

EMPLOYEE SHARE SCHEMES: REGULATION AND POLICY

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I INTRODUCTION

Through employee share schemes, employees have the opportunity to take up equity in the company for which they work. There are two distinct types of employee share schemes: 'broad-based' schemes that are open to the majority of employees within a company, and 'narrow-based' schemes that are only open to executive employees. Broad-based schemes - the focus of this article - are an increasingly common and economically significant feature of the Australian corporate landscape. At the federal level, they have been the focus of intermittent public policy interest. Most recently, as part of the 2009-10 Budget, the Treasurer announced significant changes to the taxation of these schemes.¹ This announcement was met with outcry from a range of stakeholders and the Government was quick to concede that its proposals may have had the unintended consequence of discouraging the growth of broad-based employee share ownership in Australia. After a series of consultative measures, the Government substantially revised its reforms. Employee share schemes were also recently the focus of a Senate Economic References Committee inquiry - the second parliamentary inquiry into the subject in a decade.²

Although broad-based employee share schemes have long enjoyed bipartisan political support, key issues surrounding their regulation continue to be contested. This paper identifies and discusses a number of these important policy issues, with particular

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¹ Australian Government, 'Tax Reform' in 'Statement 1: Budget Overview', *Budget Paper No 1—Budget Strategy and Outlook 2009-10*, Commonwealth of Australia, Canberra, 2009.

² Senate Economic References Committee, Parliament of Australia, *Employee Share Schemes* (2009); House of Representatives Standing Committee on Employment, Education and Workplace Relations. Parliament of Australia, *Shared Endeavours: Inquiry into Employee Share Ownership in Australia* (2000). The *Shared Endeavours* inquiry was chaired by Dr Brendan Nelson.

reference to the recent major taxation reforms. Part II of the paper provides background by briefly outlining current evidence on broad-based employee share schemes in Australia. In Part III, the authors explain the extent to which these schemes have received support from Australia's two major political parties. Part IV briefly outlines how these schemes are regulated under Australian law. In Part V, the authors discuss a number of important public policy issues which recur intermittently in public debates on employee share schemes. We conclude in Part VI by observing that although all political parties support the notion of employee ownership, the political will to support this with taxation concessions is tempered by the view that employee share schemes present the potential for abuse.

II EMPLOYEE SHARE SCHEMES IN AUSTRALIA

The precise incidence, nature and economic value of employee share schemes in Australia remains unclear. The limited evidence available suggests that these schemes are increasingly prevalent and significant to the Australian economy.³ A study commissioned by the Commonwealth Department of Employment and Workplace Relations in 2004 found that around ten percent of Australian businesses had some form of employee share ownership.⁴ Four percent of businesses surveyed had a 'broad-based' employee share scheme, defined in the study as one open to at least 75 percent of employees. Data from the Australian Bureau of Statistics (ABS) indicates that increasing numbers of employees are participating in employee share schemes: while in 1979, around 1.3 percent of employees received shares as a form of employment benefit, this had risen to 5.9 percent of employees by 2004.⁵

³ For a more detailed review of available data on the incidence and nature of employee share schemes in Australia, see Ingrid Landau, Richard Mitchell, Ann O'Connell and Ian Ramsay, 'Employee Share Ownership in Australia: Theory, Evidence, Current Practice and Regulation' (2007) 25 *UCLA Pacific Basin Law Journal* 25; and Economic References Committee, Parliament of Australia, *Employee Share Schemes*, August 2009, [4.1] – [4.13].

⁴ TNS Social Research, 'Employee Share Ownership: Executive Summary' (Research report commissioned by the Department of Employment and Workplace Relations, 2004).

⁵ Australian Bureau of Statistics, *Spotlight: Employee Share Schemes*, Australian Labour Market Statistics Cat. No. 6105.0, July 2005.

Further insight into the extent and nature of broad-based employee share ownership in Australia, particularly in larger companies, can be gained from a study conducted by into employee share scheme practice in companies listed on the Australian Securities Exchange.⁶ This study found that 57 percent of respondent companies operated at least one broad-based employee share scheme. Significantly more companies reported having a broad-based plan than a narrow-based plan: that is a plan only open to executives. The study also found that broad-based employee share ownership is a recent phenomenon, with over three quarters of those companies with a scheme having adopted it since 2000. The most common type of broad-based scheme offered was the plan structured to take advantage of the \$1,000 tax exemption available through (former) Division 13A of the *Income Tax Assessment Act 1936* (see further below). The most common type of equity offered under broad-based employee share schemes was options (around 49 percent of plans), followed closely by shares (around 47 percent of plans).

III EMPLOYEE SHARE SCHEMES IN AUSTRALIAN FEDERAL POLITICS

At a federal level in Australia, broad based employee share ownership has traditionally enjoyed bipartisan political support. The former Coalition Government (1996 – 2007) expressed strong interest in the promotion of broad-based employee share ownership. In 1999, the then Minister for Employment, Workplace Relations and Small Business, Peter Reith, directed the House of Representatives Standing Committee on Employment, Education and Workplace Relations to inquire into the extent to which employee share ownership schemes have been established in Australian enterprises and the resultant effects on workplace relations and productivity in enterprises and the economy. The Inquiry (entitled *Shared Endeavours*) produced two reports in 2000: a Majority Report and a Dissenting Report from the Labor committee members.⁷ Both reports were in favour of the promotion of broad-based employee share ownership in Australia. The Majority Report made forty-five recommendations directed at legislative and institutional reforms that would facilitate the practice. While the former Coalition Government

⁶ Ingrid Landau, Richard Mitchell, Ann O’Connell, Ian Ramsay and Shelley Marshall, ‘Broad-based Employee Share Ownership in Australian Listed Companies: An Empirical Analysis’ (2009) 37 *Australian Business Law Review* 412.

⁷ *Shared Endeavours*, above n 2.

rejected the overwhelming majority of the Committee's recommendations, it proceeded to establish a promotional Employee Share Ownership Development Unit within the Commonwealth Government's Department of Employment and Workplace Relations in 2003.⁸ In addition, in 2004, the Minister for Employment and Workplace Relations announced a target of doubling employee share ownership plans in workplaces from 5 to 11 percent by 2009.⁹

The Australian Labor Party (ALP) has also been supportive of broad-based employee share ownership, though generally not to the same degree as its Liberal counterpart. In their dissenting report to the *Shared Endeavours* Inquiry, the Labor members of the Committee agreed that broad-based employee share schemes should be encouraged and supported a number of the Majority Report's recommendations for the promotion of these schemes. However, they emphasized that there was no clear and objective evidence to support the conclusion, however intuitive it may seem, that broad-based employee share schemes better aligned employer and employee interests and fostered increased productivity and workplace harmony.¹⁰ They also expressed strong concerns with the capacity for company executives to use employee share schemes as a means of evading their tax obligations.¹¹

The ALP professed support for broad-based employee share ownership in its 2007 pre-election party platform.¹² However the former Government's promotional employee share scheme unit ceased to operate in the same year the ALP came to power. The ALP's 2009 policy platform does not mention employee share ownership. However, in announcing the reforms in mid-2009 and throughout the resulting consultative process, the Government has consistently expressed strong support for the practice.

⁸ Commonwealth of Australia, *Government Response to Shared Endeavours: An Inquiry into Employee Share Ownership in Australia* (2003), available at <http://www.treasurer.gov.au/DisplayDocs.aspx?pageID=&doc=publications/NelsonResponse.htm&min=phc> (last accessed 25 April 2010).

⁹ Press Release, Kevin Andrews, Minister for Employment and Workplace Relations, *Promoting Employee Share Ownership*, 25 February 2004.

¹⁰ *Shared Endeavours*, above n 2, 290.

¹¹ *Ibid*, 86.

¹² Australian Labor Party, *2007 National Platform and Constitution*, 130.

IV EMPLOYEE SHARE SCHEME REGULATION

Employee share schemes first became the subject of federal legislation in 1974.¹³ The main regulatory tool of employee share schemes has always been through taxation law.¹⁴ The general rule governing the taxation treatment of employee shares is that the issuing of shares or rights to an employee ‘in respect of their employment’ is treated as a substitute for cash income for services. Tax is imposed, at marginal income tax rates, at the time the share or right is acquired. The amount to be included in the employee’s assessable employment income is the difference between the market value of the share or right and any consideration provided: that is, the amount of the discount provided to the employee or service provider.

To promote employee share ownership, Australian law has traditionally provided two alternative concessions from the general rule. While these two concessions continue today, they were significantly reformed in 2009. The pre and post-reform regulatory regimes are outlined briefly below.

The pre-2009 regime

Prior to the 2009 reforms, employees who received shares or options under an employee share scheme could elect either to: (i) pay income tax upfront and receive a \$1,000 tax exemption (the *exemption concession*); or (ii) defer paying income tax on the discount for up to 10 years (the *deferral concession*).¹⁵ In order to be eligible for either of the two concessions, the shares or rights issued under the employee share scheme had to satisfy a number of conditions. These included that the share was to be in the company which is the employer of the taxpayer (or in the holding company of the employer company); the equity offered was ordinary shares, or rights to ordinary shares; that the employee not have control of more than 5 per cent of the company or be in a position to cast, or control

¹³ *Shared Endeavours*, above n 2, [2.1].

¹⁴ For a more detailed discussion of the history of, and current, taxation laws relevant to employee share schemes, see Ann O’Connell, ‘Employee Share Ownership Plans in Australia: the Taxation Law Framework’ (Research Report, Employee Share Ownership Project, University of Melbourne, March 2007).

¹⁵ Division 13A of Part III of the *Income Tax Assessment Act 1936* (Cth).

the casting of, more than 5 per cent of the maximum number of votes that might be cast at a general meeting. Finally, in the case of shares, at least 75 percent of ‘permanent employees’ (defined as employees employed full or part time with 36 months prior service) were entitled to participate in the scheme or another employee share scheme. In order to be eligible for the exemption concession it was also necessary to satisfy three additional conditions: the shares or rights not be subject to forfeiture, a minimum holding period of three years and the requirement that the scheme and any related scheme for the provision of finance be operated on a non-discriminatory basis. The deferral concession was available if there were restrictions preventing the employee from disposing of the shares or rights or conditions that could result in forfeiture and the employee did not elect to be taxed up-front. In such cases, tax would be imposed when the restrictions ended, on disposal, when employment ended or 10 years, whichever was earlier. In fact, many employees chose to pay tax up-front and to then obtain the benefit of the capital gains tax 50percent discount on disposal of the shares or rights.¹⁶ This concession was much more attractive to senior executives than the \$1,000 exemption. The concessions allowed a company to operate schemes that were open only to executives (narrow-based schemes) either by having two schemes – a broad-based scheme and a (more generous) narrow-based scheme for shares, or a narrow-based scheme that only offered options.

The 2009 reforms

The Treasurer announced significant changes to the regulation of employee share schemes in the 2009-2010 Federal Budget.¹⁷ The first major change was to the *exemption concession*. The Government announced that this concession would be limited to ‘low and middle-income earners’, defined as those with an adjusted taxable income of \$60,000 a year or less. Second, the Government announced that the *deferral concession* would be abolished completely. These measures were to take effect from 12 May 2009.

¹⁶ Div 115 *Income Tax Assessment Act 1997*.

¹⁷ Australian Government, above n 1, 1-41. See also Treasurer’s Press Release, ‘Better Targeting the Employee Share Scheme Concessions’ MR 63/09 (12 May 2009)

The changes were strongly opposed by a range of stakeholders, including tax professionals and employer and employee peak organizations.¹⁸ A number of major companies suspended their employee share schemes in response to the budget announcement.¹⁹ The Government conceded that the proposed changes may have had unintended consequences and undertook a series of consultative measures.²⁰ Around the same time, the Senate referred an inquiry into employee share schemes (including the Government's proposed changes) to the Economic References Committee.²¹ The Government subsequently introduced amended legislation to the Parliament in October 2009.²²

The Government's original proposals for reform were modified significantly in response to stakeholder concerns. Under the amended legislation which received Royal Assent in late 2009, the *exemption concession* (now renamed the 'reduction concession') is only available to individuals with an adjusted taxable income of \$180,000 or less.²³ The conditions required to access this concession are very similar to those under former Division 13A. The *deferral concession* remains, but is much more limited. The ability to defer tax on receipt of shares or rights is no longer a matter of election for the employee. Rather, equity received through employee share plans will be taxed upfront unless certain conditions are met. Deferral is only available where, under the conditions of the scheme,

¹⁸ See, eg, 'Labor's share schemes blunder', *Australian Financial Review*, 19 May 2009; Sue Lannin, 'Employee Share Scheme Changes "Bad Business"', ABC Radio National, The PM Program, 19 May 2009; Nicola Berkovic, 'Union Rage Over Shares Scheme Tax Plan', *The Australian*, 20 May 2009; The Treasury, *Reform of the Taxation of Employee Share Schemes*, Consultation Paper, 5 June 2009; and submissions in response to this paper (available at <http://www.treasury.gov.au/contentitem.asp?NavId=066&ContentID=1573>)

¹⁹ 'Labor's share schemes blunder', *Australian Financial Review*, 19 May 2009; and Nicola Berkovic, 'Share Scheme Draws Demand for Clarity', *The Australian*, 26 May 2009.

²⁰ This consultation process consisted of The Treasury, *Reform of the Taxation of Employee Share Schemes*, Consultation Paper, 5 June 2009; a public consultation period on a draft Exposure Bill; and a Board of Taxation consultation on: (i) technical issues relating to the Exposure Bill (due one month after its release); and (ii) the market value of employee share scheme equity and whether employees of start-up, research and development and speculative-type companies should be subject to separate arrangements.

²¹ The Committee was directed to inquire into the operation of such schemes in Australia, including: structure and operation of schemes; benefits; taxation issues relating to compliance of employers and employees participating in employee share schemes; the recent proposed changes to the treatment of schemes (including the Assistant Treasurer's policy statement); rules governing schemes in other countries; and any other related matters. Senate Economic References Committee, above n 2.

²² The *Tax Laws Amendment (2009 Budget Measures No 2) Act 2009* received Royal Assent on 14 December 2009.

²³ Section 83A-35 *Income Tax Assessment Act 1997*.

there is a real risk that the shares or rights will be lost or forfeited or where equity is provided through an approved salary sacrifice employee share scheme (up to \$5,000 worth of shares).²⁴ If deferral is available, tax is payable when there is no real risk of losing or forfeiting the share or right, any restrictions that prevent disposal are lifted, when employment ceases or 7 years, whichever is earlier.²⁵

The government also asked the Board of Taxation to consider two additional matters: how best to determine the market value of employee share scheme securities; and whether shares and rights under an employee share scheme that are provided by start-up, research and development and speculative-type companies should be subject to separate tax deferral arrangements despite not being subject to a real risk of forfeiture.²⁶

In relation to valuation, the Board found that the most appropriate approach was to use the ordinary meaning of market value. However, in relation to unlisted rights, there was support for the use of set statutory valuation tables. In this regard the Board recommended that the factors underlying the statutory valuation tables be reviewed and updated. The government has accepted this in principle but warned that any review will take some time. The Board also recommended that the Commissioner of Taxation provide further guidance on acceptable valuation methodologies for employee share schemes.²⁷

On the tax treatment of employee share schemes used by start-up, research and development and speculative type companies, the Board recommended against the introduction of separate tax deferral arrangements, citing a range of integrity, complexity and compliance concerns.²⁸

²⁴ Section 83A-105(3) and (4) *Income Tax Assessment Act 1997*.

²⁵ Sections 83A-115 and 83A-120 *Income Tax Assessment Act 1997*.

²⁶ Assistant Treasurer 'Details of Further Industry Consultations on Employee Share Schemes Tax Reforms' PR 17/09, 24 July 2009.

²⁷ Board of Taxation 'Review into Elements of the Taxation of Employee Share Scheme Arrangements — A Report to the Assistant Treasurer' February 2010.

²⁸ *Ibid.*

It should be noted that regulation of employee share schemes is also found in corporate law.²⁹ Here, a range of provisions directed principally at protecting investors in relation to public share offerings also apply to the issuing of securities to employees under ESOPs. The Australian Securities and Investments Commission (ASIC) has issued a Regulatory Guide and Class Order, the effects of which are to provide to companies some relief from a raft of fundraising, licensing and hawking provisions in the *Corporations Act 2001* (Cth). This relief is offered, according to ASIC, in recognition of the fact that the primary objective of employee share schemes is to foster the ongoing and mutually interdependent relationship between employer and employee, rather than fundraising.³⁰ Class Order relief is subject to a number of conditions, the most important being that there be a five percent cap on the number of shares that can be issued under an employee share scheme, that the recipients be full-time or part-time employees and that there is a history of disclosure to a well regulated market – in other words, the relief is only available to listed entities.³¹ Further regulatory principles for listed companies can be found in the ASX Listing Rules and the Employee Share Scheme Guidelines (endorsed by the Australian Institute of Company Directors, the Australian Shareholders Association and the Australian Employee Ownership Association).

V POLICY ISSUES

In this section we discuss a number of important policy issues relevant to the regulation of employee share schemes. These are the lack of data on employee share schemes which limits informed policy formulation, the policy rationales for employee share schemes, tax concessions, and compliance issues.

²⁹ For a detailed discussion of the corporate law framework underpinning employee share schemes in Australia, see Ingrid Landau and Ian Ramsay, 'Employee Share Ownership Plans in Australia: the Corporate Law Framework' (Research Report, Employee Share Ownership Project, University of Melbourne, March 2007).

³⁰ ASIC Regulatory Guide 49, *Employee Share Schemes*, [49.3] – [49.5].

³¹ ASIC Class Order CO 03/184.

Available data

A prominent and recurring feature of policy debates on employee share schemes in Australia is the difficulty posed to policy makers by the lack of comprehensive data on current practice. In 2000, *Shared Endeavours* observed that little is known about the nature, size and extent of employee share schemes in Australia, and that this absence of consistent and reliable information presented a major challenge to the inquiry.³² It recommended that the Government direct the Australian Taxation Office (ATO) to conduct a detailed study annually into employee share scheme practice in Australia, including the precise incidence and type of employee share schemes, the type of enterprises in which they operate, the number of employees participating, and the value of holdings in such plans.³³ This recommendation was not adopted by the former Government. Almost a decade later, the Majority Report from the Senate Economic References Committee's inquiry into employee share schemes, whilst acknowledging the surveys conducted by the former Employee Share Ownership Development Unit and the Australian Bureau of Statistics (ABS) in 2004 and surveys conducted since then by the University of Melbourne and private enterprises, recommended that the ABS conduct a comprehensive survey of employee share schemes in Australia every five years, commencing in 2009-10.³⁴

The lack of detailed and comprehensive data on employee share scheme practice in Australian enterprises has meant that policy makers are compelled to make regulatory decisions based on a very incomplete picture of current practice. It is difficult for policy makers to determine whether the current regulatory regime is effective in achieving the objectives upon which it has been formulated; or to identify particular types of abuses and to formulate appropriate policy responses. Indeed, it would appear that the Government was obliged to revise its initial reforms as announced in May 2009, at least

³² *Shared Endeavours*, above n 2, xxvi and 18.

³³ *Ibid*, Recommendation 1.

³⁴ Senate Economic References Committee, above n 2, Recommendation 1.

in part because it had initially lacked an understanding of prevailing industry practice in this area.³⁵

An important feature of the 2009 reforms is the introduction, for the first time, of employee share scheme reporting requirements. Employers who operate employee share schemes must now provide certain information to the ATO on an annual basis.³⁶

Collection of this data is primarily for compliance purposes³⁷ but may enable the ATO and other government agencies to compile comprehensive data on current employee share scheme practice in the future. It does not appear, however, that this information will be made available to the public.

Policy rationales for employee share schemes

A second key issue concerning employee share schemes is the question of why these schemes are promoted as a matter of public policy. There is a large body of literature which identifies and/or seeks to assess the potential benefits of employee share schemes. Some of the rationales identified by scholars and policy makers are focused on the enterprise level whilst others view employee share ownership as part of a much broader social or macro-economic project.³⁸ Commonly identified rationales include:

- improving enterprise productivity (as a result of employees feeling that they have a direct interest in the performance of the enterprise and/or through lowering monitoring costs by aligning employee interests with those of the company);
- promoting workplace cooperation and harmony through reducing the ‘them’ and ‘us’ mentality between employers and employees;
- enhancing industrial democracy through bringing employees into corporate governance;

³⁵ See, eg, the Treasury’s explanation that the \$60,000 income threshold was revised to \$180,000 as the latter was more in line with industry practices: The Treasury (in Consultation with the Australian Taxation Office), *Employee Share Scheme Arrangements: Submission to the Economic References Committee*, July 2009, 14.

³⁶ Division 392 in Schedule 1 to the *Taxation Administration Act 1953* deals with employee share scheme reporting.

³⁷ Explanatory Memorandum to the *Tax Laws Amendment (2009 Budget Measures No 2) Bill 2009*, para 1.281.

³⁸ For a review of this literature, see Landau et al, above n 3.

- increasing employees' understanding of how the economy is run;
- providing employers and employees with greater flexibility in determining the nature and mix of remuneration packages;
- contributing to national savings, through providing employees with an additional avenue for savings and investment;
- promoting innovation, particularly in small and medium unlisted companies and sunrise industries; and
- facilitating succession planning in small businesses through enabling employee buyouts.

It is important to note that, whilst studies have identified a range of potential rationales for broad-based employee share ownership, the empirical evidence in support of a number of these identified rationales is by no means clear-cut. In particular, the capacity of broad-based employee share ownership to improve enterprise productivity or to influence employee attitudes or levels of commitment to their employer, and the extent to which any positive effects are contingent upon employee share ownership being introduced alongside other human resource management initiatives, continues to be disputed.³⁹

While there has long been bipartisan political support for broad-based employee share schemes in Australia, the precise rationales upon which this support is based has not always been clear.⁴⁰ In 2000, after a relatively comprehensive examination of the potential benefits of employee share ownership and available evidence, the *Shared Endeavours* Majority Report recommended that employee share schemes be promoted in Australia to achieve four key policy objectives:

- “To align more closely the interests of employers and employees so that shareholding employees appreciate more directly the impact of management and work practices on efficiency, productivity and profitability;
- to provide a net contribution to national savings;

³⁹ See further Landau et al, above n 3 and *Shared Endeavours*, above n 2.

⁴⁰ See also Jarrod Lenne, Richard Mitchell and Ian Ramsay, ‘Employee Share Ownership Schemes in Australia: A Survey of Key Issues and Themes’ (2006) 14 *International Journal of Employment Studies* 14.

- to facilitate the development of sunrise industries where equity in the company is as crucial to key personnel as salary; and
- to facilitate succession planning and, in some cases, employee buyouts.”⁴¹

These four objectives were not, however, adopted by the former Coalition Government which, in its response to the Committee’s report, focused on a more nebulous ‘alignment of employer/employee interest’ rationale.⁴² The former Government did, however, support several other rationales for employee share ownership in different policy arenas. For example, in its industrial relations policy, the Government favoured the use of employee share schemes as a means of ‘allowing employers and employees greater flexibility and choice in their working arrangements.’⁴³ It also supported the use of employee share ownership in small and medium unlisted and sunrise companies as a means of promoting innovation.⁴⁴

The Labor members of the *Shared Endeavours* Committee were more cautious in endorsing specific policy rationales for employee share ownership. Although they supported the Majority Report’s recommendation that broad-based employee share schemes be promoted, they did not explicitly support the Majority Report’s four policy objectives.⁴⁵ They were also tentative in recognizing the benefits of employee share schemes: for example, they noted that these schemes may ‘... seed employee involvement in the employer’s business activity’ and ‘may foster the alignment of employee-employer interests.’⁴⁶

It was not until 2009 that the Labor Government clearly articulated its policy rationale for maintaining regulatory support for broad-based employee share ownership. The basis for

⁴¹ *Shared Endeavours*, above n 2, Recommendation 5.

⁴² Commonwealth of Australia, above n 8.

⁴³ *Shared Endeavours*, above n 2, [2.78].

⁴⁴ See, eg, the former Government’s strategy document, *Backing Australia’s Ability: An Innovation Action Plan for the Future*, 2001.

⁴⁵ *Shared Endeavours*, above n 2, 276.

⁴⁶ *Ibid*, 278. See also Craig Emerson MP’s (now Minister for Small Business, Independent Contractors and the Service Economy, Minister for Competition Policy and Consumer Affairs and Minister Assisting the Finance Minister on Deregulation) observation in 2004 that, as a member of the *Shared Endeavours* Committee, he discovered the links between employee share ownership and productivity to be elusive: Commonwealth of Australia, Parliamentary Debates, House of Representatives, Hansard, 1 March 2004, at 25375.

the Labor Government's policy support for employee share schemes is encapsulated in the Explanatory Memorandum to its 2009 legislative reforms:

... In recognition of the economic benefits derived from employee share scheme arrangements, the rules provide for tax concessions for employees participating in employee share schemes.

Tax support is provided on the grounds that aligning the interests of employees and employers encourages positive working relationships, boosts productivity through greater employee involvement in the business, reduces staff turnover and encourages good corporate governance.⁴⁷

The benefits of employee share schemes cited by the Government can be broadly categorized as workplace productivity and human resource management rationales. While the Government also identifies the potential for employee share schemes to improve corporate governance, it appears to be referring to narrow-based (executive) schemes rather than broad-based employee share schemes. Members of the Government and Treasury have explained that they view the reforms to employee share schemes as part of a broader project, in the wake of the global financial crisis, to ensure closer links between the performance of company executives and equity-based remuneration. More specifically, well-designed employee share schemes (whereby equity-based remuneration is genuinely 'at risk' until the individual's performance can be validated) can help ensure company executives observe good risk management practices and act in the best interests of the company over the longer term.⁴⁸

The Government's view that broad-based employee share schemes warrant support predominately because of their workplace productivity and human resource management benefits appears to be shared by key stakeholders, including business and unions. For the Australian Industry Group, for example, employee share schemes are 'a way of strengthening bonds between employees and employers and aligning the interests of

⁴⁷ *Tax Laws Amendment (2009 Budget Measures No 2) Bill 2009*, Explanatory Memorandum, cl. 1.25 – 1.26.

⁴⁸ See, eg, Mr Willcock, Treasury, Economic Reference Committee Transcript, 27 July 2009, E11; The Treasury, above n 18, 9-10; the Hon Nick Sherry, Assistant Treasurer, Address to the Australian Employee Ownership Association, 10 December 2009. For further recent discussion of narrow-based employee share schemes, see Productivity Commission, 2009, *Executive Remuneration in Australia*, Report No 49, Final Inquiry Report, Melbourne (released 4 January 2009).

employees with those of the businesses in which they are employed.’⁴⁹ The Australian Mines and Minerals Association (AMMA) has explained that companies in their industry adopt employee share schemes for four main reasons. First, they ‘provide an incentive for employees to participate in the growth of the company, establishing a better alignment between their interests and those of the employer and facilitation of greater levels of employee engagement.’ Second, they ‘... improve employee productivity by linking performance of work with the activities of the company and performance of company share prices. Third, ‘they increase workplace harmony by dissuading disputation that impacts on company performance and encouraging more cooperative relationships.’ Finally, they ‘provide flexibility to both employers and employees in remuneration packaging, particularly where otherwise high salaries and other benefits are not available.’⁵⁰

Major Australian trade unions also support an alignment of interest rationale for employee share ownership. In a joint submission in response to the Treasury’s June 2009 consultation paper, the Finance Sector Union (FSU), Australian Workers’ Union (AWU), Australian Services Union (ASU) and Shop, Distributive and Allied Employees Association (SDA), expressed their strong support for employee share schemes on the basis that they allow employees to benefit directly when their employer’s business does well and thereby help to align the interests of both parties.⁵¹ The unions also emphasise that participation in employee share schemes provides important financial benefits to many employees.⁵²

Tax concessions

A third key issue concerning employee share ownership in Australia is the availability, and nature of, tax concessions. As outlined above, the main public regulation applying to

⁴⁹ Australian Industry Group, *Response to the Consultation Paper, Reform of the Taxation of Employee Share Schemes*, June 2009, 3.

⁵⁰ Australian Mines and Minerals Association, *Reform of the Taxation of Employee Share Schemes: Submission to the Treasury, Philanthropy and Exemptions Unit, Personal and Retirement Income Division*, 12 June 2009, 5 -6.

⁵¹ FSU, AWU, ASU and SDA, *Reform to the Taxation of Employee Share Schemes*, Submission, 12 June 2009.

⁵² See also ‘Union Rage Over Shares Scheme Tax Plan’, *The Australian*, 20 May 2009.

employee share schemes has long been of a concessional nature in the area of tax liability, and there has been relatively little change to this regulatory regime since the 1970s. The current Labor Government has continued the longstanding approach of providing concessional treatment to employee share schemes in certain circumstances. It has, however, recently sought to better target eligibility for the employee share scheme tax concessions and reduce opportunities for tax avoidance. This section focuses on contestation surrounding the *exemption concession*. Debate surrounding the availability and extent of the *deferral concession* is dealt with in the next section.

In its 2009-2010 budget announcement, the Treasurer proposed limiting the availability of the exemption concession to those earning less than \$60,000 per year. This threshold was widely opposed.⁵³ A number of stakeholder groups supported the imposition of an income threshold but maintained that \$60,000 was simply too low. Trade unions, for example, argued that the Government's proposal would have a dramatic and adverse impact on ordinary employees and could result in the suspension or termination of existing employee share schemes.⁵⁴ Key employer groups, in contrast, opposed the imposition of a threshold per se. For the AMMA, the proposed threshold would preclude a significant number of resources sector employees from the benefit of the exemption as average earnings in the sector are in excess of \$105,000 per annum. It also opposed the imposition of any threshold on the basis that it would undermine 'all staff' employee share schemes (whereby both management and employees have equal accessibility to participation in the scheme) which dominate in the resources sector.⁵⁵ The Australian Industry Group stated that it did not support the change on the basis that the Government had failed to make a strong case to change the general operation of the existing tax treatment.⁵⁶

⁵³ In its June 2009 consultation paper, the Treasury identified the \$60,000 threshold as one of three principal concerns voiced by stakeholders: The Treasury, above n 18, 4.

⁵⁴ FSU, AWU, ASU and SDA, *Reform to the Taxation of Employee Share Schemes*, 12 June 2009. See also the submission of the Australian Council of Social Services, 12 June 2009.

⁵⁵ Australian Mines and Minerals Association, *Reform of the Taxation of Employee Share Schemes: Submission to the Treasury, Philanthropy and Exemptions Unit, Personal and Retirement Income Division*, 12 June 2009, 5-6.

⁵⁶ Australian Industry Group, *Response to the Consultation Paper, Reform of the Taxation of Employee Share Schemes*, June 2009.

In response to initial stakeholder concerns, the Government proposed lifting the income threshold for the exemption concession to \$150,000, on the basis that this ‘should cover the vast majority of employees who currently participate in schemes designed around the \$1,000 exemption’.⁵⁷ This was subsequently revised to \$180,000, in line with the upper marginal tax rate. The imposition of this income threshold is expected, according to Treasury, ‘to save in the order of \$5 million a year’.⁵⁸

Whilst the Labor Government has sought to better target the exemption concession, it has not sought to alter its value. The exemption concession was increased from \$500 to \$1,000 in 1997. The reluctance of successive Governments to increase the value of the concession beyond this amount has been the subject of persistent criticism. *Shared Endeavours* recommended that the \$1,000 concession be increased but, though noting that it was sympathetic to the view that it be raised to \$2,000, declined to recommend a new level in the absence of Treasury estimates as to cost.⁵⁹ The Labor members of the Committee, in their Minority Report, also expressed their strong view that no further tax concessions should be contemplated until the ATO and Treasury were in a position to generate reliable costings.⁶⁰ Nearly a decade later, the Economic Reference Committee observed that a number of submissions had suggested increasing the exemption to ‘somewhere in the range of \$1,500 to \$5,000’.⁶¹ The Labor Government’s failure to review the value of the concession in 2009 was, however, perhaps unsurprising given that the reforms formed part of a package of measures designed to yield savings needed to ‘protect Government revenues and support jobs and invest in vital nation-building in the face of the global recession.’⁶² However, given that this is the concession most commonly accessed in broad-based schemes, it is important to note that the only change has been to make access to the concession more difficult.

⁵⁷ The Treasury, above n 18, 14.

⁵⁸ Evidence to Economic Reference Committee, Parliament of Australia, Canberra, 27 July 2009, 16 (Mr Marty Robinson, Department of the Treasury).

⁵⁹ *Shared Endeavours*, above n 2, Recommendation 32.

⁶⁰ *Ibid*, 295.

⁶¹ Senate Economic References Committee, above n 2, [6.10].

⁶² Australian Government, above n 1, 1-41.

Compliance issues

A final key public policy issue and area of contestation in relation to employee share schemes is the capacity for these schemes to be used as a vehicle for tax avoidance and evasion. It is not the purpose of this Part to examine the nature of this problem in detail, but rather to demonstrate that concern with the integrity of the tax base pervades public policy debates on the promotion and regulation of broad-based employee share ownership.

The use of employee share schemes as a means of avoiding tax liability is by no means a new problem. The original Division 13A of the ITAA was introduced in 1995 largely to counter aggressive tax planning in this area.⁶³ In 2000, *Shared Endeavours* observed that the use of Division 13A for aggressive tax planning purposes persisted. It produced a number of recommendations directed at reducing the potential for tax avoidance. The Labor members of the Committee, however, did not believe that the Majority Report's recommendations in this regard were adequate to address the full extent of the problem.⁶⁴ Indeed, they were so concerned with the extensive use of employee share schemes by company executives as a means of avoiding tax liability and the consequent loss to Commonwealth revenue that they produced a dissenting report, despite broadly agreeing with the Government's policies on the promotion of broad-based employee share ownership.⁶⁵ The former Coalition Government did not adopt the recommendations in *Shared Endeavours* directed at reducing the potential for tax evasion through the use of employee share schemes.

The major reforms to the taxation treatment of employee share schemes announced by the Labor Government in mid-2009 were predicated upon a recognition that the '... complex, technical and flexible nature of existing employee share scheme arrangements has resulted in a significant amount of revenue lost through misapplication of the law and deliberate evasion.'⁶⁶ In particular, the Labor Government emphasized the serious and

⁶³ *Shared Endeavours*, above n 2, 79.

⁶⁴ *Ibid*, 276.

⁶⁵ *Ibid*, 275.

⁶⁶ The Treasury, above n 18, 7.

longstanding concerns over the use of the *deferral concession* by high income earners to evade tax obligations. The ATO has estimated the amount of revenue lost as a result of such tax evasion to be up to \$100 million per year.⁶⁷

The Labor Government introduced two key measures directed at minimizing the potential for inadvertent and deliberate tax evasion. The first key measure is the much more limited capacity to defer tax. Under the initial arrangements announced in the 2009-10 budget, the Government proposed abolishing the *deferral concession* altogether. However, this measure was met with strong opposition by stakeholders. While there appears to have been little, if any, disagreement that problems of evasion and avoidance existed and needed to be addressed, many stakeholders argued that the wholesale removal of the deferral concession was ill-conceived and heavy handed.⁶⁸ The Government conceded that there may be circumstances in which tax deferral is appropriate, and consequently modified its proposals so that whether a share or right is subject to taxation upfront or at a later date will now depend on the structure of the scheme rather than on the election of the taxpayer. In addition, deferral is now only available where there is a ‘real risk’ that the benefits of shares or rights are never realised or are subject to forfeiture or alternatively where an approved salary sacrifice arrangement is in place and the value of the shares or rights is no more than \$5,000 per annum.

The second key measure introduced to improve compliance is mandatory reporting requirements. Employers who offer employee share schemes will now be required to provide certain information to the ATO on an annual basis. The main purpose of these reporting requirements is to address the concern raised by the ATO that the current employee share scheme rules are not being complied with and that the ATO is not in a position to know the full extent of that non-compliance.⁶⁹

It is clear from both parliamentary inquiries into employee share schemes over the last decade, as well as the most recent debates, that the misuse of employee share schemes by

⁶⁷ Ibid, 8. See also the two case studies presented in the Treasury consultation paper: Ibid, 8-9.

⁶⁸ Heather Rideout, Chief Executive of the Australian Industry Group, for example, described the reforms as ‘taking a sledgehammer to a walnut’: Mischa Shubert and Lucy Battersby, ‘Employee Share Scheme Rethink’, *The Age*, 22 May 2009.

⁶⁹ The Treasury, above n 18, 21.

high income earners as a means of avoiding tax obligations has consistently pervaded and, on occasions, overshadowed discussions of broad-based schemes. In particular, as demonstrated by the Minority report in *Shared Endeavours*, policy makers have been reluctant to adopt measures directed at further promoting employee share schemes among non-executive employees in part due to a concern over the potential for the tax concession regime to be used by high income earners as a means of avoiding or minimizing tax obligations. The Labor Government has recently introduced major reforms directed at significantly reducing the scope for loss of Commonwealth revenue in this area. Whether these reforms will be successful in significantly reducing tax evasion in this area and whether this in turn will have an impact on the willingness of policy makers to contemplate further incentives directed at promoting broad-based schemes remains to be seen. What is apparent is that it is still possible to have a more generous scheme available to executives, either because it ‘piggy-backs’ off a broad-based scheme⁷⁰ or only offers options.⁷¹ Apart from requiring the conditions of the scheme to impose a real risk of loss or forfeiture, the main change in relation to the deferral concession is that it is no longer possible to make an election to pay tax upfront. This means that employees who dispose of their shares or rights within 30 days of the deferred taxing point will not obtain capital gains tax treatment and so will not be eligible for the 50 percent discount.

VI CONCLUSION

Broad-based employee share schemes are found in many Australian companies and the available evidence suggests that they are increasing in popularity. These schemes have long enjoyed bipartisan political support and, in spite of recent reforms, the fundamental features of the regulatory regime in this area are longstanding. Nonetheless, questions of why and how these schemes should be promoted as a matter of public policy continue to feature intermittently in Australian policy debates. Indeed, there have been two federal parliamentary committee inquiries into employee share schemes over the past decade.

⁷⁰ Section 83A-105(2) *Income Tax Assessment Act 1997*.

⁷¹ Section 83A-105(1)(c) *Income Tax Assessment Act 1997*.

This paper has identified and explored several of these key issues, with particular reference to recent tax reforms. These issues include our limited knowledge of relevant company practice; the many available rationales for the promotion of employee share schemes; the nature, and extent, of the tax concessions designed to promote employee share ownership; and the extent to which the existing regulatory regime provides scope for loss of revenue through tax evasion. The discussion of these policy issues indicates how employee share ownership, despite enjoying bipartisan political support, remains highly contested in terms of both the regulatory framework for employee share ownership and the key policy rationales supporting changes to that regulatory framework. Although the government has indicated its desire to encourage employee ownership on the basis that this improves the alignment of employee and employer interests, the recent reforms provide no additional incentives and in fact make access to the concessions more difficult. The problem is the conflict between the desire to encourage employee ownership and the belief that employee ownership schemes are open to abuse.