<u>EMPLOYEE SHARE PLANS</u>

INTRODUCTION

We humbly request that the government in reviewing Employee share Ownership Plans (ESPs) accept our submission. Current legislation on Employee Share Plans covered in Division 13A (Section 139) are extremely advantageous for public companies, but do not provide opportunities to the 80% of employees who do not work for listed companies. Current legislation places a discriminatory limit on Employee Share Plans and does not encourage greater equity participation by all Australian workers.

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ESP's provide the benefits of aligning the financial goals of employees and employers as one. ESP's create the opportunity to increase national savings to assist in the provision of retirement benefits to employees, and to <u>partly</u> provide financial equity capital to employers. ESPs allow employers to employ more people to increase profits, to export and to improve our balance of payments. ESP's are a sensible and prudent method for employees to diversify their investments.

Our submission primarily focuses on the benefits of ESP's to small and medium enterprises (SMEs) and their employees. We seek to allow the provision of the same benefits to be enjoyed by employees and employers of SMEs that have been enjoyed by large listed company employers and their employees for many years.

SUBMISSION

It is our submission that legislation similar to the previous 26AAC of the Income Tax Assessment Act 1936 - be reintroduced but with restraints as outlined in this paper.

BACKGROUND

For Employers

The facts of small business in Australia.

- In Australia 95% of businesses employ less than 20 employees.

- More than 44% of all workers, work in businesses that employ less than 20 employees and of which 792,000 are self employed.

- Businesses employing fewer than ten employees represent 90% of all private non agricultural enterprises in Australia.

- About 66% of all small businesses started this year are predicted to fail within five years. (The difficulty SME's have in raising equity funds results in their increased reliance on debt funds ad thereby increase the risk of business failure.)

Studies conducted by the Australian Institute of Chartered Accountants (The Road to Recovery - Solutions to Small Business) and by D.I.T.A.C. (AGM National Surveys of Small Business) have shown that SME's have three primary requirements for success:

1. They need management skills;
2. They need marketing skills;
3. They require capital.

Whilst government departments, industry and accounting professionals tackle the issues of marketing and management skills for SMEs, there are few options for SMEs to raise capital. ESPs can provide this facility.

For Employees

It is widely recognised that we have a savings crisis in Australia. The rate of savings is too low. Those employees with limited savings invest primarily in real estate. In the last 30 years the percentage of savings invested in equities was nearly halved, whilst the percentage invested in residential property doubled.

Amongst many other reports, the Fitzgerald report recognises the need to encourage medium term investment in equities and to address this imbalance.

The problem with superannuation for many people is that it is long term and inaccessible, the commitment means locking funds away. There is also real concern that even with compulsory contributions there will simply not be adequate funds available for individuals to retire with. Individuals are discouraged from simple bank account savings as deposits are subject to double taxation and rates of return are very low.

We believe ESPs should form part of an overall financial planning investment portfolio for all employees not just those that work for large public companies. It allows them diversity of their investments across the three sectors: cash, property and equities. Equities either by direct share investment or through a fund manager.

Australia - an ageing population

As our population ages so too will the need for an absolute dependence upon national savings.

As shown in Appendix A, based on research undertaken by the Australian Institute of Family Studies, by the year 2041 for every 100 workers there will be 65 dependents.

ESPs as a “Second” savings platform to superannuation will assist in alleviating this potential crisis.

SUBMISSIONS

No doubt you have received submissions already on ESPs. Our concern is that many have been submitted by large fund managers, who would be predominantly looking after their own interests.

Whilst not criticising their approach, it is our belief that ESPs should be made available to employers of all sizes and as such the ESPs should be able to be acquired by all businesses including SME's.

Self interest groups may have suggested that ESP funds should not be allowed to be invested in SMEs. Surely this defeats the purpose and flies in the face of what is best for our country. The reality is that our country's existing savings in vehicles such as superannuation and equity funds rarely end up being invested back with SME's. Fund managers are loathe to take any risk with their funds (their jobs) and therefore will only invest in large corporations. ESPs for SME's provide the opportunity to generate capital for SME's and large corporations alike.

OVERSEAS RESEARCH

United States of America

The National Centre for Employee Ownership reports that 1994 appears to have been the best year for new ESOP formations in USA since the late 1980s. Inquiries received by the NCEO were up over 50%. Consultants also informed the NCEO that they were busier than usual.

"Ownership is something people expect, much as they do health benefits" - Mr. Craig Conway - Chief Executive Officer of TGV - Santa Cruz, California.

US Employer Sponsored Retirement Plans

The Employee Benefit Research Institute of US reports that 57% of the civilian workforce (118 million) work for an employer that sponsors a retirement plan.

76% of the employees working for such employers participate in the retirement plan.

U.S. Department of Labor 1991 figure indicate that 86% of companies which lodged returns in respect of their ESOPs also provided other retirement plans for their employees.

(Note: Not all ESOP structures are required to be disclosed to the DOL).

Stock Option Plans

A survey by Share Data of US shows that 83.3% of companies with fewer than 100 employees and who operate an employee share plan grant options to all employees. The survey was conducted using 1992 data provided by more than 600 US companies.

Share Data also found that "the percentage declined with size to 9% for companies with over 1,000 employees and was 54% overall".

The trend however, towards more companies providing broadly based stock option plans is clear and dramatic.

Assets Invested Through Employee Share/Save Structures

US Department of Labor 1991 figures discerned from Form 5500 fillings:

Plan Type	*No of Plans*	*Number of Employees Participating in Plan*	*Assets Invested*
ESOP	8,558	7,000,000 employees	$150 bil
$401 (k)	114,667	21,000,000 employees	$447 bil
Profit Share	437,000	28,000,000 employees	$668 bil

Amounts expressed are in US$

Of the 8,558 ESOPs, 83% of these plans were leveraged.

The Profit Sharing Council of America analysed 1992 data on S.401(k) Plans.

29.2% of Investments were in the shares of the employer. Thus 70.8% were in diversified investments. This means that US$140 bil were invested in employer shares Vs the US $150 bil for ESOPs.

Where the employer matches the employee contribution to $401(k) Plans, 67% of these employer matching contributions were allocated to investments in shares of the employer.

A 1991 NCEO study found that an employee earning a salary of US$20,000 per annum and participating in an ESOP would on average accumulate US$83,000 in inflation-Adjusted stock value over 20 years participation in an ESOP

Comparison to Australia

57% of the US workforce working in the private sector were covered by a Retirement Benefit Plan. As participation was voluntary only 44% of the workforce actually participated. This does not include government sector employees who are also covered by pension plans. Benefits appear to be less generous than Superannuation in Australia.

Other benefits provided by US employers include health benefit plans. These are becoming more standard - expected as normal working conditions. Health benefit plans are not widely provided in Australia.

In US, 86% workers are covered by Profit Share/Save - ESOP - S401(K) structures also provide other pension plans.

56 mil. US workers are covered by Profit Share/Save -ESOP-S401(k) structures with assets now exceeding US$1,300 billion. These investments are in addition to Pension Plan Assets.

On an equivalent basis in Australia, we would need to have 3.8 million employees as members of Share/Save - ESOPs structures with assets invested (i.e: outside Superannuation Funds) in excess of AUS$119bil.

Analysis of Overseas Profit Share/Save Plans

Country	**Level of Comparable Contribution Required $**
Australia	1,500
Belgium	4,850
Germany	4,850
France	14,535
United Kingdom	12,015 to 22,095
United States	9,300 to 31,430
Canada	5,580

Countries which have Profit Share Plan Legislation which permits investment diversification: Canada, France, Germany, Netherland, U.K. and U.S.A.

France

Profit Share/Save Plans

Contributions are limited to 25% of remuneration (15% + 10%) with a limit of $3,750 for shares contributed by an employer. Funds may be directed towards other investments.

About 49.4% of these savings plans are invested in "collective portfolio of securities".

The employer obtains a tax deduction.

Benefits are not taxed if held within the ESOP for at least 5 years. There is no CGT on these benefits.

Total funds invested Ffr 70 billion - 1990 ($17.5 billion) of which Ffr 34.4 billion was in other savings (about $8.6 billion).

In respect of the tax free allowances, in Australia, a tax deductible contribution of $14,535 per annum would need to be made to give the same equivalent benefits on withdrawal from the ESOP.

Options

There are no limits on the number of options which may be issued. 10% discounts are tax free. Capital Gains Tax applies on the disposal of shares acquired but only where the gain is more than $76,750 in any year. The gain is further reduced by being divided by the number of completed years in the Plan - up to 5 years.

There is nothing so favourable in Australia to match this scheme.

United Kingdom

Profit Share/Save Plans

Contributions are limited with a base limit to all employees starting at $6,200 per annum. Contributions in excess of this must be no more than 10% of remuneration up to an upper limit of $16,500 per annum.

Contributions are tax deductible and can be structured to accommodate matching. Plans can be structured to accommodate other investments.

No income tax on disposal if shares are held in the Plan for 5 years. Capital Gains tax applies.

The first $11,400 of gain in any year is exempt from CGT.

In respect of the tax free allowances, in Australia tax deductible contributions ranging from $12,015 to $22,095 per annum would need to be made to provide the equivalent level of benefits on withdrawal from the ESOP.

Options

Savings Option Plans operate differently to traditional option plans. They allow employees to save towards the exercise payments over the option period of 5 to 8 years.

Options can be issued with a 20% discount.

Interest on the savings is tax free and the employer may make a tax deductible contribution at the end of the saving period to assist with share exercise payments.

No income tax for the employee on disposal and CGT applies with the $11,400 exemption outlined in Profit Share/Save Plans above.

U.K. also has P.E.P. schemes £3,500 p.a. may be invested in Personal Equity Plans. This means that each taxpayer may invest gross salary in shares on the London S.E. each year. The income is also concessionally treated because they have A.C.T. dividend franking.

U.K. Pension Plans are now widely offered to most employees. They are almost compulsory as most union awards require the Pension Plan contributions to be made.

Basic industry standard for a Pension Plan is

- Defined Benefit Structure — 5% employee - 10 - 15% employer
- 25 - 30 year membership
- 4 times final average salary — (last 3 years) = Benefit

Thus in approximately equivalent to Superannuation in Australia.

This is the U.K., employee benefits are:

- Superannuation — 10% - 15%
- Profit Share ESOP — £6,200 p.a. tax free
- P.E.P. — £3,500 p.a. tax free

Investment diversification is achieved through the Pension Plan which is then complimented by the P.E.P. Fund Managers provide P.E.P. investment services.

The U.K. system should be copied in Australia to create a future savings pool for Australia.

TAXATION REVENUE

There have been numerous studies conducted on the effects of taxation revenue which you are no doubt are aware of. Consultants such as "Access Economics" and studies by Dr. Vincent Fitzgerald have been reported in newspapers, and we can only rely on their studies to suggest that taxation revenues will increase as a result of ESPs. We unfortunately do not have the funds to commission our own enquiry, however the reality is:

1. Employees where they have the ability to access their savings will ultimately do so.

   The Employee Share Plans unlike superannuation should allow access, (within the restrictions as placed) to their savings, for purposes such as home extensions, school fees, holidays, or just meeting liability payments. If one assumes ESP investments will increase in value and therefore the base upon which the revenue is struck will increase and the marginal rates do not alter, it stands to reason that the revenue raised by treasury will increase.

2. The restrictions placed should have a maximum "Life" and again if the investment base increases then revenue to treasury will also increase.

3. Employees and employers do not stay together for ever. Employers will normally request and if allowed under the plan access their funds and withdraw them, ultimately paying a larger taxation revenue.

   Refer - Section on Suggested Regulatory Change.

TAXATION RORTS

There has been some commentary on the so called rorts associated with ESPs. The "sledge hammer" approach should not have been adopted but rules and regulations should have immediately introduced to "fence of" the potential abuses and achieve the ESP's full potential.

SUGGESTED REGULATORY CHANGE TO 26AAC

1. Shares should be offered to all employees, but should not be compulsorily acquired by employees. Only those employees who have a savings capacity and see it as part of their prudent financial plan should consider participation.

2. There should be a minimum period in which employees should not have to be prevented from disposing of their shares. We would suggest a minimum of four years.

3. A maximum investment period should be imposed, say a period of no more than 20 years.

4. Investments should only be allowed in Australian equites (including shares in SME's) or equity based managed funds or units in trusts. (The main justification for Employee Share Plans is to encourage investment in equities, be they equities of large corporations or of SME's.)

5. Income splitting should be prevented.

6. Subscription moneys invested should not be allowed to be <u>lent</u> back to employers, but should be allowed to be invested in the employer.

7. Employees should not be required to dispose of their shares on termination of employment. Indeed there should be portability of Employee Share Plans funds or "preservation" provisions. Ultimately we envisage Employee Share Plans will be made available to employees of many SME's and large corporations alike, and employees should be able to transfer or have portability of their funds from one employer to the next. We believe legislation should be introduced to allow this to occur.

8. All ESPs should have an audit and management regulation requirements. All Employee Share Plans, whatever the number of employees participating, should be audited on an annual basis and an information booklet should be provided to employees on the performance and status of their funds.

9. We believe there should be some commercial justification for the amount of funds that are subscribed on behalf of the employees. Funds should be allowed to be subscribed either as a salary sacrifice (as part of their remuneration package) or any bonus payment based on performance. The justification and commercial amount should be clarified by taxation rulings and we would suggest as a guideline that:

   (i) all bonuses should be allowed to be contributed to the Employee Share Plan.

   (ii) no more than 40% of the existing remuneration package should be allowed to be contributed to the ESP. Reality is that most employees would not be able to afford to contribute anything like 40% of their total employment cost to an ESP, because of the cost of living and their requirement to contribute to superannuation.

10. There should be guidelines as to where monies are allowed to be invested. We believe that ultimately, prudent investing is essential. Employees should be able to diversify their investments across the three sectors and employers, when establishing the ESP, should provide for this diversification. We believe that a percentage of the monies subscribed should be allowed to be invested back with the employer. We are suggesting that as a guideline, this investment be limited to no more than 33% of total investment funds. Of the balance, a further 33% should be invested in other growth investments and the remainder in liquid cash investments.

    It is essential for the ESP to maintain liquidity.

CONCLUSION

Quite apart from the potential role in boosting national savings, ESPs will play a significant role in lifting productivity and altering workplace relationships and attitudes. It would push along and cement the process of enterprise bargaining. If constructed properly the schemes can be tied to enterprise productivity and profitability or any measure of corporate performance that the employer and employee agree to implement. The major benefit provided by Employee Share Plans is that the control of the equity capital can rest and be utilised with financial prudence, with those who actually generate it. It provides capital to develop the businesses of SME's and increases employment which ultimately increases the standard of living in this country, and provides a sensible diversified investment for employees.

A tax ruling and/or legislation should be released to clarify what are acceptable arrangements for Employee Share Plans possibly with legislation to back up the position taken on the ruling. In any action the government takes, the value of Employer Share Plans to encourage equity investments must be recognised. Finally ESPs should be available to <u>all</u> employees.

THE KENNETHS GROUP - JOHN K. DAY

[NOT REPRODUCED]

APPENDIX A

AGE PROFILE AND PROJECTIONS

The types of family households in Australia are, in part, a reflection of the general profile of our population. In periods of high birth rates the number of families with dependent children will be high, but as the birth rate declines the proportion of couple-only and lone-person households tends to increase. Changes in the age profile of the population and consequent make-up of households have implications for family function, how families care for one another, and the need to provide services to support families.

Population profiles 1995 - 2041

Over the next 45 years the shape of the Australian population is expected to change markedly.

- The number of children aged 0-14 years will increase from 3.88 million children in 1995 to 4.0 million in 2000 and 4.3 million in 2041.

- This increase translates into a decline as a proportion of the total population from 21.5 per cent in 1995 to 17.3 per cent in 2041.

Ageing trends

One of the most significant trends for the future is the projected increase in size and proportion of the elderly population.

- The number of people aged 65 years and over is projected to increase from 2.15 million in 1995 to 5.48 million in 2041. This represents an increase in the proportion of the population from 12 per cent in 1995 to 22 per cent in 2041.

- The proportion of those aged 85 years and over is also expected to increase markedly from 1.1 per cent of the total population in 1995 to 3.5 per cent in 2041.

This aging of the population will have a number of significant implications.

- As the pool of elderly people increases, so will the pool of middle-aged carers decline (or at least the ratio of carers to careers).

- The costs of caring for a greater number of elderly people will place significant demands on public expenditure unless the elderly population is required to plan to cover a substantial proportion of its own costs.

- Since carers are typically women, the demands on middle-aged women can be expected to grow.

- As the elderly place more pressure on the public purse, there may be a backlash from younger generations against expenditure on the aged.

Dependency ratios

It is sometimes feared that, with extended periods of education for young people and increasing numbers of aged people in the population, there will be fewer participants in the paid workforce supporting greater numbers of people who are either too old or too young for labour force participation.

A concern for governments can be that this narrows the taxation base and increases the proportion of the population requiring some form of government support such as education, health or income support.

The *dependency ratio* is a way of looking at the age structure of populations. The overall dependency ratio represents the number of people aged less than 15 years and more than 65 years (the dependent age groups) as a proportion of the number of people of working age. This is expressed as the number of people in the dependent age groups per 100 people in the working age group.

Thus, the higher the ratio, the more people fall into the dependent age groups (under 15 or over 65 years) relative to those between these ages. For example, a dependency ratio fo 70 means that for every 100 people of working age there are 70 people in the dependent age groups.

There are two components to the dependency ratio: the aged dependency ratio (the elderly dependants) and the child dependency ratio (the young dependants).

Aged dependency ratio

the increased proportion of elderly people beyond the currently workforce age which will see the elderly becoming the majority dependency group, will bring increasing pressure to reduce the dependency of this age group. Under present policies the shift in the aged dependency ratio will mean a dramatic increase in the number of people not working for their income. This may mean an increase in the number and proportion of the population relying on government income support in the form of aged or other pensions.

One approach to this is to implement programs to ensure that people make financial provision for their older age (compulsory superannuation); another is to limit access to government support by assets and incomes testing and by increasing the age at which people are eligible for aged pensions; and a further approach is the abolition of compulsory retirement ages so that more elderly people can continue to earn an income.

The implication of the latter approach for the availability of jobs for young people remains to be seen. Likewise the rise in early retirement may well counterbalance any financial gain to the government by the abolition of the compulsory retirement age.

- From 1996 to 2041 there will be a steady rise in the proportion of people over the age of 65, resulting in a near doubling of the aged dependency ratio from 18.1 to 34.8.
- The rate of increase in the aged dependency ratio will increase most sharply after 2011, which is 65 years after the end of the Second World War and reflects the move of the ‘baby boomers’ into older age.

Child dependency ratio

Young people will move from being the majority of dependent people to a minority (because of population ageing). A relatively small decline in child dependency ratios is expected.

- Between 1996 and 2041 the child dependency ratio will decline from 32.1 to 28.8.

Combined dependency ratios till 2041

The dependency ratio is quite stable until 2011 then rises steadily. This increase is due entirely to the increase in the elderly population.

- Between 2011 and 2041 there will be a marked increase in the aged dependency ratio and a decline in the child dependency ratio.

The decline in child dependency ratios may partly offset increased demands for government resources caused by the increase in aged populations. However, the increase in the aged group is substantially more marked than the former. Furthermore, the costs associated with an increased ageing population are greater than the savings generated by reduced costs of children (mainly due to health care costs).

For governments, increased numbers of older people mean that there will be a shift from dependent population where expenditure might be justified in terms of future investment, to one where this justification will be less compelling. Whether the shift towards a dependent older population will have an impact on the willingness of governments and the working public to spend money on what some will view as welfare rather than investment remains to be seen.

- By he year 2041, for every 100 people of workforce age thee will be 36 elderly people and 29 child dependants.

- Overall, the dependency ratio will increase from 50.3 in 1995 to 63.6 in 2041, an increase of 26 per cent.

International comparisons

Overall dependency ratios in selected countries, 1995-2025

Country	**1995**	**2025**	**% increase**
Australia	*50*	*55*	*+10*
Canada	49	57	+16.3
China	51	46	-9.8
France	53	61	+15.1
Greece	49	61	+29.2
Hong Kong	41	59	+44.0
Indonesia	61	46	-24.6
Italy	45	58	+28.9
Japan	45	65	+44.4
Republic of Korea	40	47	+17.5
Malaysia	72	46	-36.1
New Zealand	52	55	+5.8
Papua and New Guinea	74	52	-29.7
Singapore	41	57	+39.0
Sweden	54	61	+13.0

United Kingdom	55	57	+3.6
United States	53	57	+7.5
Vietnam	72	46	-36.1

Souce: Adapted from United Nations (1993), *World Population Prospects 1992,* United Nations, New York

The above table shows the overall dependency ratios in selected countries. In a number of developing countries in our region (Vietnam, Papua and New Guinea, Malaysia, Indonesia and China), the dependency ratios are projected to decline while the dependency ratios of developed countries (Singapore, Hong King and Japan) are projected to increase.

The decline in dependency ratios reflects the high birth rate in recent decades and anticipated decline in population growth in these counties. This means that developing countries will have increasing numbers of people available for the labour force.

It remains to be seen, however, whether this will lead to increased competitiveness of these countries (through a capacity to keep wages low), lead to social problems related to unemployment, or provide governments with a workforce base that will enable an increase in the national standard of living. The dependency ratios of developed nations in the region may produce the revers pressures in these counties.

Several points stand out from comparisons:

- Dependency ratios across this range of countries will converge by the year 2025.
- The increase in Australia's dependency ratio is far less than that of many comparable countries, but is higher than the United Kingdom and United States.
- By the year 2025 Australia will have a dependency ratio that is in the mid-range internationally.

References: Australian Institute of Family Studies