

Introduction

History of the reference

- 1.1 On 9 March, 1999, the Minister for Employment, Workplace Relations and Small Business, the Hon Peter Reith MP, wrote to the Standing Committee on Employment, Education and Workplace Relations, asking it to inquire into and report on employee share ownership plans.¹ The reference follows almost three decades of mostly bipartisan support for employee share plans. During this time no thorough investigation of employee share plans, which included an examination of their operation, tax treatment and legislative foundation, had been conducted. The time had arrived for a close examination of employee share plans.

Focus of the inquiry

- 1.2 Minister Reith's reference asked the Committee to focus on three issues:
- (a) the extent to which employee share plans have been established in Australian enterprises;
 - (b) the resultant effects upon workplace relations and productivity; and
 - (c) the resultant effects upon the economy.
- 1.3 In the course of the inquiry it became apparent that little accurate and detailed information was available that could provide definitive answers to these questions. Moreover, the evidence available was, largely, of an anecdotal nature. However, sufficient evidence was available to identify problem areas with the existing arrangements and suggest courses of action that would address them. In particular, the Committee found that while executives have access to a range of share plans, general employees are not included in employee share plans to the same extent.

1 The terms of reference for the inquiry are set out at the start of this report.

Consequently, a principal focus of the inquiry became to examine possible means of increasing the opportunity for general employees, including in unlisted, small and medium enterprises, and in sunrise industries, to participate in employee share plans.

What are employee share plans?

- 1.4 There is no single type of employee share plan. The plans are structured in different ways but they all have three elements in common:
 - (a) they aim to transfer equities to employees;
 - (d) the transfer is on favourable terms to both employer and employee;
and
 - (e) the recipient of the equities is an employee of the person providing the equities.
- 1.5 All employee share plans meet these three conditions. How they differ is in respect of:
 - (a) the conditions that attach to the transfer of the equities – such as length of service, performance and the period of time the equities must be held before disposal;
 - (b) the types of equities provided. Plans differ in terms of whether they provide shares, options or stapled securities;
 - (c) the funding arrangements—that is, how the equities are paid for;
 - (d) who is eligible to participate in a particular plan; and
 - (e) the motivation and purpose of the plan. Some plans are provided to employees as a bonus on their existing salary; others are provided as an element in a strategy to minimise tax on income; others are provided to foster cultural change and a better alignment of employee and employer interests. Many plans rest upon mixed motives.
- 1.6 The result is that there are a large number of employee share plans that differ from each other in terms of their specific requirements. Moreover, Division 13A of the *Income Tax Assessment Act 1936* provides concessional taxation treatment for plans that meet certain requirements. These concern the funding arrangements, the types of shares provided, who is eligible to participate in the plans and when the equities in the plan are liable to taxation.

The need for a thorough examination of employee share plans

- 1.7 An examination of the current arrangements and business practices concerning employee share plans indicates clearly that a thorough review is required.
- 1.8 First, the complexity of business arrangements in respect of employee share plans has considerable implications for public policy. The major issue is establishing a legislative framework that permits the creation of employee share plans but does not thereby provide an opportunity for aggressive tax planning or expose general employees to risks of which they may not be aware.
- 1.9 Second, over the past five years the number of employees participating in employee share plans, the number of employers offering these plans and the value of plans have steadily increased. According to some figures, over 440,000 employees (or about 5 per cent of the workforce) now participate in these programs. The value of employee-held shares and options is estimated to exceed \$10 billion.
- 1.10 Third, the number of equities offered in some enterprises is considerable and can exercise a significant effect on the viability, or perceived viability, of an enterprise.
- 1.11 Finally, the advocates of employee share plans claim that they are part of a management outlook that can increase productivity and national savings and thereby ensure that Australia is a leading edge economy. It is the case that other developed nations, such as the United Kingdom and the United States, view employee share plans in these ways and foster them, in part for this purpose.
- 1.12 The Committee considered evidence that:
- the incidence of employee share plans is increasing;
 - the value of equities is by any reckoning considerable;
 - employee share plans are sometimes used for aggressive tax planning;
 - owing to the number of equities involved in some plans, they have the potential to affect enterprises through their operation;
 - employee share plans not only have the potential to affect the wider economy but they do.
- 1.13 It was surprising to the Committee that so little is known about their operation and the effect they have or may have upon the economy and government revenue.

- 1.14 For these reasons, a thorough investigation of employee share plans was long overdue. The purpose of this inquiry was to examine the operation of the plans and their place in economic and social development, and to identify how to spread the benefits more broadly within the community.

Context of this inquiry

- 1.15 The present inquiry was undertaken within a changing legislative and social landscape. The two pieces of legislation that have the most direct effect upon the creation and operation of employee share plans experienced fundamental change during the course of this inquiry. The taxation system underwent the most significant changes in the past fifty years, if not since Federation. These had implications for some of the conclusions reached by the Committee and the recommendations it made. Significant changes were also made to the corporations law.
- 1.16 Australian society is undergoing substantial changes which stem from the ongoing restructuring of the economy and society, brought about by the rapid development of a more integrated international economy.
- 1.17 A small but increasing number of employees benefit from being able to market their skills globally, becoming, in effect, well-remunerated, itinerant employees moving from country to country. For the vast majority of Australians such mobility does not occur.
- 1.18 Importantly, as an element in these changes, the role, purpose and function of government is also under review. Consistent with trends in other nations, Australian governments have moved towards encouraging individuals to take greater responsibility for such matters as providing for their own health care costs and making provision for their retirement. This has been reflected in recent years in concepts such as 'mutual obligation' and 'a social coalition' for the provision of social infrastructure.
- 1.19 The ageing population profile, with its implications for government revenue and expenditure, poses enormous challenges. The significant projected changes in the age dependency ratio mean that greater financial demands may fall on people in work. What is certain is that individuals will be required to plan well in advance and raise their level of savings for their retirement years. Governments have a responsibility to facilitate such planning.
- 1.20 Advocates of employee share plans claim that such plans are one facet of an innovative employment market. They claim that these plans should be part of a management culture that increases productivity, and which more closely aligns the interests of employees and employers. Advocates also claim that the plans can be used as an effective supplement to compulsory

superannuation. For the development of appropriate and responsible public policy these claims must be evaluated.

1.21 From this overview it is clear that this report sits within a context of substantial change, the evolving role of the Commonwealth and the challenges facing the community. In particular, the report addresses a fundamental set of issues in the new integrated employment and social welfare environment:

- how to better align the interests of employers and employees and increase the extent of employee participation in the operation of an enterprise, so as to increase productivity through attracting and retaining more highly motivated employees;
- how to encourage people to increase significantly the level of their savings so as to be more financially independent;
- how to ensure that incentives to establish employee share plans are not misused;
- how to foster the spread of employee share plans generally, including amongst the unlisted, small and medium sized enterprises and within sunrise industries;
- how to facilitate employee buyouts and succession planning.

Public policy parameters

1.22 It became apparent to the Committee that employee share plans will spread through the private sector only if there are appropriate public policy settings to encourage them. Legislators are faced with the challenge of:

- encouraging the development of employee share plans through sympathetic public policy; while
- preventing the use of these plans for aggressive tax minimisation, or exploitation of participants.

1.23 Given this, the following are important foundations upon which policy must be based:

- Equity. The recommendations should be seen to promote the equitable treatment of all Australians;
- Easy to use legislation. If the legislative foundation for employee share plans is unclear, ambiguous or complex, then employers and employees may be deterred from participating in the plans;

- Clear monitoring and quality control. Concessional taxation treatment is necessary to encourage the further spread of employee share plans. The community has a right to know that the concessions are attaining their intended results. Close monitoring and supervision of plans is therefore required;
- It would be desirable for policy settings to enjoy bipartisan support and be stable. Employee share plans often involve long-term planning on the part of individuals and employers. Such planning enables the participants and the community to attain the maximum benefit. This will occur only if employers and employees can be confident of relatively long-term stability in policy;
- Protection for employee share plan members and general shareholders. Experience from the United States indicates that employee share plans can be used to defraud or otherwise disadvantage employees and other shareholders. Legislation that affects employee share plans must be capable of dealing with people who engage in activities that seek to exploit the operation of employee share plans.

Structure of the report

- 1.24 The report moves systematically through the issues that face the development of employee share plans. The Committee concluded that general employee share plans will require additional taxation incentives if they are to substantially increase in number and coverage, especially among unlisted companies and those in sunrise industries.
- 1.25 However, in the Committee's view, any further incentives are justified on two conditions:
- (a) If appropriate legislation is introduced and practices are adopted that will deal decisively with the abuse of employee share plans and other employee benefit arrangements by aggressive tax planners for the primary purpose of minimising tax;
 - (b) If there are clear benefits to the community through allowing such concessions.
- 1.26 It seems to the Committee that the concessional treatment required to promote the development of employee share plans is more soundly grounded if employee share plans operate within a controlled environment, ensuring that they are not used primarily as tax minimisation vehicles, and if justifications can be provided that go beyond simply aligning the interests of employers and employees.
- 1.27 Consequently, Chapter 2 examines the rationale for employee share plans and seeks to extend it so that additional benefits flow to the community

from the operation of these plans, while at the same time protecting revenue. For these reasons, Chapter 2 seeks to estimate the nature, extent and value of employee share plans. It goes on to examine the rationale for employee share plans. This information provides the foundation for the remainder of the report.

- 1.28 Chapter 3 examines the legislative basis for employee share plans and seeks to address a number of problem areas that exist in their operation. The Committee concluded that there were two major problem areas. First, the present arrangements are unduly complex. Employers and employees must navigate two pieces of complex legislation—the Income Tax Assessment Act and the Corporations Law. The committee concluded that stand-alone consolidated legislation would be desirable.
- 1.29 Second, the present arrangements provide opportunities for aggressive tax planning. They operate both within Division 13A and outside it. The Committee therefore makes a number of recommendations which are intended to prevent these practices. The recommendations made are of a general nature. The Committee believes that if implemented they will also act as a deterrent to aggressive tax planners without imposing additional, unnecessary regulatory burdens.
- 1.30 Chapter 4 focuses on the problems that present arrangements pose, from a taxation point of view. The Committee examined systematically the dominant issues raised by witnesses and makes recommendations to address them. The Committee believes that implementation of these recommendations will greatly encourage the creation of employee share plans, and with the recommendations made in Chapter 2, will do so within a legislative framework that will reduce misuse.
- 1.31 Chapter 5 examines the corporate law issues raised by witnesses and also a number of problems that could arise in corporate governance should plans be allowed to proliferate in an uncontrolled manner. The Committee also examines the equity issues that surround employee share plans, namely that at most only 20 per cent of the population would be able to participate in plans, owing to the nature of the economy. The Committee makes substantial recommendations to redress the equity issues for these employees.
- 1.32 In Chapter 5 the Committee also makes recommendations that seek to extend the use of employee share plans in a number of enterprise sectors.
- 1.33 Overall, the report identifies feasible policy initiatives that will foster the development of employee share plans but do so within an innovative and clear legislative framework.

- 1.34 For this reason, the report forms an integrated proposal: the measures designed to prevent exploitation of share plans for aggressive tax planning are as important as the policy initiatives designed to foster the growth of employee share plans in Australia and enhance economic opportunities for Australians. As such, they are presented as a package.