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The Parliament of the Commonwealth of Australia

# **Shared Endeavours**

**Inquiry into employee share ownership in Australian enterprises**

House of Representatives

Standing Committee on Employment, Education and Workplace Relations

September 2000  
Canberra

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ISBN 0 642 45191 5

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## Foreword

Robert Menzies led his party to the 1949 federal election on a platform that included the belief that the best foundation for full employment would be found in “the prosperity of the business undertaking in which the man works”. One mechanism he nominated for achieving this objective was “the encouragement and introduction of profit sharing schemes wherever practicable”.

Half a century later, though encouraged to varying degrees by successive governments, employee share ownership is yet to take root in the every day Australian workplace. It remains largely confined to a flourishing executive remuneration sector. Where share ownership has come to the workshop floor has been in large public companies, usually with unionised workplaces. Employee relations in such companies are typically of a structured nature of which a share plan has been but one part.

This report represents the first detailed examination of the place of employee share schemes in the Australian economy, their public policy basis and outlook for the future. Hence the title – “Shared Endeavours”.

Employee Share Ownership should have at its core, four key policy objectives:

- to align more closely the interests of employers and employees so that share holding employees appreciate more directly the impact of management and work practices on efficiency, productivity and profitability;
- to provide a net contribution to national savings;
- to facilitate the development of sunrise industries where equity in the company is as critical to key personnel as salary; and
- to facilitate succession planning and, in some cases, employee buyouts.

The widespread adoption of an employee share ownership culture may also serve two other important objectives.

Though close to half of the Australian population directly owns shares, half do not. Employee Share Ownership Plans (ESOPs) provide an opportunity for many

more working men and women to experience the benefits of share ownership through the relatively stable and structured vehicle of ESOPs.

A further observation is that at the economic and social epicentre of changes being worked into Australian society – in the regions, rural areas and outer suburbs of our major cities – deep concerns are harboured about the extent of foreign investment upon which our standard of living relies. One contemporary form this has taken is the desire to purchase Australian owned and manufactured products.

If employee share ownership were to assume in the workplace, the status afforded superannuation savings, a practical vehicle would exist for Australians to invest in their own companies. In doing so, Australia might potentially make some inroads not only into the present low levels of national savings, but also the nation's Net Income Deficit comprising the bulk of its Current Account Deficit.

Though agreeing with a number of the general conceptual themes of the report, Labor members have dissented from a number of recommendations for reasons set out in their minority report.

Liberalising and encouraging the development of, and access to, genuine Employee Share Ownership comes at a price. That price is increased regulation and a tightening of those provisions applying to share plans that are currently the exclusive domain of executives. Some equity and salary packaging arrangements are increasingly out of step with community expectations.

The majority report adopts a balanced approach intended to strengthen the integrity of the revenue base while improving regulatory conditions to facilitate the movement of ESOPs into workplaces of all types. As such, the recommendations should be seen as an integrated package. Compliance measures proposed in some areas are offset by much needed liberalisation in others.

The Committee sees Division 13A of the Taxation Act as being the most desirable mechanism for ESOPs and has offered recommendations that would entrench – but improve – the operation of both tax 'exempt' and 'deferred' plans. The Committee proposes that foregone income will ultimately be taxed as such but that any increased value in the shares should be treated as capital gain for taxation purposes. It further proposes the preferential tax treatment of shares acquired under ESOPs when transferred to a registered superannuation fund or liquidated for retirement.

Central to the report's initiatives and the integrity of its recommendations, is the proposed establishment of an Employee Share Plan Monitoring Agency under the aegis of the Australian Taxation Office. In conjunction with a proposed single ESOP legislative instrument, such a unit would administer and monitor ESOPs. In doing so it would enable the construction of a more accurate picture of employee share ownership in Australian workplaces. This would complement an ESOP



Promotional Unit envisaged for the Department of Employment, Education, Workplace Relations and Small Business, providing not only advice but 'off the shelf' plans for smaller businesses.

The Committee places particular emphasis on assisting an ESOP culture in small and medium businesses. Emerging 'sunrise' industries require specific preferential tax treatment for a defined start-up period if high calibre individuals are to be recruited from a highly mobile international labour market.

The inquiry required little persuasion of the need to review the system of Private Binding Rulings (PBRs) initiated by the Keating government. Their use in the development and marketing of certain executive remuneration packages is considerable. When the possible benefits of PBRs are combined with salary sacrifice, generous employer provided loans that are interest-free and the capacity of employee share plans to significantly reduce tax liability, a need for a systematic review of these areas emerges.

This inquiry has necessarily dealt with complex legislation and public policy issues. Though the concept of employee share ownership has intuitive appeal, its application involves a myriad of issues, not the least of which is ensuring the integrity of the tax base and the equitable distribution of public incentives.

International experience of meeting these joint challenges is set out in appendix F, which reviews employee share plans offered by Australia's major trading partners. The proposals offered by this report will not only be seen to be in step with international trends but would place Australia in the first rank of nations encouraging employee share ownership, but in ways appropriate to our own circumstances.

Thank you to those many individuals and organisations who gave so much of their time to assist the Committee's deliberations and members of the secretariat for their diligent hard work.

Finally, this report includes recommendations to government that will be seen as controversial by some. It has also produced a dissenting report from all Labor members on the Committee. It is hoped that at the very least the Committee's work will launch a constructive debate about a concept whose time has well and truly come.





## **Membership of the Committee**

**Chair**            Dr Brendan Nelson MP

**Deputy Chair**   Mr Rod Sawford MP

**Members**        Mr Phillip Barresi MP

Mr Kerry Bartlett MP

Mrs Kay Elson MP (from 31/5/00)

Mr Craig Emerson MP

Ms Teresa Gambaro MP

Mrs Joanna Gash MP (to 31/5/00)

Ms Julia Gillard MP

Hon Bob Katter MP (to 31/5/00)

Mrs Margaret May MP (from 31/5/00)

Mr Kim Wilkie MP

## **Committee Secretariat**

<b>Secretary</b>	Mr Paul McMahon (to 30 June 2000) Mr Richard Selth (from 1 July 2000)
<b>Inquiry Secretary</b>	Ms Lexia Bain (to 1 August 1999) Dr Andrew Brien (from 11 October 1999)
<b>Research Officer</b>	Ms Sonya Fladun (to 31 January 2000) Ms Margaret Atkin (from 1 July 2000)
<b>Administrative Officers</b>	Mrs Gaye Milner Mrs Lisa Kaida Miss Jennifer Cochran



## **Terms of reference**

On 9 March 1999 the Minister for Employment, Workplace Relations and Small Business requested the Committee to:

Inquire into and report on 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.



## List of abbreviations and glossary

401K plans	Named after the section of the United States 1974 Employee Retirement Income Security Act (ERISA). This Act gave 401K plans a legal foundation. The 401(k) is not leveraged. It is typically funded out of remuneration. Employee profit shares, salary sacrifice and matching employer contributions are used to purchase not merely shares in the employer's company but also shares in other listed companies. The US Congress obliged 401(k) plans to invest partly in non-employer equities as a prudential measure. In establishing the 401(k) plan, Congress sought to develop an alternative to the Kelso ESOP so that workers could take a stake in their employer's company without having all their eggs in the one basket. <sup>1</sup>
AEOA	Australian Employee Ownership Association
Aggressive tax planning	Taxation arrangements which are blatant, artificial and contrived, and/or designed to serve a purpose other than the purpose intended by Parliament.
ASIC	Australian Securities & Investment Commission
ASX	Australian Stock Exchange

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<sup>1</sup> AEOA, submission no. 5, p. 7.

ATO	Australian Taxation Office
Call option	An equity option that entitles the buyer (taker) to buy a fixed number of underlying securities at the exercise price on or before a particular date, after which the entitlement ceases. For example, a call option over 5,000 shares in firm ABC with an exercise price of \$8.00 gives the buyer the right to buy 5,000 ABC shares at \$8.00 each from the person or entity offering the option on or before the expiry date. <sup>2</sup> [Cf. 'put option']
Capital Gains Tax (CGT)	Tax on the profit obtained from the sale of an asset, such as shares. The profit made by selling an asset, such as shares, for more than their cost is the capital gain. 'Profit' is the amount left when the cost of acquiring and disposing of the asset (or 'cost base') is deducted from the sale price. [NB: some assets are exempt, such as the family home.] The 'cost base' includes not only the cost of the shares but also brokerage fees and stamp duty incurred in the buying and selling of the shares. <sup>3</sup>
DEWR&SB	Department of Employment, Workplace Relations and Small Business
Discount	The difference between the market value of the share or right, at a cessation time, less any amount paid or given by the taxpayer as consideration for the acquisition of the share or right.
Dividend	A distribution of part of a company's net profit to shareholders usually as cash reward. Typically it is expressed as a

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2 Adapted from 'Call option', glossary, Australian Stock Exchange internet site, <http://www.asx.com.au/>. Downloaded 20 June, 2000.

3 Adapted from 'Capital gains tax', glossary, Australian Stock Exchange internet site, <http://www.asx.com.au/>. Downloaded 20 June, 2000; and 'Capital gains tax', glossary, Australian Taxation Office internet site, <http://www.ato.gov.au/content.asp?doc=/content/corporate/glossary.htm>. Downloaded 20 June, 2000.



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	number of cents per share. <sup>4</sup>
Dividend imputation	Australian tax rule that enables shareholders to claim a tax rebate for the tax that a company has already paid on its profit. Dividends that include the right to a tax credit are called <i>franked</i> . <sup>5</sup>
Dividend streaming	Arrangements which enable shareholders to choose between franked and unfranked dividends or to select the source of their dividends so as to circumvent rules which require a combined class of dividends to be equally franked. The arrangement is designed to permit franked dividends to be diverted away from those who cannot get the maximum value from them, eg low tax rate or non-resident shareholders.
Division 13A (of the <i>Income Tax Assessment Act 1936</i> )	The Division of the <i>Income Tax Assessment Act 1936</i> that provides for the taxation of the discount on shares or rights acquired under an employee share plan. The Division sets out the circumstances where taxpayers can claim an exemption or opt to defer tax on income gained through an employee share plan.
EBAs	Employee benefit arrangements. This refers to any of a number of schemes, including employee share plans, designed to provide employees with benefits as a reward, or in payment, for services rendered.
EIS	Employee incentive scheme. A scheme for the issue or acquisition of equities in a firm to be held by, or for the benefit of, participating employees or non-executive

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4 Adapted from 'Dividend', glossary, Australian Stock Exchange internet site, <http://www.asx.com.au/>. Downloaded 20 June, 2000; and 'Dividend', glossary, Australian Taxation Office internet site, <http://www.ato.gov.au/content.asp?doc=/content/corporate/glossary.htm>. Downloaded 20 June, 2000.

5 Adapted from 'Dividend imputation', glossary, Australian Stock Exchange internet site, <http://www.asx.com.au/>. Downloaded 20 June, 2000.

	directors of the firm or a related firm.
Employee Share Plan	<p>This is the generic name used in this report to refer to any of the different types of plan established by a company to enable the employees of that company to obtain a stake in their employer by acquiring shares in their employer.</p> <p>Typically, the equities are provided as a reward, or in payment, for services rendered.</p>
ESAC	Employee Share Acquisition Company. A special company that has as its sole or dominant purpose facilitating the purchase of a firm's shares by the employees of that firm.
ESAS	Employee Share Acquisition Scheme.
ESOP	Employee Share Ownership Plan.
ESOS	Employee Share Ownership Scheme.
ESS	Employee Share Scheme.
Exemption conditions	Conditions that shares or rights must satisfy in Division 13A (in addition to the qualifying conditions) to enable the shares or rights to receive concessional taxation treatment, up to certain limits.
Exercise (or exercising an option)	When person holding an option decides to purchase or sell the underlying security over which they have an option. The exercise price is the amount of money that must be paid by the taker (in the case of a call option) or the writer (in the case of a put option) for the transfer of each underlying instrument on exercise of the option. <sup>6</sup>
FBT	Fringe benefits tax.

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<sup>6</sup> Adapted from 'Exercise' and 'Exercise price', glossary, Australian Stock Exchange internet site, <http://www.asx.com.au/>. Downloaded 20 June, 2000.

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Franked dividend	A dividend paid by a company out of profits on which the company has already paid tax. The investor is entitled to an imputation credit, or reduction in the amount of income tax that must be paid, up to the amount of tax already paid by the company. <sup>7</sup>
Fringe benefits tax	A tax payable on the non-salary benefit provided to an employee by an employer in respect of the employee's work, and in substitution for salary and wages. <sup>8</sup>
IR	Industrial relations
ITAA	<i>Income Tax Assessment Act 1936</i>
Leveraged Employee Share Scheme	An employee share plan that uses loans provided to employees to fund the acquisition of equities in the employer. The loan may be repayable out of salary (pre or post tax) and/or dividends. <sup>9</sup> [Cf. Unleveraged employee share scheme]
Market capitalisation	The market value of a company, calculated by multiplying the number of shares on issue by the market price of these shares at a given point in time. <sup>10</sup>
Medium business	Those businesses that are not small business, but employ less than 200 people. <sup>11</sup>

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7 Adapted from 'Franked dividend', glossary, Australian Stock Exchange internet site, <http://www.asx.com.au/>. Downloaded 20 June, 2000.

8 Adapted from 'Fringe benefits tax', glossary, Australian Stock Exchange internet site, <http://www.asx.com.au/>. Downloaded 20 June, 2000; and 'Fringe benefits tax', glossary, Australian Taxation Office internet site, <http://www.ato.gov.au/content.asp?doc=/content/corporate/glossary.htm>. Downloaded 20 June, 2000.

9 Adapted from AEOA submission no. 5, pp. 7-8.

10 Adapted from 'Market capitalisation', glossary, Australian Stock Exchange internet site, <http://www.asx.com.au/>. Downloaded 20 June, 2000.

11 W McLennan, *Small Business in Australia - 1999*, Australian Bureau of Statistics, Canberra: Commonwealth of Australia, 2000, p. 149. This report goes on to say also that large businesses are those that employ more than 200 people; micro businesses are those that employ fewer than 5 Full Time Equivalent people.

Options [or share options]	An option gives a person the right, but not the obligation, to buy or sell stock at a set price on or before a given date. Options not exercised by that date expire. <sup>12</sup>
Ordinary share	The most commonly traded security in Australia. Holders of ordinary shares are part-owners of a company and may receive payments in cash, called dividends, if the company trades profitably. When a company is being wound up: a class of shares which do not confer upon their holders preferential rights to dividends out of profits or capital. <sup>13</sup>
Perverse incentive	<p>A benefit</p> <ul style="list-style-type: none"><li>■ originally provided to an employee by an employer to further the employer's interests;</li><li>■ that if manipulated in a particular way will produce a larger benefit to an employee than the original benefit;</li><li>■ but only by harming the employer's interests.</li></ul> <p>The benefit does not then provide a reason to promote the employer's interests but a reason for the employee to promote her own interests but only at a cost to the employer's interests.</p>
Phantom share plan	See Replicator share plan
Prospectus	A formal written document issued by a body corporate that invites applications or offers to subscribe for the securities of a body corporate; or which offers the securities for subscription. A prospectus describes the plan for a proposed business enterprise, or the facts concerning an existing one, in order

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12 Adapted from 'Option', glossary, Australian Stock Exchange internet site, <http://www.asx.com.au/>. Downloaded 20 June, 2000.

13 Adapted from 'Ordinary share', glossary, Australian Stock Exchange internet site, <http://www.asx.com.au/>. Downloaded 20 June, 2000.

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	<p>that an investor may make an informed decision on buying or selling securities in the enterprise.</p> <p>The content of a prospectus is subject to the regulations of the ASX and the provisions of the Corporations Law, as administered by ASIC.<sup>14</sup></p>
Put option	<p>A put option gives the holder of the option the right to sell the equities over which the option exists to the person providing the option, at a specified price on or before the expiry date.<sup>15</sup></p>
Qualifying shares or rights	<p>Those shares or rights that satisfy the conditions in Division 13A 139CD. If a share or right is qualifying then it may be eligible to receive concessional taxation treatment.</p>
Replicator share plan	<p>Replicator share plans replicate a 'normal' employee share plan, however they do not issue equities in a person's employer. They are used where the company cannot or is unwilling to issue equities in itself. These plans are also known as 'phantom', 'synthetic' or 'shadow' share plans. The benefits employees receive under a replicator scheme mimic the benefits which they would have received had they held shares in the employing company, or in a division or branch of that company where they work.</p>
Replicator shares	<p>Equities that are provided as part of a replicator share scheme.</p>
RPC	<p>Remuneration Planning Corporation</p>

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14 Adapted from 'Prospectus', glossary, Australian Stock Exchange internet site, <http://www.asx.com.au/>. Downloaded 20 June, 2000.

15 Adapted from 'Exercise' and 'Put option', glossary, Australian Stock Exchange internet site, <http://www.asx.com.au/>. Downloaded 20 June, 2000.

Salary sacrifice plan	Funds to pay for participation in the share or option plan are deducted by the employer from the employee's pre-tax salary. The funds are paid directly to the plan operator by the employer, rather than, as in the case of a contribution plan, the employee paying for participation after tax has been deducted. <sup>16</sup> [Cf. 'contribution plan']
Section 26AAC of the Income Tax Assessment Act 1936	The section of the ITAA that specified the taxation treatment of equities acquired under an employee share plan until it was replaced in 1995 by Division 13A of the ITAA.
Share option	See 'options'
Shares	Certificates or book entries representing ownership in a corporation or similar entity. <sup>17</sup>
Small business	A company which is not a subsidiary of another company and is neither a public company, unincorporated cooperative or incorporated association and which employs less than 20 Full Time Equivalent persons. <sup>18</sup>
Stapled Securities	Different securities that may be traded only together and never separately. Usually one of them is an ordinary share. Such securities are said to be 'stapled' together. For example, a share which is purchased with an option to buy another share. If the share and option are "stapled" the owner cannot unbundle the share from the option and sell them separately.
Stock	North American term for 'shares'.

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16 Adapted from RPC, submission no. 30, p. 2, and exhibits provided by RPC.

17 Adapted from 'Share', glossary, Australian Stock Exchange internet site, <http://www.asx.com.au/>. Downloaded 20 June, 2000.

18 W McLennan, *Small Business in Australia - 1999*, Australian Bureau of Statistics, Canberra: Commonwealth of Australia, 2000, p. 149.

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Strike price	Another name for 'exercise price'. The specified price at which an option may be exercised. <sup>19</sup>
Subscription plan	An employee share plan in which the participants pay a regular contribution, usually from their regular salary, to the plan manager in order to obtain equities in their employer. <sup>20</sup>
Sunrise industry	<p>There is no accepted definition of 'sunrise industry'. In ordinary usage, and adopted in this report, a 'sunrise' industry typically has the following features. It is</p> <ul style="list-style-type: none"><li>■ knowledge intensive;</li><li>■ in an emerging area of the economy; and</li><li>■ commercialising recently developed technology and/or research and development outcomes.</li></ul> <p>Contemporary examples are: biotechnology; medical technology; information technology, (which includes software design, computer chip and integrated circuit design and manufacture); internet service providers; and internet businesses.</p>
Sunrise enterprise	<p>A company that operates in a sunrise industry; and is</p> <ul style="list-style-type: none"><li>■ small or medium in size;</li><li>■ typically less than five years old rather than being an established company; and</li><li>■ speculative, knowledge intensive and/or relying on venture capital.</li></ul>
TAA	<i>Taxation Administration Act 1953</i>

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19 Adapted from 'Strike price', glossary, Australian Stock Exchange internet site, <http://www.asx.com.au/>. Downloaded 20 June, 2000.

20 Adapted from RPC, submission no. 30, and exhibits provided by RPC.

**Unleveraged plan**

Any plan that does not involve the use of loans to fund the purchase of equities in an employee share plan. Such equities may be provided gratis or partly paid and financed through a subscription collected from an employee's regular salary. When the employee has paid for the equity, the employee enjoys full ownership rights, under the plan, in the equity.<sup>21</sup> [Cf. leveraged plan]

**Vest**

Shares or options vest when full ownership is transferred to the recipient and the recipient acquires full ownership rights. Typically on vesting, the recipient may deal with the equities as they please and without restriction.

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21 AEOA, submission no. 5, pp. 7-8.





# Executive summary

## Overview

The report has two aims:

1. to foster the spread of employee share plans amongst general employees, for all employees in the small, medium and unlisted sector, and in enterprises in the sunrise industries, especially the biotechnology, high technology and IT sectors; and
2. to curtail the inappropriate use of employee share plans for aggressive tax planning.

These aims are complementary, in that together they deliver to the community substantial benefits. Specifically, the benefits are to:

1. better align the interests of general employees and employers, leading to more productive enterprises;
2. increase national savings, translating to improved individual provision for retirement planning;
3. facilitate the development of the small, medium and unlisted sector, and enterprises in the sunrise industries, especially the biotechnology, high technology and IT sectors; and
4. facilitate employee buyouts and succession planning in small business.

At all times the changes recommended must fit into a framework of prudent public policy that not only identifies realisable goals, but which provides assurance to the community that the policies are effective and not open to misuse.

## **Chapter 1 Introduction**

Throughout the inquiry, witnesses and submissions referred to ‘employee share plans’ as a single type of phenomenon. It was apparent from the evidence that there were many types of employee share plan. Moreover, the inquiry was conducted within a context of significant legislative and social change. As well, the analysis of the information collected, along with the development of the recommendations, occurred within a public policy framework. This framework stipulated parameters for the inquiry that had to be satisfied in order that the report and recommendations, when implemented, maximise the benefits to the community. This chapter sets out and considers these matters. As well, an outline of the report is provided. The Committee emphasises that the report is to be seen as an integrated proposal, and that the measures designed to prevent inappropriate use of share plans for aggressive tax planning purposes are as important as the policy initiatives designed to foster the growth of employee share plans in Australia and enhance economic opportunities for Australians. The recommendations are presented as an integrated package.

## **Chapter 2 ESOPs antipodean fables: nature and rationale**

It emerged in the course of the inquiry that very little is known about the nature, size and extent of employee share plans. The reason is that information is not systematically collected by any single department or agency of the Executive Government. The Committee made a number of recommendations designed to remedy this (recommendations 1 and 2).

The inquiry revealed that employee share plans are often linked to contemporary management practices. However, such information, while available to larger enterprises may not be readily available to smaller firms. The Committee recommended that such information be more readily available (recommendation 3).

The rationale for employee share plans was not uniform between the public and private sector. The Committee examined this issue and determined that from a public policy perspective the rationale that had formed the basis of public policy (improving enterprise performance by better aligning employee and employer interests) should be expanded to include promoting national savings especially for retirement purposes (recommendation 5 and 6). As a result, the Committee recommends that employee share plans should not be considered as alternatives to compulsory superannuation (recommendation 4) and that a study of retirement planning options should be undertaken (recommendation 7).

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## Chapter 3 Aligning interests: employee share plans and public policy

The development of employee share plans will occur only within an appropriate public policy environment that not only promotes plans but also strengthens the integrity of the tax base (recommendations 8–9 and 15–20). Among the most significant recommendations are those which:

- advocate the enactment of a single piece of legislation, drawing together in the one piece of legislation the various laws that apply to employee share plans while clearly specifying parliamentary intent (recommendation 8); and
- advocate the creation of an employee share plan regulatory agency (recommendation 18).

Apart from institutional arrangements designed to ensure compliance, attaching to employee share plans, the Committee recommends that existing, highly concessional avenues be reviewed (recommendations 14 and 15) and that current provisions in the taxation law enacted by the Keating Government be tightened to reduce the temptation for misuse (recommendation 21).

The Committee was concerned that policy in one area did not undermine the effectiveness of that in others. For this reason, a number of other measures are recommended that will foster the development of employee share plans, including:

- clarifying their status within the *Workplace Relations Act 1996* (recommendation 23);
- providing for qualifying plans clearly guaranteeing freedom of choice for employees in respect of employee share plan participation (recommendation 24); and
- proscribing the unilateral employer-directed trading of employee share plan participation for salary reductions or future salary increases (recommendation 25).

The Committee was aware that as a result of the way a company is initially organised, or a later restructure, an employee may not satisfy the employment eligibility conditions of Division 13A. The Committee recommends the partial relaxation of these conditions (recommendation 22).

## Chapter 4 Administration and taxation arrangements

The Committee received a considerable amount of evidence concerning the present arrangements enacted by the Keating Government for the taxation treatment of employee share plans. The major difficulties in this area were anomalous treatment, unclear and unsympathetic legislation. The

recommendations address those matters that most impede the development of employee share plans. Among these recommendations are:

- that explicit and clear taxation policies be developed (recommendations 26 and 27) and existing legislation clarified (recommendation 35);
- that existing arrangements for the taxation of equities acquired under a tax deferred scheme be modified to allow the income portion of a discounted equity to be taxed as income and the capital gain portion to be taxed as a capital gain (recommendation 27);
- the removal of disincentives in the current arrangements (recommendation 30);
- relaxation, on certain conditions, of various conditions within the existing legislation. These include the cessation rules, an increase in the amount exempt from income tax in Division 13A plans, the limit on the number of equities that a single employee may hold, the use of equities other than ordinary shares, (recommendations 27, 31, 32, 34, 36 and 37). In particular, recommendation 34 is targeted at small, medium or unlisted enterprises and firms in sunrise industries; and
- the waiving of the restriction on the sale of employee share plan equities in cases of genuine hardship (recommendation 38), the waiving of tax grouping rules, under certain circumstances, and the elimination of double taxation on equities acquired under an employee share plan by a resident of the Commonwealth while abroad (recommendation 39).

## **Chapter 5 Further initiatives to facilitate the growth of employee share plans**

Taxation was not the only area that needed to be addressed if the goal was to be attained of increasing the number of employee share plans, their value and the number of general employees participating in them. Disincentives in the Corporations law also had to be addressed, in particular the prospectus conditions (recommendation 40).

It also came to the attention of the Committee that there is a case for disclosing the value and extent of employee share plans in annual reports. The Committee recommends that enterprises operating plans should be required to disclose fully the extent, nature and value of employee share plans, how they are operated, and that this information be readily available. This represents a simple fact: markets operate more efficiently and effectively if investors know the complete financial position of the enterprises in which they invest (recommendations 41-43).

Apart from modifying existing arrangements so as to facilitate employee share plans, the Committee considered it important to identify various potential

innovations that could promote still further the spread of plans (recommendation 45).

The Committee also considered a number of matters that fell outside the terms of reference but which nevertheless may affect the level of participation in employee share plans (recommendation 44). These matters can be properly evaluated only with additional information such as would be generated by registering plans and regulating them. The Committee recommends that these matters be investigated when the information is available (recommendation 45).

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# List of recommendations

## Chapter 1 Introduction

(No recommendations)

## Chapter 2 ESOPs antipodean fables: nature and rationale

### Recommendation 1

The Committee recommends that the Government direct the Australian Taxation Office to conduct a study to determine:

- the number and type of employee share plans operating in Australia;
- the types of enterprise in which they operate;
- the number of employees in such plans;
- the value of holdings in those plans;
- the amount of revenue provided to the Commonwealth each year from the sale of employee share plan equities;
- revenue foregone by the Commonwealth through the operation of employee share plans; and
- the performance of these plans in attaining the public policy objectives set for them and in doing so, identify and report upon problem areas in plans operating both inside and outside Division 13A.

The Committee recommends that the Australian Taxation Office collect such information annually. The Government should consider the merit of making such information publicly available and, if so, on an annual basis.

### Recommendation 2

The Committee recommends that the Government fund, on a contestable basis, independent, university-based research into best practice management in relation to employee share plans.

### Recommendation 3

The Committee recommends that the Government develop, in conjunction with educational institutions and private sector industry groups, educational programs designed to make information about contemporary management practices available to small and medium unlisted companies, and companies in sunrise industries.

### Recommendation 4

The Committee recommends that legislative measures should ensure that employee share plans are not used as an alternative to mandatory superannuation for general employees.

### Recommendation 5

The Committee recommends that public policy should be formulated so as to promote employee share plans for the following purposes:

- to better align the interests of employees and employers;
- to develop national savings;
- to facilitate the development of sunrise enterprises; and
- to facilitate employee buyouts and succession planning.

### Recommendation 6

The Committee recommends that the Government introduce a concessional taxation rate on up to 50 per cent of the proceeds of the sale of any equities acquired under an employee share plan that operates under Division 13A of the *Income Tax Assessment Act 1936*, and which is open to 75 per cent of a company's employees, where the taxpayer:

- invests, as a preserved contribution, up to 50 per cent of the proceeds of the sale of any equities acquired under such a plan in an approved superannuation fund in the participant's name; or
- invests in an approved trust structure established to provide income for a dependant, for the term of their legal dependency; or
- has reached retirement age or after, and uses the proceeds to fund retirement.

The Committee recommends that a maximum allowable limit should be applied in any one tax year. That limit should be set to advantage general employee share plans. The concessional tax treatment will apply only to that qualifying portion of the proceeds invested in the terms described. The nature and level of taxation concessions provided should be



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determined by the Government after consultation with appropriate industry bodies, the Employee Share Plan Advisory Board (see recommendation 9) and the Australian Taxation Office.

#### **Recommendation 7**

The Committee recommends that a national review be conducted on the possible investment options, that could be encouraged in addition to compulsory superannuation, that would:

- increase national savings, and in the longer term,
- promote greater self-reliance in retirement.

### **Chapter 3      Aligning interests: employee share plans and public policy**

#### **Recommendation 8**

The Committee recommends that Parliament enact a single piece of legislation, bringing under one Act all laws governing employee share plans, their structure, taxation treatment, reporting and disclosure requirements. This legislation should apply to those plans presently operating under Division 13A as well as those plans that do not. The advice of relevant regulatory, industry and accounting bodies should be sought in undertaking this significant reform.

#### **Recommendation 9**

The Committee recommends that an Employee Share Plan Advisory Board be established:

- consisting of all relevant interests, including but not limited to: the Australian Taxation Office, the Australian Securities and Investment Commission and representatives of employers and employees; and
- to provide advice on the policies to be implemented in order to foster the widespread development of employee share plans amongst general employees and in sectors where uptake has been poorer, such as in small and medium companies and sunrise enterprises.

#### **Recommendation 10**

The Committee recommends that the Department of Employment, Workplace Relations and Small Business establish an Employee Share Plan Promotional Unit. Its purpose would be to actively promote employee share plans, including assistance with design, implementation and the provision of information to both employers and employees.

#### **Recommendation 11**

The Committee recommends that the Employee Share Plan Promotional Unit should aim, in cooperation with a proposed Employee Share Plan Regulatory Agency in the Australian Taxation Office, to develop and make available to employers and employees, *model* or off-the-shelf plans. This would reduce costs to smaller businesses while facilitating the uptake of employee share plans already approved by the ATO as being consistent with taxation provisions.

#### **Recommendation 12**

The Committee recommends that a minimum information list for employees be developed and specified in legislation for all employee share plans.

#### **Recommendation 13**

The Committee recommends that the Australian Taxation Office receive an additional, specific appropriation to fund investigation of the promoters of aggressive tax schemes. Further consideration should be given to appropriations in support of ATO-initiated legal action should this be supported by the outcome of systematic inquiry.

#### **Recommendation 14**

The Committee recommends that the Government consider that a cap be applied to salary sacrifice arrangements when foregone salary is contributed to an employee share plan qualifying under Division 13A. Further concessional arrangements should apply to sunrise industries, small and medium businesses where the Share Plan Regulatory Agency recommended elsewhere in this report is satisfied that the employee share plan is a bona fide employee buyout. This arrangement would apply for a defined period of time to be negotiated between the Government, the regulatory agency and relevant industry bodies.

The Committee further recommends that the Government give consideration to requiring all sacrificed salary in executive-only or non-13A plans be assessable in the income tax year in which the sacrificed salary was earned, having conducted first an analysis of its impact on corporations, especially their ability to attract and retain key personnel.

Any substantial changes to the taxation treatment of executive remuneration packages should be phased in and prospective.

### **Recommendation 15**

The Committee recommends that the Government establish an independent inquiry to examine:

- the extent to which FBT exemptions are being used to develop and underwrite executive salary packaging, the cost to revenue and the economic benefits, including the attraction and retention of key personnel;
- the merit of plans, open to executives only, which operate on a salary sacrifice basis or on low or no interest loans, or which use various FBT exemptions, to continue to operate as they stand;
- whether limits should be placed on the amount of salary that may be sacrificed, the size of a low or no interest loan that may be accepted, or the amount of FBT exemption that may be allowable, without the value of the benefit being treated in the same way as cash income; and
- whether sunrise enterprises should be given access to concessional taxation treatment in respect of the FBT liability or the taxation treatment of salary sacrifice and company provided loans.

### **Recommendation 16**

The Committee recommends that the Attorney General prepare a discussion paper for public consideration, on the issues surrounding the clarification of the powers of the Commissioner for Taxation in relation to the discovery of information concerning aggressive tax planning schemes. This would include information held by legal practitioners. Particular consideration should be given to ensuring that information collected is used only for the detection and prevention of aggressive tax planning.

### **Recommendation 17**

The Committee recommends that any legislation providing for employee share plans contain a preamble that clearly articulates the public policy goals intended by Parliament.

The Committee recommends that the Commissioner for Taxation and any other regulatory authority be required to take notice of, and give effect to, this preamble in their rulings in respect of employee share plans legislation.

### **Recommendation 18**

The Committee recommends that:

- an Employee Share Plan Regulatory Agency be established, by legislation and operate under the aegis of the Australian Taxation Office;
- the agency should be established as an element of any consolidated employee share plan legislation; and
- the agency's responsibilities should be to:
  1. administer any employee share plan legislation;
  2. monitor the operation of employee share plans;
  3. advise appropriate regulatory authorities so that the intent of the legislation can be attained;
  4. advise government of improvements to legislation that would facilitate the creation of employee share plans while at the same time reducing opportunities for their use other than for purposes intended by Parliament. This would include, but not be limited to, defining small, medium and sunrise enterprises and establishing criteria for determining what constitutes an aggressive tax planning scheme; and
  5. develop, in consultation with stakeholders, a number of model plans with known taxation consequences, and provide these to the Employee Share Plan Promotional Unit in the Department of Employment Workplace Relations and Small Business, recommended elsewhere in this report.

### **Recommendation 19**

The Committee recommends that:

- all employee share plans operating in Australia be registered with the regulatory agency and be given a unique identifying number, whether or not they operate under Division 13A or some other arrangement;
- registration of employee share plans involve providing to the regulatory authority the following information:
  - ⇒the names of participants;
  - ⇒the type, number and value of equities provided;
  - ⇒the method of valuing equities;
  - ⇒the rules of the plan and how it operates and is administered;

⇒the duration of the plan;

⇒any concessions provided to the plan; and

⇒the number of times equities have been issued under the plan;

- taxpayers be required to disclose on their tax returns their participation in employee share plans; and
- data be collected, on an annual basis, as to the number and types of membership, size of employee share plan and other operational details.

#### **Recommendation 20**

The Committee recommends that the regulatory agency be empowered to declare that a certain share plan has a primary purpose beyond that intended by Parliament. The agency should be empowered to make an assessment in respect of the income and/or equities in the plan.

#### **Recommendation 21**

The Committee recommends that:

- the Government re-examine the underlying policy of private binding rulings, and consider options for increasing the transparency of such rulings; and
- the feasibility of posting rulings issued in respect of employee share plans on the Australian Taxation Office internet site should be examined, provided that no taxpayer identifying information is provided.

#### **Recommendation 22**

The Committee recommends that the Employee Share Plan Regulatory Agency, or failing the creation of such an agency, the Commissioner for Taxation, be provided with a discretionary power to waive sections 139CD(3) and 139 DD(3) of the *Income Tax Assessment Act 1936*, provided that:

- the plan in question would otherwise satisfy Division 13A;
- the Commissioner is satisfied that the plan is not being used and will not be used for aggressive tax planning; and
- there is another plan operating under Division 13A, but open to 75 per cent of employees, with an uptake rate of more than 50 per cent and no disincentive conditions, that is offered at the same time and in respect of which the same exemption is sought.

### **Recommendation 23**

The Committee commends the draft Registered Organisations Bill 2000 to Parliament and recommends that any legislation dealing with employee associations, provide explicitly:

- for membership of employee share plans;
- that when the members of a plan are also members of an employee association, the eligibility for registration of that association; and
- for the protection of the freedom of choice of employees who participate in enterprise associations and also participate in an employee share plan.

### **Recommendation 24**

The Committee recommends that the Government refer to the Employee Share Plan Advisory Board the question of whether taxation concessions available to employers for establishing qualifying employee share plans be conditional upon there being a non-interference clause inserted in the qualifying conditions in Division 13A. The intention would be to provide explicit guarantees for the freedom of choice and association of employers and employees.

### **Recommendation 25**

The Committee recommends that employees and employers be permitted to reach an agreement to trade wages and conditions (but not superannuation entitlements) for participation in an employee share plan so long as the following conditions are met:

1. the agreement is part of a reasonable strategy to deal with a business crisis;
2. the agreement is not contrary to the public interest;
3. the agreement involves full disclosure of the company's situation and risks that can reasonably be known;
4. the negotiations leading to the agreement involve an independent assessment that the strategy is soundly based;
5. the participants negotiate free of duress; and
6. any agreement struck should be ratified by an independent arbiter, such as the Australian Industrial Relations Commission or the Office of the Employment Advocate.

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## Chapter 4 Administration and taxation arrangements

### Recommendation 26

The Committee recommends that the Government clarify the taxation treatment of trust arrangements that are used to operate bona fide employee share plans established under Division 13A, and legislate specifically to exempt such trusts from proposed entity taxation provisions.

### Recommendation 27

The Committee recommends that the Government amend those sections of Division 13A of the *Income Tax Assessment Act 1936* providing for taxation of equities in tax deferral elections, currently 139B(3) and 139CC(3) and 139CC(4), to give effect to the following taxation treatment of the gain in capital value:

1. That income tax be levied on: the value of the discount on the equity when originally allocated, inflated by the application of compound interest, for the period of time the equity has been held and at an interest rate as determined from time to time;
2. That if income tax or FBT has not otherwise been paid on sacrificed salary, then the amount of salary sacrifice that has funded the purchase of an equity, be liable to income tax calculated as the value of the sacrificed salary inflated by the application of compound interest for the period of time the equity has been held, at an interest rate as determined from time to time; and
3. That capital gains tax be levied on: the value of the gain in capital value less the inflated value of the discount and, if applicable, the inflated value of any salary sacrificed. In considering this recommendation, the advice of the Australian Taxation Office should be sought to ensure that it is satisfied with the integrity measures and that the amendment is made in the knowledge of its revenue implications.

### Recommendation 28

The Committee recommends that:

- the Government direct the Australian Taxation Office and the Australian Securities and Investment Commission, in consultation with interested stakeholders, to develop appropriate and simplified valuation processes;
- the anomalies and uncertainties in the present valuation system be addressed and where possible removed; and

- model plans should be devised by the ATO, in consultation with stakeholders, and that these model plans specify appropriate, simplified and ATO-endorsed valuation processes.

#### Recommendation 29

The Committee recommends that the Australian Taxation Office and the Australian Securities and Investment Commission, in consultation with interested stakeholders, develop appropriate and simplified processes for valuing the discount on shares and the value of untraded shares or options.

#### Recommendation 30

The Committee recommends that the Government move to amend the relevant sections of Division 13A of the *Income Tax Assessment Act 1936*, so that when:

- (a) shares or options, in an enterprise which is subject to a corporate restructure, merger, takeover, or acquisition have to be exchanged for other shares or options; and
- (b) the original shares or options are qualifying shares or rights, held under a Division 13A plan; and
- (c) a tax deferral election had been made in relation to those shares or options; and
- (d) the new shares or options are qualifying shares or rights, offered under a Division 13A plan; then:
  - any income tax liability from the proceeds of the compulsory disposal of the original shares or options should become payable when a cessation event for the new shares or options takes place; or the employee be given the opportunity to transfer the entire interest to a preserved superannuation fund, at the taxation rate applicable to contributions to superannuation contributions.

#### Recommendation 31

The Committee recommends that the Government move to amend the *Income Tax Assessment Act 1936* so that for shares or rights allocated under a Division 13A deferred election plan, liability for taxation occur at the time of disposal, provided that:

- The plan is one open to 75 per cent of an employer's employees; or
- If the plan is open to a lesser number of employees (i.e. it is a restricted plan), then there was offered in that tax year or concurrently with the



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restricted plan, another plan that is open to 75 per cent of employees and meets the qualifying conditions in Division 13A; or

- If such a plan is not offered, reasons must be provided to the Employee Share Plan Regulatory Agency by the employer, explaining why either of the first two conditions have not been met.

#### **Recommendation 32**

The Committee recommends that the \$1,000 concession available to share plans operating under Division 13A be increased. Though noting and being sympathetic to the view that it be raised to \$2,000, a specific new level is difficult to recommend in the absence of Treasury estimates as to cost.

#### **Recommendation 33**

The Committee recommends that three years from the commencement of its operation, the Share Plan Regulatory Agency examine the operation of employee share plans and supporting legislation, and report to Parliament. In particular the agency should examine:

- the cost to revenue of employee share plans, whether they operate under Division 13A or not;
- participation rates;
- whether the legislation is achieving the public policy outcomes intended when it was enacted; and
- any possible improvements to the legislative arrangements that would promote the further spread of plans amongst general employees.

#### **Recommendation 34**

The Committee recommends that the 5 per cent limit on the number of qualifying shares or rights described in section 139CD(6) and (7) of the *Income Tax Assessment Act 1936*, be removed and replaced with a rule that:

(a) stipulates that any allocation under an employee share plan that will result in an employee holding more than 5 per cent of the shares or controlling more than 5 per cent of the votes at a general meeting be advised to, and approved by,

- a general meeting of owners; and
- the Share Plan Regulatory Agency on the basis that it is a genuine employee share plan established for a recognised purpose, such as:

⇒an employee buyout;

⇒spreading equity ownership throughout a small or medium enterprise;  
or

⇒facilitating the creation and growth of a 'sunrise' enterprise.

(b) allows an employee to hold as many shares as any other member in a particular share scheme, up to a maximum of 25 per cent for each employee in that scheme, provided that:

(c) if the scheme in (b) is restricted to a small number of employees, rather than provided to all employees, then there is at the same time another 'general' scheme open to at least 75 per cent of employees, which:

- is not structured in any way so as to deter employees from participating; and
- provides for each member of that scheme to be allocated equities, the value of the discount of which must exceed the level of the discount allowable as a tax exemption under a tax exempt scheme operating under Division 13A. This is currently \$1,000.

#### **Recommendation 35**

The Committee recommends that:

- the intent of section 139CE(2) of the *Income Tax Assessment Act 1936* be clarified, so as to remove doubt about its meaning; and
- unlisted enterprises be permitted to require employee share plan participants to sell any equities acquired through an employee share plan to the plan manager when they choose to dispose of the equities. The valuation method used should be determined by the Employee Share Plan Regulatory Agency.

[Section 139 CE(2) of the *Income Tax Assessment Act 1936*, requires that a share plan not contain any condition that would result in the forfeiture of the shares or rights acquired.]

#### **Recommendation 36**

The Committee recommends that Division 13A be amended to allow stapled securities as qualifying equities in addition to ordinary shares or options to ordinary shares, provided that any plans that do use such equities have the approval of the Share Plan Regulatory Agency.

### **Recommendation 37**

The Committee recommends that employee share plans operating under Division 13A and which are open to at least 75 per cent of a company's employees, not be confined to ordinary shares or options to ordinary shares. They should also be permitted to offer any other instrument or security in the employer which is able to be dealt with by an employee, provided that such an instrument or security confers no less ownership entitlements upon the employee shareholder than those usually conferred by ordinary shares in a company.

### **Recommendation 38**

The Committee recommends that, in cases of genuine hardship, employees who are members of plans open to more than 75 per cent of the employees of an enterprise, be exempted from the three-year sale restriction limit. Exemptions would be granted only on application to the Employee Share Plan Regulatory Agency, that has been previously recommended. (Chapter 3, recommendation 17.)

### **Recommendation 39**

The Committee recommends, subject to the Australian Taxation Office being satisfied as to the strength of the integrity measures, that:

(a) where the tax grouping rules prevent the creation of employee share plans, case by case relief from them should be provided, so long as the plan is operated under Division 13A and it is a plan in which general employees are eligible to participate; and

(b) where a person becomes a resident of the Commonwealth, for taxation purposes, and has acquired before becoming a resident, equities as part of an employee share plan; then

- any tax paid on those equities in a foreign jurisdiction should be taken into account in their taxation liability in respect of those equities in Australia; so that

⇒ any income derived from those equities should be taxed in such a way that the person will not pay tax on those equities at a higher rate than would be the case if the equities had been acquired by a resident of the Commonwealth.

## Chapter 5 Further initiatives to facilitate the growth of employee share plans

### Recommendation 40

The Committee recommends that the Australian Securities and Investment Commission:

- monitor the operation of the provisions of *Corporate Law Economic Reform Program Act 1999* and Policy Statement 49 in respect of their effect on employee share plans and advise the Treasurer annually as to:
  - ⇒the number of applicants who seek to use the relevant provisions of the CLERP Act;
  - ⇒the number of applicants who seek relief under Policy Statement 49;
  - ⇒the number of applications in each class which were approved;
  - ⇒the number of applications which were not approved; and
  - ⇒if not approved, the reasons why they were not approved.
- advise the Government as to any amendments that may be required to facilitate the operation of the *Corporate Law Economic Reform Program Act 1999* in respect of employee share plans without unduly increasing investor risk;
- if necessary, amend Policy Statement 49 so as to facilitate the creation and operation of employee share plans, especially in regard to unlisted, small and medium companies, and those in sunrise industries, without unduly increasing investor risk; and
- advise the Treasurer on the feasibility of a specific disclosure document designed to be used by the operators of employee share plans that cannot otherwise use the disclosure exemption provisions or the Offer Information Statement provisions of the CLERP Act.

### Recommendation 41

The Committee recommends that it be a requirement that the following information pertaining to employee share plans be provided in a readily understandable form in all annual reports:

- the total value and size of all employee share plans, including the value of options and other equities and number thereof;
- the value and number of equities allocated in the year in respect of all plans and types of equity;

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- the method of valuing the equities and determining the size of allocation;
  - the aggregate amount received in the year by all employees. The aggregate sum received by directors and executive employees and other employees receiving executive-level remuneration should be identified as a specific line item;
  - the total value and number of equities of all sorts allocated to, or exercised by, directors, executives and any other employee receiving executive-level remuneration, and the value and number of options which they allowed to lapse;
  - whether the equities allocated in the year in question or in previous years under an employee share plan gave rise to an expense for the enterprise and the size of that expense; and
  - the effects, if any, of the exercise of those options on the enterprise's financial standing.

#### **Recommendation 42**

The Committee recommends that information about all of an enterprise's employee share plan or plans:

- be held by a designated officer of each company;
- be notified to the regulatory agency or, failing the establishment of such an agency, the Australian Securities and Investment Commission.

The Committee further recommends that failure to disclose that information or providing misleading information should be considered an offence.

#### **Recommendation 43**

The Committee recommends that when a significant proportion of the equities held by an executive or director of a company is to be disposed of within a two-week period, fourteen days notification should be provided to the Australian Stock Exchange and the Australian Securities and Investment Commission, for public release. The threshold which triggers the requirement for such notification should be determined by the Government in consultation with the Employee Share Plan Advisory Board.

#### **Recommendation 44**

The Committee recommends that the Australian Taxation Office and Treasury evaluate the feasibility of requiring, through legislation, employee share plans to provide guaranteed levels of employee share ownership to different classes of employees, in listed private sector organisations that have more than twenty employees.

#### **Recommendation 45**

The Committee recommends that when more information is available about the operation of employee share plans, a further Parliamentary inquiry be conducted into the use and nature of employee equity arrangements, with particular emphasis on the feasibility of:

- providing equities at full cost;
- providing equities in enterprises other than in the employer of the person receiving the equity;
- further assisting share plans designed to facilitate succession and employee buyouts and buy-ins and as elements in industry assistance programs; and
- allowing taxation concessions on some portion of a capital gain arising from the sale of equities into an employee share plan, so long as the proceeds are invested in another enterprise.