Dissenting Report—Labor members of the Committee

Summary

This inquiry, instigated by the Minister for Employment, Workplace Relations and Small Business, the Hon Peter Reith MP, has uncovered large-scale tax avoidance by company executives through the abuse of employee share ownership plans. These contrivances have been likened by the Australian Taxation Office (ATO) to the 'Bottom of the Harbour ' schemes of the late 1970s and early 1980s. Despite public warnings from the ATO that company executives are using employee share plans as a vehicle for tax avoidance, the Government to date has refused to legislate against these schemes. In fact, the Treasurer recently told Parliament that the Government sees no need to legislate against these paper schemes, on the grounds that they will be caught by the general anti-avoidance rule contained in Part IVA of the Income Tax Act. Yet, after many years of documented avoidance activity, the ATO has brought no cases before the courts.

The Labor members of the House of Representatives Standing Committee on Employment, Education and Workplace Relations are so concerned about this tax abuse problem that they have considered it necessary to produce this minority report.

The Labor members believe that new legislation is urgently required, and share the view of tax academics that this large-scale tax avoidance would not have occurred if the Coalition had supported anti-avoidance legislation twice

introduced into the Parliament by the previous Labor Government but blocked in the Senate.

This inquiry has also revealed the extent to which the administration of the Commonwealth can be the victim of intense lobbying by powerful self-interested pressure groups. Accordingly, while the Labor members of the Committee support a number of the recommendations, they believe that the majority report has failed to provide decisive recommendations to deal with problems in the present system. Disturbingly, recommendations of the Government members of the committee are likely to provide additional opportunities and incentives for tax avoidance.

The challenge of broadening and democratising share ownership in Australia is one that Labor is happy to accept; indeed, it is a key facet of Labor thinking around encouraging Australia's participation in new economy industries such as information technology. However, broadening share ownership must not be a tax avoidance device for company executives. Those who genuinely support employee share ownership have an obligation to prevent the kind of rorting that brings legitimate schemes into disrepute.

Recommendation 1

The Labor members recommend that:

- **the ATO be required to provide updated estimates of the revenue involved in the abuse of employee benefit arrangements by company executives;**
- **the Government legislate against these schemes without further delay; and**
- **all advice about these schemes provided by the ATO and the Treasury to the Treasurer and Assistant Treasurer be tabled in the Parliament at the earliest opportunity.**

The Labor members support the following recommendations contained in the Government members' report:

- the extension of bona fide employee share schemes designed for general employees;
- the creation of model schemes and promotion of their advantages by a share plan promotions unit;
- the creation of a dedicated regulatory agency;

- the mandatory registration of all share schemes, whether they take advantage of the concessional arrangements under Division 13A or whether they operate outside it;
- the clarification and extension of the Taxation Commissioner's power to deal with aggressive tax minimisation arrangements;
- the power of the Taxation Commissioner to declare that schemes have the intention of aggressive tax minimisation and therefore should be subject to income tax at the relevant marginal rate; and
- improved corporate disclosure laws in relation to employee share schemes to better promote the integrity of the financial system and investor information.

The Labor members strongly oppose the following recommendations contained in the Government members' report:

- the removal of the cessation requirements; and
- the change in the taxation treatment of deferred taxation election share plans.

The Labor members also condemn the failure to deal decisively with tax loopholes in the FBT system, in particular the ineffective taxation of salary-sacrifice and company-provided low or no interest loans.

The Labor members are deeply concerned that if the Government adopts the changes to the cessation requirements and the taxation treatment of tax deferred schemes, as recommended by the Government members, additional opportunities for tax avoidance will be created.

Introduction

Employee share plans are of two distinct types.

The first can be defined as 'genuine' or 'bona fide' employee share plans, which are available to employees throughout the employing company, and have as their predominant purpose more clearly aligning the interests of employees and the employer in order to increase productivity and workplace harmony.

The second can be defined as 'executive' employee share plans. These plans are available only to executive, high income employees and have as their real purpose the tax effective or tax free provision of remuneration. Many of these arrangements are designed and marketed by aggressive tax planners and are described by the ATO as 'blatant, artificial and contrived'[1].

1 *Transcript of Evidence*, p. 355.

The Committee heard evidence during the course of the inquiry that, for the most part, non-executive employees participating in employee share ownership plans receive small parcels of shares. Typically, these parcels provide a taxable discount of no more than $1,000. As a result, general employees select the tax exemption election and face no additional income tax liability. These elections were described by the Australian Employee Ownership Association (AEOA) as 'entry level schemes' and are intended, AEOA advised the Committee, to deliver wide rather than deep employee share ownership.[2] Such schemes are particularly useful in encouraging access to and participation in employee share ownership. In that way they seed employee involvement in the employer's business activity and may foster the alignment of employee-employer interests.

In contrast, executives participate in employee share schemes that have a narrow membership focus: executives and directors of the enterprise. These limited schemes allocate to executives and directors amounts of shares and options that are many times larger than those received by general employees. They are designed to deliver remuneration to executives in a tax effective manner.[3] Given the number of equities allocated, electing for income tax deferral tends to increase the beneficiary's personal wealth more effectively than any other option.

The Labor members are completely opposed to the Government supporting the further development of executive share plans. Substantial sums of Commonwealth revenue are already at risk because such arrangements are flourishing and the Government has failed to respond. The Labor members believe that the only form of Government action in this area should be legislation to close down these tax scams. Issues relating to executive share schemes are discussed in the next section of this dissenting report.

The Labor members are broadly supportive of government policies designed to facilitate the further development of bona fide employee share plans. Issues relating to bona fide employee share plans are discussed in the subsequent section of this dissenting report.

2 AEOA, submission no. 5.4.

3 AEOA, submission no. 5.4.

Employee Benefit Arrangements for Company Executives: the Government's New 'Bottom of the Harbour' Scheme

Government turns a blind eye

> …some of the arrangements that have emerged over recent years smack very much of the ingredients that were tax avoidance paper scheme rorts of the 1970s and early 1980s.[4]

This warning was given to the Committee by Mr Michael D'Ascenzo, Second Commissioner in the ATO, when the ATO was recalled to give evidence at the request of Labor members following revelations that the ATO had issued favourable private binding rulings on employee share schemes. Earlier, the ATO had advised the Committee that, *on a conservative estimate*, the total amount which it believed clients of aggressive taxation arrangements had contributed to employee benefit arrangements was approximately $1.5 billion.[5]

Evidence provided to the Committee, at that reconvened hearing on 11 May 2000, raises the question as to whether tax avoidance through employee benefit arrangements is this Government's new 'Bottom of the Harbour' scheme.

Just as the previous Coalition Government, when the present Prime Minister was Treasurer, received an enormous amount of advice from the ATO before finally taking action against 'Bottom of the Harbour' schemes, the ATO has been advising the present Government of blatant tax avoidance through the abuse of employee benefit arrangements. The ATO has confirmed that it has provided advice in the following terms:

> …we certainly would be providing advice to the government of the day on tax issues.[6]

and:

> We would have kept the Government informed all the way through the process.[7]

In spite of this advice and information, the Government has refused to introduce legislation ensuring that proper tax is payable in respect of employee share schemes for company executives, having defeated repeated Labor attempts, dating back to 1994, to do exactly that.

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4 *Transcript of Evidence*, p. 362.

5 ATO, submission no. 24, p. 16. Emphasis added.

6 *Transcript of Evidence*, p. 352.

7 *Transcript of Evidence*, p. 361.

Only after a Labor member, at the reconvened hearing, tabled an example of an employee share scheme that was still being actively promoted did the Government finally announce seven weeks later that it would review the need for legislation to ensure that employee share schemes for company executives are subject to FBT.[8] There is no commitment to addressing the issue, only a review. Meanwhile, more revenue is being put at risk as employee share schemes continue to be aggressively promoted to company executives to minimise their tax. Subsequent to the announcement of a review, and before its completion, the Treasurer advised the Parliament that the schemes will be caught by Part IVA of the Income Tax Act,[9] suggesting no new legislation was needed. The Treasurer's confidence seems odd given the fact the ATO has not yet successfully litigated against any of the executive share schemes in which $1.5 billion is invested.

The original intention of tax concessions for employee share ownership plans was to encourage the ownership of shares in companies by the employees of those companies. However, over the last few years, employee share ownership plans have become vehicles for aggressive tax planning for the benefit of company executives. The objective of these schemes, some of which have been described by the ATO as 'no more than shams',[10] is to minimise tax on income paid by company executives. These schemes have nothing to do with encouraging share ownership by general employees and everything to do with opening up new opportunities for company executives to avoid paying their fair share of tax.

This section of the dissenting report sets out the sequence of events of the Coalition's refusal, first in Opposition and then in Government, to support or introduce legislation combating tax avoidance through employee share schemes.

A history of Coalition obstruction of anti-avoidance measures

Treasury began warning against a proliferation of employee share schemes involving aggressive tax planning for company executives as early as the beginning of 1994. In an executive minute of 12 January 1994, Treasury advised the previous Labor Government that employee share acquisition schemes, involving salary sacrifice for the acquisition of share options, were being marketed to avoid FBT. The minute identified the Remuneration Planning Corporation (RPC) as one of the companies that appeared to be "ahead of the pack" but warned that the big fund managers would be quickly into the field to protect their competitive positions if the Government were to decide that the trend towards new generation arrangements should not be curtailed. The minute went on to advise that no one was "able to say how significant this trend might become but

8 Assistant Treasurer, Press Release No. 035, 30 June 2000.

9 House of Representatives, *Debates*, 6 September 2000.

10 ATO, submission no. 24, p. 12.

the industry says that it could envisage amounts in the billions of dollars being channelled through these sorts of arrangements".[11]

Treasury advised the Government that the appropriate response was to subject the discounts on shares provided through employee share schemes to FBT.

The Government acted promptly on this advice, announcing in the 1994-95 Budget that it would legislate against these schemes by subjecting to FBT any discounts above a specified threshold dollar amount and by limiting to 10 years the period over which income tax could be deferred. Further, the legislation sought to apply FBT to funds provided by employers to companies in which executives of the employing company had taken shares. Such arrangements, using intermediate companies, were being used in executive tax avoidance schemes. These schemes enabled the employing company to get a tax deduction for the funds paid and for executives to buy shares in the intermediate company for low values and then have them revalued to much greater values following the investment of funds in the intermediate company by the employer.

The legislation, Taxation Laws Amendment Bill (No. 4) 1994, was prepared and introduced into the House of Representatives in November 1994, where it was opposed by the Coalition. This followed a recommendation in a submission to the Shadow Cabinet by then Shadow Treasurer, Peter Costello, that the Coalition vote to remove the provisions relating to employee share schemes and 'vote against the entire Bill if the amendment is not accepted in the House'.[12]

This recommendation was made, accepted and implemented by the Coalition, notwithstanding the advice of Shadow Treasurer Costello in his submission to the Shadow Cabinet that:

> The Government's decision to impose the fringe benefits tax on employee share acquisition schemes is motivated by the desire to stamp out potential abuse of such schemes.[13]

The opposition of the then Shadow Treasurer to the attempts of the Labor Government to close these tax rorts followed intense lobbying by the promoters of the schemes and members of the business community.[14]

The arguments the then Opposition gave for opposing the initiative of the Labor Government were identical to those of the commercial interests lobbying the

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11 Treasury Executive Minute, 12 January 1994.

12 Submission by Shadow Treasurer Costello to the Shadow Cabinet, 7 November 1994, p. 20.

13 Submission by Shadow Treasurer Costello to the Shadow Cabinet, 7 November 1994, p. 20.

14 See RPC, submission no. 30, p. 12. Also, the Australian Taxpayers' Association, 1 May, 1995, p. 119; R. Gleeson, 'The Fight for a Fair Share', *The Australian Accountant*, March, 1995; then Shadow Treasurer, Peter Costello MP, Press Conference, 20 June, 1995; Shadow Treasurer Costello, House of Representatives, *Debates*, 22 June 1995, 2087.

Opposition at that time - that the Government's legislation would deprive general employees of the opportunity to participate in employee share schemes.

It appears that the primary motivation of the lobbyists was to protect the tax loopholes available to executive employees. There are three reasons for this conclusion, as set out below:

- The proposals of the previous Labor Government contained concessions specifically targeted at plans most likely to be used by general employees. If the then Opposition was concerned about the effect of the previous Labor Government's proposals on general employees then these limits should have been liberalised, as the Labor Government proposed to do, rather than opposing the entire plan.[15]
- Following the rejection of the previous Labor Government's initial proposals and the subsequent enactment of Division 13A, evidence available to the Committee indicates that there was no great expansion of employee share schemes amongst general employees. For example, RPC advised the Committee that in 1995 only 16.57 per cent of Australia's Top 350 Companies had employee share plans that could be described as meaningful; that is, greater than 50 employee participants and or representing more than two per cent of the capital of the company. By 1997, this figure had risen marginally to 18.5 per cent.[16]
- According to the groups which lobbied the then Shadow Treasurer, the previous Labor Government's legislation would cut Australians out of international share plans. However, as this inquiry revealed, such plans are overwhelmingly open only to executive employees and therefore do not benefit general employees.

Increasingly concerned about the revenue leakage from the abuse of employee share schemes following the blocking in the Senate of Taxation Laws Amendment Bill (No. 4) 1994, the then Labor Government decided in 1995 to try again. It introduced Taxation Laws Amendment Bill (No. 2) 1995 which, *inter alia,* replaced s. 26AAC with a new Division 13A that remains in force to this day.

Having gained the approval of Shadow Cabinet again to oppose the Government's attempts to stamp out abuse of employee share schemes, Shadow Treasurer Costello announced at a press conference the next day:

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15 The irony is that the previous Labor Government proposed to increase the FBT exemption threshold from the $1,500 initially proposed, to $5,000. This would have resulted in an even more generous treatment for general employees than available under the current Division 13A, while eliminating the potential for aggressive tax planning in this area. The then Opposition, with the Democrats, blocked this in the Senate. See *The Australian Accountant*, March, 1995, p. 3.

16 See RPC, submission no. 30, pp. 19, 21.

> Now this is the Government's third attempt in thirteen months to wipe out the attractiveness of employee share ownership schemes. We've knocked off the last two, and we plan to knock this one off as well.
>
> …
>
> It's one of the clear lines of demarcation at the next election, and it's one of the reasons why we will be opposing root and branch the Government's latest proposals.[17]

In speaking against the legislation in the Parliament, Shadow Treasurer Costello asked:

> So has he [the Treasurer] got it right the third time with the proposals that have been brought back to this House for debate today? The answer is a resounding no. Wrong the first time, wrong the second time, wrong the third time. Three strikes and you are out. We the Coalition will vote against that part of the bill.[18]

Six months later the Senate passed the proposed Division 13A with the support of the Democrats and the Greens but against the opposition of the Coalition. In welcoming the passage of Division 13A the then Treasurer said:

> The Coalition's opposition to the legislation in the Senate today demonstrated that if elected to Government, they would take the tax system back to where it was when they were last in Government - riddled with opportunities for abuse by those on high incomes while those on low and middle incomes would be required to pay higher taxes to make up the lost revenue.
>
> Many of the existing schemes are no more than executive remuneration packages designed to convert salary into shares or share rights in order to take advantage of the open ended tax deferral opportunities available under the existing legislation.[19]

Faced with the challenge of this new anti-avoidance legislation, tax planners quickly began to contemplate new ways of abusing employee share schemes for company executives. As the ATO advised the Committee:

> Their focus swiftly fell on trust structures, which provided adequate potential to avoid the operation of the increasingly restrictive legislation. … The schemes have been too numerous to

17 Shadow Treasurer Peter Costello, press conference, Parliament House, 20 June 1995.

18 Shadow Treasurer Peter Costello, House of Representatives, *Debates*, 22 June 1995, 2087.

19 Treasurer Ralph Willis, Press Release No. 169, 1 December 1995.

> individually outline their mechanics. However, they evolved to the point where promoters were claiming 'total tax wipeouts'.[20]

After its election to Government in 1996, the Coalition introduced legislation to relax the provisions of Division 13A, raising the taxation concession applying to the tax exemption election operating under Division 13A from $500 to $1000. However, there was no anti-avoidance legislation enacted at the time this concession was increased. The ATO has conceded that, at the same time, in some instances promoters of aggressive tax minimisation schemes sought rulings from the ATO. These schemes were often not structured in the way initially explained to the ATO:

> We provided comfort to some of these arrangements on the basis of our understanding at that time as to the application of the law, and the features of the arrangements. However, when investigations are made into how the arrangements were implemented, the ATO has found that the arrangements were often not in accordance with the legal opinion and memorandum of explanation provided to the ATO. In some circumstances the arrangements appear to be no more than shams.[21]

On 26 March 1999, the ATO announced an embargo on the issuing of private binding rulings and that it was withdrawing a number of advance opinions previously issued. Public Ruling TR 1999/5 was issued in May 1999.

Curiously, in that Public Ruling the ATO provided an exemption for some existing schemes: 'The Ruling does not apply to taxpayers who have received a Private Ruling (under Part IVAA of the *Taxation Administration Act 1953*) and have implemented the arrangement ruled on, in substantially the same terms as the Private Ruling'.[22]

This exemption was not provided in Draft Taxation Ruling 98/D12 of November 1998 on which Public Ruling TR 1999/5 was based. The effect of this exemption appears to be to prevent any action being taken into an unknown number of employee share schemes which had obtained private binding rulings.

The Labor members are concerned that the ATO, having expressed total confidence to the Committee that the revenue at risk from the more than $1.5 billion of contributions to abusive employee benefit arrangements would be fully recovered since the schemes are illegal, may have exempted some schemes from its ruling of illegality. The Committee has not been advised by the ATO how much revenue has been foregone in respect of the schemes for which it has provided favourable private binding rulings and which have been exempted from its

20 ATO, submission no. 24, p. 4.

21 ATO, submission no. 24, p. 12.

22 ATO, Taxation Ruling TR 1999/5, p. 2.

unfavourable Public Ruling TR 1999/5. Given that the ATO has advised the Committee that it does not keep records specifically on the operation of employee share schemes,[23] its lack of advice on this matter may be due to the fact that it does not know with any certainty or is unwilling to say. This seems to have been confirmed in correspondence of 6 September 2000 from Mr Michael D'Ascenzo, Second Commissioner of the ATO, to the Chair of the inquiry and in an answer to a question from the Chair at the public hearing of 11 May 2000.[24]

In the answer to a question about additional integrity measures to deal with the use of employee share schemes for tax avoidance, the ATO advised the Committee that it was '…closely monitoring the situation and [is] aware of the problems. The ATO is preparing advice to provide to Government.'

In effect, the ATO refused to provide to the Committee the information that it had gathered and its recommendations to the Government.

However, on 6 September 2000, Mr D'Ascenzo advised the Chair that the ATO had provided the inquiry with all the information in its possession. The information the ATO has provided, however, indicates that it knows very little about the operation of employee share schemes.

The Labor members are gravely concerned by the fact that a key government agency is unable or unwilling to provide (or that it has been instructed not to do so) reliable information on the cost of a concession, the extent to which it is abused and the actions that could remedy the abuse.

The Labor members are also concerned that an unknown amount of revenue must have been lost from schemes that benefited from favourable private binding rulings and that are exempt from the Public Ruling. It is assumed this revenue is substantial.

Quite apart from the substantial amount of revenue at risk from the ready access to tax minimisation loopholes in the taxation laws, the current administration of the taxation system is also of grave concern to the Labor members. The inquiry revealed that such concerns are well founded.

On its own admission, the ATO is aware that there are problems in this area; yet it is unable or unwilling to provide reliable figures on the number and value of schemes. Alternatively, if some information is available, as the response to the question from the Chair on 11 May would seem to suggest, it would appear that the Government is unwilling to allow the ATO to release publicly that information and options the ATO has developed for dealing with the abuse of the taxation system. The release of that information would enable the public to assess the

23 ATO submission no. 24.2, p. 2.

24 *Transcript of Evidence*, p. 359; ATO, submission no. 24.3.

effectiveness of the Howard Government's administration of the taxation laws and the origin of the deficiencies uncovered by this inquiry.

Recommendation 2

The Labor members recommend that the ATO be required to:

(a) urgently develop a methodology to allow calculation of the amount of revenue foregone under both traditional and variant employee benefit schemes;

(b) provide estimates of the revenue that has been lost from employee benefit schemes, separately listing the revenue lost from schemes that have been exempted from Public Ruling TR 1999/5, together with a report on the basis of the exemptions granted;

(c) provide estimates of the revenue that has been lost from employee benefit schemes that rely on PBRs, either directly or through marketing of a PBR, including details of all representations made by taxpayers with private binding rulings to the ATO; and

(d) detail recoveries so far of the revenue at risk from the $1.5 billion in contributions to employee benefit schemes.

ATO officials advised that if the courts were to find against the ATO they would recommend retrospective legislation to the Government.[25] The Labor members are very concerned that after many years of significant avoidance activity in the employee benefits area, the ATO has not yet brought cases to the courts. The delay has not been adequately explained by the ATO.

The Labor members consider this inactivity could be construed by promoters as tacit approval of these arrangements by the Government and hence contribute to the further aggressive marketing of these arrangements. When asked by Labor members of the Committee whether employee share schemes continued to be aggressively marketed, the ATO officials responded:

> In terms of 'aggressively marketed' we do not seem to see the mass marketing of these arrangements, but I would be cautious in

25 *Transcript of Evidence*, pp. 355-356.

> saying that some categories or variants might not still be in the marketplace.
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> …
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> At this time of year there is always a particular focus on mass marketed schemes. We have not seen any evidence of share schemes or trust schemes being marketed this year but there are other types of schemes.[26]

A Labor member of the Committee, Julia Gillard MP, then produced a copy of a share scheme being marketed at the time by the Kenneths Group. Since this was a share scheme, of which the ATO had seen no evidence in that year, Ms Gillard suggested that the revenue at risk could have escalated beyond that generated by the $1.5 billion in contributions to employee benefit arrangements, as estimated more than a year before. The ATO responded: 'That is right and, indeed, that is good feedback for us because we are very keen to try to make sure that people are not duped into arrangements that are going to be challenged'.[27]

The Labor members are deeply concerned that the ATO was unaware that the Kenneths Group and the Remuneration Planning Corporation were aggressively marketing employee share schemes and that the revenue at risk could therefore significantly exceed that generated by the conservatively estimated $1.5 billion in contributions to employee benefit arrangements.

The Kenneths Group document says:

> The Plan Management of the Company Management Employee Incentive Plan will be operated by the TRINITY MANAGEMENT GROUP (TMG).
>
> TMG is jointly owned by the Kenneths Group and Remuneration Planning Corporation Pty Ltd.[28]

The document outlines the experience of the Kenneths Group and the Remuneration Planning Corporation:

> The Kenneths Group experience (in conjunction with Remuneration Planning Corporation, RPC) in Remuneration Planning and Employee Share plan design and implementation is unsurpassed in Australia and New Zealand together with the joint venture management company - Trinity Management Group. Over the past 10 years we have been responsible for the

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26 *Transcript of Evidence*, p. 363.

27 *Transcript of Evidence*, pp. 363-364.

28 The Kenneths Group, "Proposal: Employee Participation Plan and Remuneration Planning for …", p. 28.

> development of all major initiatives in Remuneration Planning and Employee Share Plan in Australia.[29]

The Labor members are also deeply concerned that the Kenneths Group document offers to clients a range of services that includes 'Taxation Office approval'.[30]

In a chronology in its submission to this inquiry, the Remuneration Planning Corporation states: '1999 Shadow of uncertainty placed over ESOPs by ATO's embargo on ESOP rulings in April 1999. RPC lobby for lifting of embargo'.[31]

Having been made aware by Labor members that the Kenneths Group and the Remuneration Planning Corporation were aggressively marketing employee share schemes, and that the revenue at risk could therefore significantly exceed what might otherwise be generated from the $1.5 billion of contributions, it seems likely that the ATO provided further advice to the Government about the need for legislation to ensure that FBT was payable on employee share schemes. Belatedly, late in the day on 30 June 2000 (the eve of the introduction of the GST), the Assistant Treasurer announced only a review:

> In addition, Senator Kemp has asked the Tax Office to review the interaction of the income tax and fringe benefits tax laws to ensure that employee benefit trust and employee share plans are taxed appropriately. The Tax Office has advised the Government that some variations of earlier arrangements are being marketed. If legislative change is necessary to combat the ongoing marketing of these schemes, further amendments will be introduced.[32]

This announcement was made by the Assistant Treasurer (not by Treasurer Costello) six years and more than $1.5 billion after the Coalition first successfully opposed the application of FBT to employee share schemes. Shadow Treasurer Costello told the Parliament on its second successful blocking of the legislation that the application of FBT to employee share schemes was "atrocious":

> When it was clear to everybody that the Treasurer's plan to bring employee share ownership plans into the net of fringe benefits was atrocious and would effectively destroy the operation of all existing schemes, the Treasurer carried on regardless, not listening to anyone, steadfastly ignoring industry concerns, and seeking to push ahead with his plan, under cover and with all sorts of outlandish claims.[33]

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29 The Kenneths Group, "Proposal: Employee Participation Plan and Remuneration Planning for …", p. 34.

30 The Kenneths Group, "Proposal: Employee Participation Plan and Remuneration Planning for …", p. 35.

31 Remuneration Planning Corporation, submission no. 30, p. 12.

32 Assistant Treasurer, Press Release No. 035, 30 June 2000.

33 House of Representatives, *Debates*, 22 June 1995, p. 2087.

The Assistant Treasurer's announcement of a review is consistent with the Government's inactivity in dealing with tax avoidance through these schemes since 1996. The problem has been ignored until that approach has become untenable, and then only a review has been announced. That review is not being conducted in public, but within the ATO. Meanwhile, Government legislative action against this large-scale avoidance activity is being delayed indefinitely.

The Labor members note that the review may lead to legislation to ensure FBT is payable, legislation which the Treasurer has previously described as "atrocious". The Labor members are concerned that the Government's long-standing opposition to legislation to prevent the avoidance of FBT through aggressive tax planning of executive share schemes will lead it to decide that no new legislation is necessary for combating the abuse of employee share plans by company executives.

Recommendation 3

The Labor members recommend that the Government introduce into the Parliament, without further delay, legislation to ensure that employee benefit trust schemes face an appropriate tax regime.

The Labor members also recommend that all advice provided by the ATO and Treasury to the Treasurer and Assistant Treasurer concerning employee benefit schemes be tabled at the earliest opportunity.

The Government members have made it clear through the recommendations in their report that they consider tax concessions for employee share ownership plans should be made more generous. Most of the recommendations of the Government members that would increase the generosity of employee share plans actually relate to the tax *deferral* option which, the Committee heard, is used by company executives (non-executive employees preferring the tax *exemption* option). That is, the recommendations of the Government members would increase the generosity of tax treatment for company executives. This is contrary to the stated position of the Chair of the Committee, when speaking on behalf of himself and the Government:

> It needs to be made perfectly clear - and I have said as the chairman of the committee on numerous occasions, which also reflects the government's position - that we are not interested in doing anything to liberalise access to employee share ownership plans at the executive end of the market. That is not what the inquiry is about. … The committee's work and the inquiry's work, and certainly the government's perspective in terms of the

> reference, is not in any way about liberalising it other than if there is to be any liberalisation it is about making sure the employee share ownership is more accessible to everyday workers.[34]

Recommendations 6, 22, 26, 27, 30, 31, 34 and 39 of the Government members' report would provide company executives with access to more generous taxation arrangements than those available to non-executive employees. Only recommendation 32 is specifically directed towards the tax exemption election typically used by non-executive employees.

The Labor members are concerned that the recommendations providing more generous tax concessions for company executives have been developed without the benefit of advice from the ATO as to:

- their cost to revenue; and
- their potential to open up new avenues of tax abuse for company executives.

Consequently, the Labor members do not support these recommendations. Further, the Labor members would want the opportunity of weighing up policies to provide greater incentives to bona fide employee share ownership plans against competing budget priorities.

Bona fide employee share plans

Many of the parties who appeared at the inquiry believed 'genuine' employee share plans were an effective mechanism to better align employer and employee interests and to foster increased productivity and workplace harmony.

The Labor members accept that this conclusion seems logical but note that there is no clear and objective evidence on the question. No submissions to the inquiry produced a sound study which demonstrated the claimed benefits of employee share plans.

The Department of Employment, Workplace Relations and Small Business provided statistical data from the last Australian Workplace Industrial Relations Survey which showed a statistical correlation between improved productivity, a greater propensity to measure productivity, lower levels of absenteeism, labour turnover and dismissals, higher levels of workplace change and higher levels of unionism.[35]

34 *Transcript of evidence*, p. 358.

35 Submission 38, appendix A.

Of course this data does nothing to determine causal relationships but it does lead to the general conclusion that bona fide employee share plans tend to be located in larger, unionised, highly productive enterprises.

Notwithstanding the lack of hard data, the Labor members do accept that as one aspect of a participative workplace culture, employee share plans do assist with aligning employer and employee interests. The Labor members also note that significant union involvement in enterprises appears to help foster the development of bona fide employee share plans.

The second main rationale advanced for government support for bona fide employee share plans is that it will assist with increasing national savings. The Labor members note that proving this contention is virtually impossible given the inability to analyse the substitution effects created if government policy fosters one savings vehicle, such as employee share ownership, over other savings vehicles.

The Labor members note that many employers who provided evidence to the Committee indicated that they viewed bona fide employee share plans as an additional benefit for employees, which was not a substitute for wages or conditions. In these circumstances there would appear to be a net savings benefit created by the existence of such schemes.[36]

However, other employers in their evidence indicated that participation in employee share plans was viewed as part of the wages and conditions package and particularly viewed as a substitute for cash bonuses.[37] The savings effect of these arrangements cannot be ascertained in the absence of data about the savings and consumption patterns of the cash bonuses or other benefits forgone to secure participation in the share plan. The Labor members note that there may also be a cause for concern in relation to security of entitlements for employees if government policy distinctly favours bona fide employee share ownership plans over other forms of savings vehicles. In the case of a corporate failure, employees could be faced not only with the loss of their jobs, but potentially the loss of accrued entitlements and the loss of their savings if those savings are invested in the employing company.

Such a problem is exacerbated if employees have foregone wages and conditions in exchange for shares in circumstances where their employer was in severe financial difficulty. Evidence was also provided of one such circumstance that fortunately resulted in the survival of the company involved. However, the risk for employees of such a strategy is significant.

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36 RPC, submission no. 30.2, annexure, letter from Mr Vince Fitzgerald, reasserting his 1993 conclusion set out in his report, 'Saving Through the Firm', The Allen Consulting Group: 1993; *Transcript of Evidence*, pp. 1, 3; *Transcript of Evidence*, pp. 34-46.

37 Qantas, submission no. 35, p. 9; *Transcript of Evidence*, p. 67.

A third rationale advanced for fostering employee share ownership was that it spreads ownership of capital and consequently democratises it. The Labor members agree that the ownership of capital should be spread more widely but are sceptical of the claims that so-called "mums and dads" investors have sufficient power to "democratise" capital. While share ownership is undoubtedly growing, as the statistics reveal, the so-called "mums and dads" shareholders have modest holdings in relatively few shares. According to the ASX, share holdings by households account for approximately 25 per cent of the total equity market. Of that 25 per cent, 31 per cent own only one stock, 31 per cent own two or three stocks, 26 per cent own four to 10 stocks and eight per cent own more. Amongst these shareholders, 41 per cent have a portfolio value less than $10,000, 25 per cent have a portfolio valued at $10,000 to $50,000, eight per cent have a portfolio valued at $50,000 to $100,000 and only nine per cent have a portfolio valued in excess of $100,000.[38]

As outlined in the previous section, employee share plans have also tended to favour the wealthier executive section of the workforce. However, the Labor members are supportive of flowing share ownership through bona fide employee share plans and would support such plans being part of participative structures which afford employees a real say in the enterprises for which they work.

Against this general background of accepting bona fide employee share plans are beneficial in better aligning employer and employee interests and flowing share ownership to general employees is worthwhile, the Labor members considered the following issues:

- Who has access to bona fide employee share plans?
- What level of government support is appropriate to facilitate the spread of bona fide employee share plans?

Who has access to bona fide employee share plans?

The report canvasses the penetration of bona fide employee share plans in Chapter 2.[39]

Bona fide employee share plans are most likely to exist in publicly listed companies and employees in such companies have the benefit of accessing shares which have a price determined publicly by the share market. Subject to any restrictions imposed by the employee share plan on the ability of employees to trade these shares, employees in such companies gain an asset the value of which is known and which can be easily traded.

38 Australian Stock Exchange, 2000 Share Ownership; see also Australian Stock Exchange, 2000 Share Ownership Study.

39 Paras 2.42ff.

Non-listed public companies are also in a position to allocate to employees shares for which there is a market, albeit a limited one.

However, increasingly Australians are employed by small and medium size businesses which are general proprietary limited companies.[40] By definition, there is no real market for shares in such companies and there is no objective mechanism for valuing shares. The Labor members note that in the United Kingdom steps have been taken to create an 'artificial market' for these shares[41] through the use of trust structures and to facilitate the valuation of shares by the Inland Revenue operating a Shares Valuation Division, which provides valuations of shares for most of the employee share schemes that operate in the UK.[42]

However, in the absence of such initiatives, which have not been the subject of a thorough examination in the course of this inquiry, employee share ownership does not have much meaning for this section of the workforce. The same position applies to those employees working for the general government sector and the not for profit sector.

The Labor members recognise that significant limitations therefore exist on access to employee share ownership flowing to all sections of the workforce.

The Labor members are keen to facilitate the development of the small, medium and unlisted sector and enterprises in the sunrise industries, especially the biotechnology, high technology and IT sectors.

That said, the Labor members doubt the ability of the recommendations in this report to facilitate development within the small, medium and unlisted sector for the reasons cited above.

The Labor members also believe care needs to be taken in assessing the merits of adopting differential policies for sunrise industries. Advocates of such policies advised the Committee that Australia faced difficulties in attracting high skilled sunrise industry workers because the current taxation arrangements prevented the offering of share options in a way which would assist in designing globally competitive salary packages.

The Labor members understand that the labour market for such workers is global and that competitive salary packages need to be offered. If government funds are to be used to support sunrise enterprises then there needs to be a clear and

40 According to the Australian Bureau of Statistics report, Small Business in Australia, of 5,701,700 people employed in the private sector, some 3,119, 600 were employed in workplaces of fewer than 20 people and a further 1,278,900 in enterprises of between 20 and 99 employees. (Australian Bureau of Statistics, Canberra: 1999, catalogue number: 1321.0, p. 32.)

41 See Proshare, 'ProShare's Employees' Trusts Fact Sheet', available at: www.proshare.org/eso/employeetrust.asp; Capital Strategies, 'FAQ', available at: www.capitalstrategies.co.uk/esops/faqs.htm.

42 Proshare, 'Valuation of Shares in Unquoted Companies', available at: www.proshare.org/eso/valuation.asp.

transparent process of the allocation of such funds and close monitoring of the employment and wealth generation outcomes. The Labor members do not believe that government subsidies should be allocated to a broad and difficult to define industry sector in the manner contemplated by the report, given the inability for there to be a clear assessment of any positive outcomes generated.

What level of government support is appropriate to facilitate the spread of bona fide employee share plans?

As noted in the report of the Government members, [43] the data on employee share ownership in Australia is poor.

The ATO and Treasury were unable or unwilling to provide costings regarding the recommendations in the Report which deal with changing the taxation arrangements in relation to employee share ownership.

The Labor members are both amazed and disturbed that the ATO and Treasury were unable to provide any advice on the costs to government revenue of the increase from $500 to $1,000 for the tax concession available for employee share plans which comply with Division 13A.[44]

The Labor members do not believe any further tax concessions can be contemplated in this area until the ATO and Treasury are in a position to generate reliable costings for such initiatives. In the absence of such costings there is no real way to measure the merits of such proposals with the benefits that could be generated by alternate uses of the revenue.

Conclusions

This inquiry into employee share ownership plans was initiated by the Minister for Employment, Workplace Relations and Small Business, the Hon Peter Reith MP, as a means of generating evidence and recommendations in support of the Government's commitment to make these plans more generous. Instead, the inquiry has unearthed evidence of large-scale tax avoidance by company executives through the abuse of employee share ownership plans. These avoidance schemes have been likened by the ATO to the "tax avoidance paper scheme rorts of the 1970s and early 1980s" - the infamous 'Bottom of the Harbour' schemes.

The similarities between the exposing of large-scale tax avoidance through employee share schemes for company executives and the 'Bottom of the Harbour'

43 Paras 2.24ff.

44 *Taxation Laws Amendment Act (No. 1) 1997* – (Act 122 / 1997).

schemes do not end there. In both cases, an inquiry was initiated by a Coalition Government for another purpose. In both cases, the inquiries unexpectedly exposed massive tax avoidance. In both cases, the inquiries painted a picture of Government inaction and an unwillingness to legislate against the tax avoidance schemes. But there is an important difference: the Government finally *did* legislate against the 'Bottom of the Harbour' schemes when the revenue leakage and public outcry became intolerable, yet in the case of employee share schemes the Government is still refusing to legislate, announcing only an internal ATO review.

The ATO has estimated contributions to employee benefit arrangements which it considers are blatant tax avoidance schemes (which include employee share schemes and offshoots of them in the area of superannuation) at $1.5 billion. However, that estimate was provided in April 1999 and Labor members have since produced evidence of ongoing aggressive marketing of employee share schemes to company executives. Further revenue leakage has therefore inevitably occurred since early 1999. Moreover, a public ruling issued in May 1999, which re-affirmed the ATO's view that these schemes are illegal, specifically exempted schemes for which a favourable private binding ruling had previously been issued and which had been implemented substantially in accordance with the arrangements advised to the ATO. An unknown amount of revenue has been foregone through this curious exemption. The only conclusion that can be drawn from the evidence is that contributions to contrived employee benefit arrangements for executives are now well in excess of $1.5 billion.

Government members have made a number of recommendations in their report that will further increase the generosity of employee share plans for company executives. These recommendations are uncosted and have been developed without the advice of the ATO. Since these recommendations will inevitably open up or officially condone new avenues of abuse for company executives, the Labor members strenuously oppose them.

The Labor members do support the widening of employee share ownership among non-executive employees. However, the Labor members consider that policies to encourage the widening of employee share ownership among non-executive employees should be based on advice from the ATO as to any unintended opportunities they may create for further abuse by company executives, be properly costed and be compared with competing budgetary priorities.

Rod Sawford MP
Deputy Chair

Craig Emerson MP

Julia Gillard MP

Kim Wilkie MP