Chapter 4

Employee share schemes in Australia and overseas

Employee share schemes in Australia

4.1 In Australia, employee share schemes have operated since the 1950s and under legislation since 1974.[1] A number of submitters noted that employee ownership is 'still at an early developmental stage' in Australia, in comparison to the United States, United Kingdom, France and Japan where they are a 'significant workplace phenomenon'.[2] According to Dr Klaas Woldring, Australia 'is well and truly behind' by 20–30 years.[3]

4.2 A study found that a number of leading Australian corporations understand the importance of the employee share schemes for productivity.[4] Employee share schemes can bring advantages to Australia's economy if they 'can be transformed into broad based medium term savings vehicles' instead of treating them as risk-based remuneration schemes. Employee share schemes are also said to save jobs through capital investment, improving productivity, facilitating strategic change and cost effectively remunerating staff.[5] However, a submission suggested that legislators are seen to underestimate and often 'completely' misunderstand 'the scale, strategic application and importance of the employee share schemes'.[6] Employee share schemes are said to enjoy and have enjoyed bipartisan support.[7]

4.3 The Remuneration Strategies Group noted that Australia should not miss any further opportunities to develop employee ownership policies because 'Given looming demographic pressure, any future failure to promote commitment and productivity in the workplace will have a serious effect on this nation's prosperity and the distribution

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1 House of Representatives Standing Committee on Employment, Education and Workplace Relations, *Shared Endeavours—An Inquiry into Employee Share Ownership in Australia*, 2000, p. 9.

2 Australian Employee Ownership Association, *Submission 4*, p. 2.

3 Klaas Woldring, *Submission 2*, p. 2.

4 David Hetherington, 'Employee Share Ownership and the Progressive Economic Agenda', Per Capita, 2009, p. 8.

5 Australian Employee Ownership Association, *Submission 4*, pp. 3, 6.

6 CRA Plan Managers, *Submission 8*, pp. 2–3.

7 See for example House of Representatives Standing Committee on Employment, Education and Workplace Relations, *Shared Endeavours—An Inquiry into Employee Share Ownership in Australia* (2000), paragraph 2.16; Jarrod Lenne, Richard Mitchell and Ian Ramsay, *Employee Share Ownership Schemes in Australia: A Survey of Key Issues and Themes*, University of Melbourne, 2005, p. 10.

of that prosperity'.[8] The Australian Employee Ownership Association recommended the establishment of an Employee Share Plan Promotional Unit to develop model or off-the-shelf plans for employers and employees.[9] Mr Fauvet thought a unit would help 'very definitely' and mentioned that they are in existence overseas, for example in the UK, where there is 'a whole unit dealing with share schemes' providing model plans etc.[10]

Committee view

4.4 Having heard the evidence to this inquiry, the committee sees benefit in promoting employee share schemes in Australia and supports the Australian Employee Ownership Association proposal of a promotional unit to encourage further uptake of employee share schemes.

Data

4.5 Evidence to the inquiry was clear about the lack of current 'comprehensive information on the number, nature and extent' of employee share schemes in Australia. In the early 2000s, there was an Employee Share Ownership Development Unit (ESODU) in the then-Department of Employment and Workplace Relations, collecting data on the prevalence of employee share schemes, but it was disbanded in the mid-2000s. The Australian Bureau of Statistics (ABS) or bodies such as the ATO or ASIC, despite their 'significant regulatory responsibilities in the area', do not collect data.[11] This has contributed to the near lack of:

> …understanding of how businesses in Australia are structuring their employee share ownership plans and how, if at all, they are integrating employee share ownership into their broader human resource management strategies.[12]

4.6 The lack of data also makes it 'difficult to identify whether the tax rules operate to encourage or discourage employee share ownership'.[13]

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8 Remuneration Strategies Group, *Submission 29*, p. 20.

9 Australian Employee Ownership Association, *Submission 4*, p. 6.

10 John Fauvet, *Proof Committee Hansard*, 27 July 2009, p. 42.

11 Ann O'Connell, 'Employee share ownership plans in Australia: The taxation law framework', Research Report, Employee Share Ownership Project, University of Melbourne, March 2007, pp. 17–18.

12 Ingrid Landau, Richard Mitchell, Ann O'Connell and Ian Ramsay, 'An overview of existing data on employee share ownership in Australia', Employee Share Ownership Project, University of Melbourne, March 2007, p. 11.

13 Ann O'Connell, 'Employee share ownership plans in Australia: The taxation law framework', Research Report, Employee Share Ownership Project, University of Melbourne, March 2007, pp. 17–18.

4.7 Previously collected data and surveys conducted by various organisations and companies are available but the information is hard to compare because of the lack of standardisation. However, findings indicate that there is 'significant diversity' regarding the type and nature of employee contribution and the conditions that must be satisfied.[14] Employee share schemes appear to be more likely in large and publicly listed companies and companies with overseas offices and among full-time employees and those with higher weekly earnings.[15] An ASX survey found that only nine per cent of the surveyed adult shareholders had obtained their shares through employee share schemes.[16]

4.8 A University of Melbourne study on Australian listed companies revealed that more than half (57 per cent) of the companies that responded to the survey 'had at least one broad-based' employee share scheme. Broad-based schemes are more common than narrow-based schemes and are structured to take advantage of the $1,000 tax exemption. The most common type of equity was options (48.7 per cent), closely followed by shares (46.7 per cent), and require a financial contribution from the employee to participate.[17]

4.9 Executive equity schemes have grown in importance in Australia particularly over the past decade and are 'a key strategic remuneration tool' linked to company performance. According to a 2008 Hay Group survey, overall, 46 per cent of senior executive and 31 per cent of chief executive officer incentive pay were subject to performance requirements.[18] Mr Hetherington argued that 'the benefits of Australia's 15-year economic boom have flowed disproportionately to investors (owners of capital) rather than workers (owners of labour)', a situation which employee share schemes could alter by offering employees access to returns on corporate profits.[19]

4.10 Remuneration Strategies Group noted that in 2002, 'a very high proportion', estimated to be around 90 percent, of Australian listed companies had an employee share scheme, including some executive-only plans. Only about 0.9 per cent of unlisted companies offered employee share schemes, as opposed to 90 per cent of both listed and unlisted US companies. The value of Australia's schemes was estimated to

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14 Ann O'Connell, 'Employee share ownership plans in Australia: The taxation law framework', Research Report, Employee Share Ownership Project, University of Melbourne, March 2007, pp. 17–18.

15 Ingrid Landau, Richard Mitchell, Ann O'Connell and Ian Ramsay, 'An overview of existing data on employee share ownership in Australia', March 2007, p. 11.

16 ASX, 2008 Australian Share Ownership Study, p. 19.

17 Ingrid Landau, Richard Mitchell, Ann O'Connell, Ian Ramsay and Shelley Marshall, 'Broad-based employee share ownership in Australian listed companies: Survey report', Employee Share Ownership Project, University of Melbourne, April 2009, pp.1– 2.

18 Hay Group, *Submission 15*, p. 4.

19 David Hetherington, 'Employee Share Ownership and the Progressive Economic Agenda', Per Capita, 2009, p. 9.

be between $3 billion and $4 billion, with about $1.5 billion in executive schemes. A 'significant' proportion of the total comes from a small number of very large firms.[20]

4.11 According to the 2004 ABS and the Employee Share Ownership Development Unit (ESODU) survey, 10 per cent of Australian businesses had some form of employee share scheme. Of nearly half a million employees in these businesses, 5.9 per cent held shares as a form of employment benefit. Manufacturing industry had the highest employee share scheme incidence (22 per cent), followed by finance and insurance (19 per cent) and communication services (15 per cent). Employee share schemes were least likely in the retail industry (14 per cent).[21]

4.12 According to a more recent CRA Plan Managers survey, 46 of the top 250 listed public companies issued securities under an employee share scheme in June 2008, with the gross value of $162 million.[22]

4.13 Remuneration Strategies Group expressed concern that there is 'conflicting and limited data regarding the implementation' of employee share schemes and 'no comprehensive (accurate) survey of the incidences' of the various scheme types by business type in Australia.[23] CRA Plan Managers submitted that 'detailed and properly funded research into the benefits of employee equity participation in Australian should be a mandatory precursor to any change'.[24]

Committee view

4.14 The committee notes the comments regarding the lack of recent data on employee share schemes in Australia. It acknowledges the University of Melbourne's project on employee share schemes and other surveys conducted by private enterprises to collect data. Considering that the latest survey by a government agency was conducted in 2004 and that there has apparently been an increase in the uptake of the schemes since, the committee recommends that a new survey be undertaken to establish the occurrence of employee share schemes in Australia. The committee hopes that the survey standardises the terminology relating to the various scheme types.

Recommendation 1

4.15 The committee recommends that in consultation with but not limited to employee share ownership groups, unions and academics, the Australian Bureau

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20 Remuneration Strategies Group, *Submission 29*, p. 31.

21 Ingrid Landau, Richard Mitchell, Ann O'Connell and Ian Ramsay, 'An overview of existing data on employee share ownership in Australia', Employee Share Ownership Project, University of Melbourne, March 2007, pp. 1, 4.

22 CRA Plan Managers, *Submission 8*, pp. 2–3.

23 Remuneration Strategies Group, *Submission 29*, p. 30.

24 CRA Plan Managers, *Submission 8*, p. 7.

of Statistics conduct a survey of employee share schemes in Australia every five years, starting at the end of the 2009–10 financial year. The survey should collect data on, but not limited to, the following:

- **number and type of employee share schemes;**
- **number, size and industry of companies offering these schemes;**
- **number of employees and equity held by them;**
- **breakdown of employees by occupation, educational level and wage;**
- **reasons for offering (employers) and participating (employees) in the scheme;**
- **perceived effects and effectiveness of the schemes for both employers and employees;**
- **perceived barriers in the take-up of the schemes; and**
- **breakdown of general employee (broad-based) versus executive (narrow) schemes in terms of the number of shares offered; number of participants and equity held.**

Expanding take-up of employee share schemes

4.16 Evidence to the inquiry seems to agree that there is room for further uptake of employee share schemes in Australia. However, according to the Australian Institute of Company Directors (AICD), the Government's proposal 'still does not adequately recognise the fundamental imperative to promote *ongoing* share ownership'.[25]

4.17 The Institute of Chartered Accountants observed that a decade ago, the Government 'was actively encouraging Australian companies' to set up employee share schemes, with funding available to government agencies to actively promote them. This should be revisited to encourage the take-up of share schemes and would require tax rules that do not 'unduly jeopardise' or serve as a disincentive for employees.[26]

Impediments

4.18 Several impediments were identified in the evidence to the inquiry. They include prospectus requirements, several pieces of legislation, public awareness and perceptions.[27] According to a number of witnesses, the governance framework—the standards and best practice reward structures—should enhance the alignment of the long-term interests of employer, employees and shareholders.[28] Some witnesses also

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25 Australian Institute of Company Directors, *Submission 12*, p. 1.

26 Yasser El-Ansary, *Proof Committee Hansard*, 27 July 2009, pp. 40–41.

27 Australian Employee Ownership Association, *Submission 4*, p. 2.

28 Yasser El-Ansary, *Proof Committee Hansard*, 27 July 2009, pp. 40–41; see also Ann O'Connell, *Proof Committee Hansard*, 27 July 2009, p. 49.

argued that the tax system should provide greater concessionality to enhance employee share ownership.[29]

Solutions

4.19 Mr David Hetherington proposed linking share ownership schemes to superannuation. This would involve employees being 'entitled to take up to one fifth of their Superannuation Guarantee Contribution (SGC) in employee share allocations where employers offer such plans'. This arrangement should receive the same tax treatment as the SGC and the employee should be entitled to 'liquidate the shares after 10 years, rather than waiting until retirement'.[30] Mr Price observed that through applying capital gains tax on gains or through a rollover to superannuation, holding shares or other entitlements after their vesting could 'be considered as a form of adding to national saving'.[31]

4.20 Following international examples, tax deductions could be provided for the employer company to equal the value of rights and options provided to an employee, with a cap of, for example, $10,000 per year per employee.[32]

Committee view

4.21 The committee notes the impediments and solutions above regarding increasing the take-up of employee share schemes in Australia. It believes that there is merit in further examining these options and urges the Government to take note of these comments and adjust the legislation and policy accordingly. It considers that using schemes as an alternative form of retirement savings merits further examination, considering the increasing number of retirees in Australia. The committee notes that legislation should have in-built safeguards to ensure the spread of risk.

Comparison of Australian and overseas schemes

4.22 Overseas, employee share schemes are 'a significant workplace phenomenon', particularly in the United States, Great Britain, France and Japan.[33] Details regarding the schemes in the US and the UK are in Appendix 3.

4.23 Similarly to the current situation in Australia, international comparisons of employee share schemes are difficult with little data available and studies not

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29 John Fauvet, *Proof Committee Hansard*, 27 July 2009, p. 41.

30 David Hetherington, 'Employee Share Ownership and the Progressive Economic Agenda', Per Capita, 2009, p. 20.

31 Geoff Price, *Proof Committee Hansard*, 27 July 2009, p. 79.

32 David Hetherington, 'Employee Share Ownership and the Progressive Economic Agenda', Per Capita, 2009, pp. 20–21.

33 Australian Employee Ownership Association, *Submission 4*, p. 3.

standardised.[34] However, evidence to the inquiry identified certain differences or similarities between Australian and overseas schemes.

4.24 The available data appear to suggest that while the incidence of schemes in Australia is lower than that in the US or Europe, it is on the increase.[35] Overseas, it is usual for companies to have three to five different plans at the same time to meet different remuneration objectives and directed at different levels of the organisation. In Australia, it is common for employers to have two plans (tax-exempted and deferred) for the staff.[36]

4.25 As opposed to the US and the UK where 'tax structure favour [employee share schemes] over ordinary equity investments', in Australia investments in the share market are favoured over the employee share schemes despite their 'wider economic benefits'. Mr Hetherington called for share schemes to 'incentivise investment in employee-owned companies'.[37]

4.26 Australia's tax rules appear to be more complex than those in most other countries.[38] This is said to discourage or at least not encourage employee share schemes. Ms Sarah Bernhardt, Tax Adviser to Rio Tinto Limited, noted that in the UK, taxing of the options at exercise attracts a capital gains tax treatment which is 'deliberately offered as an incentive' to encourage people to participate in the plan. In comparison, she noted that in Australia, employees are taxed 'on exercise on everything they made' at their income rate, which left UK participants 'in a much better position than the Australian participants'.[39]

4.27 The main difference between Australian and US schemes is that in Australia schemes are limited to listed companies, whereas in the US 'the overwhelming majority—according to some estimates, 90 per cent'—are unlisted businesses.[40]

4.28 A comparison of six schemes in terms of returns to employees and impact on government tax receipts and implications found that returns to employees in the UK and US were far higher than in Australia (approximately 10 per cent versus Australia's 5 per cent). In the UK and US schemes, tax exemptions and government co-contributions offset most of the taxes upon disposal whereas Australian schemes

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34 Ingrid Landau, Richard Mitchell, Ann O'Connell and Ian Ramsay, 'An overview of existing data on employee share ownership in Australia', March 2007, p. 9.

35 Ingrid Landau, Richard Mitchell, Ann O'Connell and Ian Ramsay, 'An overview of existing data on employee share ownership in Australia', March 2007, p. 11.

36 Geoff Price, *Proof Committee Hansard*, 27 July 2009, p. 79.

37 David Hetherington, 'Employee Share Ownership and the Progressive Economic Agenda', Per Capita, 2009, p. 4.

38 Martin Morrow, *Proof Committee Hansard*, 27 July 2009, p. 71.

39 Sarah Bernhardt, *Proof Committee Hansard*, 27 July 2009, p. 21.

40 Australian Employee Ownership Association, *Submission 4*, p. 4.

suffer from the 'effective doubling of the tax rate on capital gains in the tax-deferred scheme'.[41] The study argued that the Australian tax-deferred scheme is 'deeply unattractive' because 'the entire capital gain is taxable at the employee's marginal income tax rate' rather than 50% of the gain being taxable (capital gains tax), and saw 'no obvious economic rationale' for this. Thus, Australian schemes 'deliver the highest tax receipts to government' due to higher tax rates and lower tax discounts than in the US and the UK. The 'strong correlation between returns enjoyed by employees and tax forgone by government' suggests that in order to advance uptake of employee share schemes, the government should forgo some of the tax revenue as employees join these schemes for superior returns which rely on tax concessions.[42] The Treasury noted that most of the countries that Australia would compare itself to have arrangements for tax concessionality.[43]

41 David Hetherington, 'Employee Share Ownership and the Progressive Economic Agenda', Per Capita, 2009, p. 16. The six plans were tax-exempt and tax-deferred schemes in Australia, Share Incentive Plan (SIP) and Save as You Earn Scheme (SAYE) in the UK and Employee Share Ownership Plan (ESOP) and 423 Plan in the US.

42 David Hetherington, 'Employee Share Ownership and the Progressive Economic Agenda', Per Capita, 2009, pp. 17–19.

43 Michael Willcock, *Proof Committee Hansard*, 27 July 2009, p. 3.