Chapter 3

Employee share schemes

Background

3.1 Some employers believe staff will be more motivated if they are also shareholders in the company and offer schemes to encourage this. This argument seems most applicable to a small business. An individual employee of a large company would own such a minute share of the company and their contribution to the company's total profits is so small it is hard to see how it could be much of a motivator. But the impact of a 'cultural change' can not be entirely dismissed.

3.2 Empirical evidence on whether such schemes do better align employer and employee interests, and significantly increase productivity, is mixed.[1] In Australia:

> A thorough examination of …employee share plans and their effect, if any, on productivity in Australia has not been undertaken. In fact, very little of a substantive nature is known about employee share plans in Australia at all.[2]

3.3 In the United States, where they have been most intensively studied:

> A comprehensive study on employee share ownership was conducted by the US General Accounting Office in 1986. Its report was based on a survey of 4,174 plans covering more than seven million employees. It demonstrates well the equivocal nature of the evidence concerning the efficacy of employee share plans.[3]

3.4 There are also concerns that employees already rely on the firm for their regular salary and having more of their wealth tied up in that company leaves them excessively exposed and they would be better off holding a more diversified share portfolio.

3.5 Amendments to the *Income Tax Assessment Act* in 1974 aimed to encourage employees to own shares in the company in which they worked. This policy enjoyed cross-party support, at least until concerns were raised that top executives may have been manipulating the provisions as part of aggressive tax planning.[4]

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1 It is even more doubtful when the employee receives options rather than shares as options increase in value as the firm's revenue becomes more volatile.

2 House of Representatives Standing Committee on Employment, Education and Workplace Relations, *Shared Endeavours – Inquiry into Employee Share Ownership in Australian Enterprises*, September 2000, pp 41–2.

3 *Shared Endeavours*, p. 43.

4 *Shared Endeavours*, Chapter 2.

Election mechanism

3.6 A common means of encouraging employees to hold shares in the firm is to offer them shares at a discount from the market price. This discount is assessable income for tax. An employee can choose to be either taxed in the year the shares are acquired or at a later 'cessation' time.[5]

3.7 Schedule 1 of the bill amends the *Income Tax Assessment Act 1936* so that an employee wishing to be assessed on discounts on shares received in the year of acquisition must make the election in the year in which they are acquired.

3.8 Some tax experts argue that the proposed changes to taxing of employee share schemes will have no effect:

> We are all surprised about the announcement because it's nothing more than what the current law is.[6]

3.9 Asked about this, Treasury replied:

> The essence of the change in relation to employee share schemes is just to give certainty to the application of the law.[7]

3.10 The measure is projected to raise around $20 million a year.[8]

Removal of double taxation

3.11 Schedule 1 of the bill also amends the *Income Tax Assessment Act 1997* to ensure a trustee or beneficiary of an employee share trust is not subject to capital gains tax where an employee who exercises employee share scheme rights becomes absolutely entitled to the shares in the trust. This measure is not expected to affect revenue. The measure is relatively uncontroversial with the only reference to it in submissions being a request for an earlier application date.[9]

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5 The *Explanatory Memorandum* (p. 18) explains that 'cessation time' occurs at the earliest of:

- when restrictions on sale are lifted;
- an employee sells the shares;
- employment ceases; or
- ten years after the shares were acquired.

6 Mr Martin Morrow, KPMG, quoted in *Australian Financial Review*, 15 May 2008, p. 12.

7 Mr Tony Coles, Treasury, *Proof Committee Hansard*, 20 June 2008, p. 8.

8 The *Explanatory Memorandum*, p. 4, estimates the revenue impact as $77 million over four years.

9 Corporate Tax Association, *Submission 5*.