

Australian Taxation Office

2 Constitution Ave Civic ACT 2601
PO Box 990 Civic Square ACT 2608

Telephone: (02) 6216 2858
Facsimile: (02)6216 1937

Inquiry into Employee Share Ownership in Australian Enterprises

I refer to the House of Representatives Standing Committee on Employment, Education and Workplace Relations.

At the public hearing on 10 June 1999 the ATO took on notice a question from Mr Baressi. A response is enclosed.

In addition, you sought additional information arising from the hearing in a letter dated 24 June 1999. Responses to this request are enclosed.

Should you require any further assistance in relation to this material please contact Julie Howe on (06) 62162858.

Yours sincerely

Michael DAscenzo Second Commissioner

encl.

House of Representatives Standing Committee on Employment, Education and Workplace Relations.

**Reference: Employee share ownership in Australia enterprises
Public hearing Thursday 10 June 1999.**

Mr Barresi asked a question on notice at page EEWR 28

Would you have a list somewhere in your files of those companies who have entered into employee share ownership schemes? I am not interested in the actual names of these companies, more in the type of industry that they represent and in the size of the industry. Can you give us a breakdown through your records?According to industry type and the number of companies out there, and perhaps the number of employees that would be covered by those schemes.

Answer:

- (1) Taxpayers are not required to seek approval or to notify the Australian Taxation Office (ATO) about proposed ESOP arrangements.
- (2) The ATO is not able to collect this information from current tax returns. However, the ATO records details on the Private Binding Rulings issued, at the request of taxpayers. Taxpayers are not obliged to carry out the arrangement that the tax ruling covers ie the fact that a ruling was obtained concerning an ESOP is not evidence that the ESOP was ever implemented or implemented as described in the ruling.

Such details for advanced opinions are not available.

Enclosed are statistics on the rulings by the ATO issued during the period 1.1.97 to 30.6.99. In examining the enclosure the following information will be of assistance:-

- Large Business & International services clients with turnover in excess of \$ 10 million
- Small Business services clients under the \$10 million turnover threshold
- Individual Non-Business services individuals who do not conduct a business
- These figures do not include the numbers of Private Binding Rulings that were applied for but subsequently withdrawn by the taxpayer.

PBR/ Case reports by BSL and Segments

1997

Business Line	No of Cases	% of Total
Large Business& International (LB&I)	16	73%
Small Business Income (SBI)	2	9%
Individual Non Business (INB)	4	18%
Total	22	100%

Segments in LB&I	No of Cases	% of Total in LB&I	% of Total
Mining & Petroleum	1	6%	5%
Manufacturing	4	25%	18%
Retail Trade & Business	2	13%	9%
Media & Communication	5	31%	23%
Insurance and Superannuation	0	0%	0%
Banking & Finance	1	6%	5%
Tourism & Recreational	3	19%	14%
Total	16	100%	73%

PBRI Case reports by BSL and Segments

1998

Business Line	No of Cases	% of Total
Large Business& International (LB&I)	38	78%
Small Business Income (SBI)	1	2%
Individual Non Business (INB)	10	20%
Total	49	100%

Segments in LB&I	No of Cases	% of Total in LB&I	% of Total
Mining & Petroleum	5	13%	10%
Manufacturing	16	42%	33%
Retail Trade & Business	3	8%	6%
Media & Communication	11	29%	22%
Insurance and Superannuation	2	5%	4%
Banking & Finance	1	3%	2%
Tourism & Recreational	0	0%	0%
Total	38	100%	78%

PBR /Case reports by BU and Segments

1999

Business Line	No of Cases	% of Total
Large Business& International (LB&I)	5	63%
Small Business Income (SBI)	1	13%
Individual Non Business (INB)	2	25%
Total	8	100%

Segments in LB&I	No of Cases	% of Total in LB&I	% of Total
Mining & Petroleum	2	40%	25%
Manufacturing	2	40%	25%
Retail Trade & Business	1	20%	13%
Media & Communication	0	0%	0%
Insurance and Superannuation	0	0%	0%
Banking & Finance	0	0%	0%
Tourism & Recreational	0	0%	0%
Total	5	100%	63%

PBR/ Case reports by BSL and Segments

Total (01/01/1997-30/6/1999)

Business Line	No of Cases	% of Total
Large Business& International (LB&I)	5938	75%
Small Business Income (SBI)	4	5%
Individual Non Business (INB)	16	20%
Total	79	100%

Segments in LB&I	No of Cases	% of Total in LB&I	% of Total
Mining & Petroleum	8	14%	10%
Manufacturing	22	37%	28%
Retail Trade & Business	6	10%	8%
Media & Communication	16	27%	20%
Insurance and Superannuation	2	3%	3%
Banking & Finance	2	3%	3%
Tourism & Recreational	3	5%	4%
Total	59	100%	75%

TRUSTS

- (2) The Tax Commissioner released a fringe benefits tax ruling some weeks ago. In so far as it relates to the use of trusts by ESOPs, would you provide a brief summary of the ruling?

Answer

The Ruling does not apply to trusts, the sole purpose of which, is to acquire shares in the employer company.

Where the sole activities of the trust are obtaining shares or rights to acquire shares in the employer company, then the provision of money or other property to the trust does not constitute a fringe benefit. [see: the definition of "fringe benefit" in section 136 of the *Fringe Benefits Tax Assessment Act* 1986 paragraph (hb)].

TAX RULINGS

(1) In March 1999 the Tax Commissioner announced he had put a freeze on 'private binding rulings and advance opinions' related to ESOPs.

(a) What is the status of that freeze?

(b) What is the effect of this on the implementation of ESOPs?

Answer:

(a) The embargo was announced by the issue of a media release 99/12 on 26 March 1999. The media release 99/16 on 19 May 1999 ended the embargo as the ATO had completed its review and published its position. To ensure consistency of treatment and correctness of the advice given to taxpayers the ATO has put in place a centralised quality assurance process for processing these rulings.

(b) The media release of 26 March 1999 made reference to employee benefit schemes, controlling interest arrangements, offshore and non-complying superannuation funds. On the same day an ATO internal minute to staff indicated that only employee share arrangements that involved the use of special purposes companies were subject to the embargo. There were six known arrangements that fell into this "special purpose company" category. To ensure that no ruling requests for acceptable employee share arrangements were delayed a clearance process was instituted allowing staff to issue rulings not intended to be covered by the ruling.

As the ATO does not process large numbers of rulings for ESOPs the effect on implementation of acceptable arrangements would have been minimal.

DIVISION 13A OF THE INCOME TAX ASSESSMENT ACT

(3) Does Division 13A disadvantage unlisted companies wanting to implement ESOPs?

The Committee has received evidence indicating that the tax treatment of unlisted and listed companies' ESOPs differs. This seems, in part, to stem from the meaning of the term 'ordinary share'. How does the ATO define 'ordinary share'?

(4) Is piggy backing of non-qualifying plans a common occurrence and do companies and individuals derive the same tax benefits as for qualifying schemes?

Answer:

(3) The *Income Tax Assessment Act* (ITAA) does not define the term ordinary share. The term takes its ordinary meaning.

The reason that Division 13A of the ITAA only provides concessions for the provision of ordinary shares (rather than other types of shares) is that the rights contained in an ordinary share give an employee some basic guarantees concerning what is being provided by the employer. In particular, an ordinary share means that the

employee has a right to vote in the affairs of the employer. One of the primary purposes of Division 13A is to strengthen employee participation in Australian businesses (in particular, their own employer's business), with the aim of achieving increased employee productivity.

If the shares' voting rights are removed or reduced, or other share rights are removed, then the share becomes little more than a disguised salary sacrifice pay rise.

(4) The ATO does not have any information on whether the piggy backing of non-qualifying plans is common as employers are not required to advise the ATO when they commence an employee share scheme.

Taxpayers receiving non-qualifying shares or rights do not receive any concessional tax treatment. The benefit they receive from obtaining discounted shares or rights is taxed in the year in which those shares or rights are acquired.

Taxpayers in receipt of qualifying shares or rights can receive the following concessional tax treatment:

- they can defer from assessable income for up to 10 years any benefit they receive from obtaining discounted shares or rights; or
- they can elect that the discount be included in their assessable income in the year of acquisition of the shares or rights and, if they meet certain exemption conditions, the first \$1,000 of the discount is excluded from their assessable income.

Further, companies providing qualifying shares or rights that satisfy the exemption conditions will be entitled to a deduction of up to \$ 1,000 per employee per year for the cost of providing the shares or rights. No such deduction is available under the employee share scheme provisions to companies that provide non-qualifying shares or rights to employees.

EMPLOYEE BEHAVIOUR

(5) Based on the ATO's own intelligence and/or its processing of income tax returns, are you able to say if ESOPs are helping to shift employees' views about their remuneration towards a longer term view?

- Is there a trend, for example, for executives to sell ESOP shares immediately after the exercise of options?
- If executives tend to sell their ESOP shares immediately, is this usually caused by the need to pay their tax liability?

(6) The Committee has received evidence that some ESOPs fail to achieve a reasonable level of employee participation because employers fail to communicate with, or educate, their employees about share ownership obligations. Are you able to make any comments about the level of employees' understanding of shares based on knowledge gained from tax return processing.

Answer:

(5) The ATO does not collect information on ESOPs in its tax return processing. No research has been undertaken on this area.

- The ATO has no data on whether executives are selling shares immediately after the exercise of the option.

- The ATO has no data in relation to this question.
- (6) The ATO does not collect information on ESOPs in its tax return processing and has no information in relation to this matter.

IMPEDIMENTS CAUSED BY CLASH OF LEGISLATION

- (7) Would you comment on how well the Corporations legislation interacts with the tax acts as far as ESOPs are concerned?

Answer

Share capital provisions

- The share capital rules in the Corporations Law include a number of provisions designed to facilitate employee share schemes. In particular, a company is able to:
 - follow a simpler procedure for buying back shares issued under an employee share scheme. The buy-back scheme must be approved by the company in a general meeting, and generally only requires lodgment of a notice that the company intends to carry out the buy-back with the Australian Securities and Investments Commission (ASIC) at least 14 days before the agreement is entered into;
 - take a security over shares issued under a company employee share scheme approved by the company, its listed Australian holding company, if applicable, and, if there is no such holding company, the ultimate holding company where it is incorporated or formed in Australia. The company would also be able to acquire its own shares for a period of 12 months, which may be extended by ASIC;
 - give financial assistance for the acquisition of its shares under an employee share scheme approved as above - this special exemption allows approval by ordinary resolution rather than special resolution and there are no specific disclosure requirements in addition to those ordinarily involved in calling the meeting and proposing a resolution.
- The concept of 'employee share scheme' was broadened on 1 July 1998 to give companies increased flexibility in structuring their share schemes. That is, the definition was amended to include acquisitions of shares by a corporation all of whose members are employees of, or directors holding salaried employment or office (ie executive directors) in, the company or a related body corporate. It also continues to apply to acquisitions by or on behalf of employees or executive directors of the company or a related body corporate.

Fundraising

- Currently, employee share ownership plans (ESOPs) may be subject to the fundraising provisions of the Corporations Law. Typically this would require the preparation of a prospectus where shares, or options over shares, are offered to employees.
- ASIC has a policy of providing relief from the fundraising provisions where ESOPs meet certain conditions. The relief is targeted to small-scale offers of shares where the primary aim of the offer is not capital raising, but to foster the relationship between the company and its employees. To ensure that employees receive appropriate disclosure, the relief is currently only available to listed companies.

The Corporate Law Economic Reform Program Bill 1998, currently before the Parliament, will reform the fundraising provisions of the Corporations Law. The reforms are designed to minimise the costs of fundraising while improving investor protection. In framing the Bill, it was considered that specific exemptions for ESOPs were not appropriate because of the large variation in the types of ESOPs currently being used.

Instead, the Bill will facilitate ESOPs as follows:

A range of reforms are designed to facilitate fundraising by small to medium sized entities. It is anticipated that these reforms will provide an avenue for smaller entities to offer shares under ESOPs. In particular, smaller entities will be able to raise up to \$2 million each year from up to 20 investors without preparing a prospectus. Smaller entities will also be able to raise up to \$5 million based on an offer information statement. It is anticipated that preparing an offer information statement will be less costly than preparing a prospectus.

ASIC will continue to have the power to exempt companies from the fundraising provisions where appropriate. It is envisaged that ASIC's current relief for ESOPs will continue under this power.

The cost of ESOPs will also be reduced by the implementation of the other fundraising reforms. These include facilitating the use of short-form prospectuses and shorter profile statements, and rationalising the current liability rules.

Additional information requested by the House of Representatives Standing Committee on Employment, Education and Workplace Relations.