Qualifying Employee Share Trust (QUEST) http://www.capitalstrategies.co.uk/rewards/quest.htm.

45 Submission no. 38, p. 15.

46 The National Centre for Employee Ownership Library, "Growth of employee ownership accelerates rapidly in US and Abroad", http://www.nceo.org/library/growth.html. Downloaded 3 May, 2000.

47 Submission no. 38, p. 15.

According to DEWRSB,

> employee share ownership schemes in Japan have often been developed in the context of broader participative practices, including greater employee involvement in a firm's decision making.[48]

The Department also reported that, shares in an employee share scheme are generally held in trust. Employee shareholders are represented at Annual General Meetings by a specifically designated Director. Unlike other countries, where management executives are usually major participants in employee share schemes, in Japan executives are not allowed to participate.[49]

Singapore[50]

The Singapore Finance Minister Dr Richard Hu issued a statement on 22nd May, 2000, announcing an 'Entrepreneurial Employee Stock Option Scheme'. The scheme, Dr Hu said, 'aims to foster an entrepreneurial spirit in the smaller high risk companies and [their] employees, many of whom have to forego more secure and higher paying jobs to start or join these start-up companies'. Under this scheme:

> …a 50 per cent income tax exemption will be granted on gains arising from exercising ESOP. The 50 per cent tax exemption would be granted to up to $10 million of gains, over a 10-year period. To illustrate, if an employee exercises his stock options and makes a gain of $1 million, 50 per cent or $500,000 of the gains will be exempt from tax. Over the next 9 years, he can enjoy 50 per cent tax exemption on a further $9 million gains from ESOP

In order to benefit from this scheme, companies may have assets of up to S$100 million at the time the scheme is established. The scheme has been structured with minimal restrictions and conditions. Features include:

- The scheme has not been restricted to the high technology sector, but is available to companies from all business sectors;

48 Submission no. 38, p. 15.

49 Submission no. 38, p. 15.

50 This information has been taken from Minister Hu's announcement, available at: http://www.gov.sg/sprinter/archives/00052204.htm; downloaded on 5 June, 2000; and Inland Revenue Authority of Singapore circular, 22 May, 2000, 'Entrepreneurial employee stock option scheme', available at http://www.iras.gov.sg/Download/Word/Esopcir2.doc; downloaded 21 June, 2000.

- Companies may be listed or unlisted but they must be incorporated in Singapore and carry out business activities in Singapore;
- The schemes may provide only ordinary shares. Redeemable, preference or convertible shares are excluded;
- Vesting rules are determined by the current Singapore Stock Exchange's rules on vesting periods for employee share schemes of companies listed on the Exchange. These are:
  - ⇒ where the exercise price of the share is equivalent to its market value at the time of grant of option, the option given on the share may not be exercised within 1 year from the grant of the option;
  - ⇒ where the exercise price of the share is at a discount to its market value at the time of grant of option, the option given on the share may not be exercised within 2 years from the grant of the option;
- Employee share schemes of companies not listed on the Singapore exchange must also satisfy the above vesting period requirement in order to be considered as Entrepreneurial employee share schemes;
- Where the market value of the shares of an unlisted company is not readily available to be used to determine which vesting period shall apply, the net asset value of the shares will be used;
- The market value of the shares at the time the option is granted. For a company listed on the market value is the average market price prevailing during the price fixing period immediately before the options are granted. The price fixing period is explicitly defined for each share option scheme in the company circular to the shareholders, which informs them of the proposed motion to approve the share option scheme. The computation of the average market price is decided by the company and is also stated in the same circular;
- A company does not have to apply for approval from the Comptroller of Income Tax to have its employee share plan considered as Entrepreneurial an ESOP Plan. However, companies that wish to operate such plans do have to keep sufficient documentation to show, when required by the Comptroller, that their employee stock option plans satisfy the required vesting period;
- Gains in the value of equities held in an employee share plan accrue to an employee when options are exercised. The amount of taxable ESOP gains is determined based on the difference between the market value or net asset value of the shares, as the case may be, and the exercise price;
- Companies are currently required to give to each of their employees an annual return of remuneration. However, companies may arrange to transmit salary data electronically to the Comptroller for automatic inclusion into their employees' assessments. The annual return of remuneration or the salary data

transmitted to the Comptroller electronically should contain details of any stock option gains, for the year concerned; and

- The details of all stock option gains must be segregated into those qualifying for the 50 per cent tax exemption under the Scheme and those that do not (including the amount of discount enjoyed by an employee on the stock options).

The scheme is intended to be attractive to those employees who devote a significant portion of their working time to the company offering the scheme. Minister Dr Richard HU went on to say in his statement:

> …to qualify, the employee must work at least 30 hours per week for the company. An employee who works less than 30 hours for a company can also qualify if he spends at least 75 per cent of his total working time per week with that company. A non-executive director will not qualify. In addition, the employee should not control 25 per cent or more of the voting rights of the company.

The scheme will apply to qualifying schemes issued on or after 1 June 2000. It will operate for five years, after which it will be reviewed to determine whether the objectives set for the scheme have been met. As well, modifications will be made to the scheme during this period if they are required.

The Minister for Finance also indicated employee share schemes were relevant to larger and more established companies and that they should be encouraged. Dr Hu observed that the degree of incentive 'will be less as established companies have less problems with attracting and retaining people'. He then announced that the Singapore ministry of finance will be reviewing the tax treatment of employee share schemes for larger companies and that a scheme for established companies would be announced in the 2001 Budget Statement.