AUSTRALIAN EMPLOYEE OWNERSHIP ASSOCIATION

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Dr Brendan Nelson NP
Chairman
House of Representatives Standing Committee on Employment
Education and Workplace Relations
Parliament House
CANBERRA ACT 2600

Employee Share Plans and Corporate Tax Reforms

Dear Dr. Nelson,

1 am responding to your telephone request of last week that the AEOA might like to make some observations about the impact on employee share plans of the new Corporate Tax Reforms contained in *The New Business Tax System* (Treasurer's Press Release, No. 58, 21 Sep. 1999) and the final Ralph Report, *A Tax System Redesigned.* Our comments will be made under the headings below.

CGT

The changes in the taxation of capital gains will have the effect of re-aligning the relative tax advantages of various share plans:

- The **tax-exempt** Division 13A share plan will be advantaged by the tax reforms. Up to $ 1,000 worth of shares, per employee per annum, can be acquired under a tax-exempt share plan. The value of the shares acquired is exempt from all tax. However, if the shares increase in value and are sold, then the increase, or capital gain, is subject to CGT. Under the new regime the CGT will fall more lightly on this gain.

- The **tax-deferred** Division 13A plans will be disadvantaged relative to plans subject to CGT. This is because tax-deferred plans are subject to Income Tax. Tax is levied at the marginal rate on the full value of the shares when sold. This disadvantage, however, will be offset, in part, by new and lower marginal tax rates.

- Share plans which are structured around a loan and which, on this account, are subject to CGT, will be advantaged by the new system relative to the tax-deferred plan.

Implications

The key implication seems to be that tax-exempt share plans and share plans utilising loan structures will be relatively advantaged by the changes in the CGT regime. The big winners from this are more likely to be executives who would be especially attracted to leveraged structures with a lower CGT profile. One might predict that the traditional loan plan will get a fillip from the new tax system.

Taxation of Trusts as Companies

Neither the final Ralph Report - *A Tax System Redesigned* - nor the Government's response to it - *The New Business Tay System* - specifies that share plan trusts will be exempt from the new entity taxation system. One might infer from the fact that both Telstra 1 and 2 contain in employee share ownership element designed around a trust-based share plan that the Government does not intend to tax share plan trusts as if they were companies. Certainly, there have been informal and vague 'assurances' from various, and non-authoritative, sources on this point. But the AEOA finds it very strange that the Government, so far, has taken no definitive steps to clarify this

issue. A clear and unambiguous exemption of share plan trusts from the entity taxation system needs to be made as a matter of some urgency.

The ESOP Agenda

The above observations suggest that the Federal Government needs to formulate its agenda for Employee Share Ownership and to implement it as an integral part of its program of taxation reform.

The key issues which have emerged from your inquiry into employee share ownership seem to have been:

- **The need to tax employee shares at the time of sale;**
- **The need for Employees Share Ownership Plans (ESOPs) to ernploy a wider range of equities -** indeed, any equity, in the employer's company;
- **The need to address the 5 per cent limit on an individual employee's acquisition of voting shares -** the AEOA recommends a 10 per cent limit for companies with 100 employees or less; and
- **The need for prospectus requirements to serve rather than to restrict the spread of E50Ps -** the AEOA recommends the extension to ES0Ps of the simplified prospectus requirements contained in the CLERP legislation.

Conclusion

The above measures could be implemented with limited, surgical amendments to Division 13A of the Income Tax Assessment Act. They would represent a major advance for employee share ownership, above all among unlisted and private companies and their employees.

With employees like those at Ansett now actively developing a buy-out proposal for News Limited's half-share of the company, Australia is (potentially) on the threshold of a major change in the culture of the workplace - a project very close to the heart of the Federal Government. To achieve this objective, however, Industrial Relations reforms cannot suffice. Active participation by employees in the ownership of businesses must accompany IR changes. This can only be achieved in an environment defined by flexible employee share plan legislation and by an ESOP-friendly tax administration.

The AEOA looks to you and your Committee to recommend to the Government, in the most persuasive terms, the virtue of this proposal.

Yours sincerely

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