

## **Share and share alike**

If employee share schemes are complicated, why are they becoming more popular? Leon Gettler reports

**By Leon Gettler**

In May last year, the government unwittingly walked into a firestorm when it announced plans in its budget to axe tax breaks on employee share schemes for workers earning more than \$60,000 a year. Under the previous rules, workers could opt to pay the tax on their shares upfront and get a \$1000 discount on their liability. Or they could defer paying tax until the shares were sold – and then pay tax on the gap between the market rate and the price they paid for them.

Under the tax deferred plans, employees could put off paying tax on the shares for up to 10 years. The government's agenda was simple: restore the budget to surplus. At the time, it claimed it was just closing a tax loophole. Finance minister Lindsay Tanner told the ABC's AM program that the \$60,000 cut off point was reasonable and that "the bulk of use of this particular arrangement was by people at the upper end of the income scale primarily focused on minimising their tax".

The government was shocked at the reaction which created some unusual alliances. Numerous companies, including Coles, Wesfarmers and Alcoa, either suspended or reviewed their share schemes. The federal opposition and employers were joined by unions, such as the Finance Sector Union, the Shop Distributive and Allied Employees Association and Australian Workers Union attacking the government. While employer groups like the Australian Chamber of Commerce and Industry said the system was not broken so it did not need to be fixed, the unions said people on \$60,000 were not living champagne lifestyles and that share packages were often an important component in their planning for retirement.

In the end, the government backed down. In legislation passed at the end of the year, effective from 1 July 2009, the government raised the income threshold below which workers were eligible to certain exemptions on upfront tax to \$180,000. This was in line with the top income tax bracket and well up from the \$60,000 originally proposed. However, some of the tax rules were tightened.

Ian Ramsay, the director of the Centre of Corporate Law and Securities Regulation at the University of Melbourne, says the episode showed how badly the government had underestimated the significance of employee share schemes. "We suddenly got a realisation that the government had screwed up," Professor Ramsay says. "They might have had something in mind but the

way they executed it meant the industry ground to a halt for a while. How they approached the target seemed to be not very strategic.”

Data from the Australian Bureau of Statistics shows that an increasing number of employees are taking up shares as an employment benefit. In 1979, the proportion of employees receiving shares as a benefit was 1.3 per cent. Between 1989 to 1999, this proportion had increased from 2.4 per cent to 5.5 per cent. In 2004, the proportion of employees receiving shares as an employment benefit was 5.9 per cent. ABS figures also show that the insurance and finance industry have the highest proportion of employees holding shares in a company. While only 4 per cent of employees worked in finance and insurance, they accounted for 21 per cent of all employees who received shares. The ABS also found that employees who received shares as a benefit generally earned more than their counterparts. Interestingly, trade union members were more likely to have shares than non-trade union members.

Listed companies were more likely to have employee share schemes. There are some good reasons for that. Ian Crichton, managing director of CRA Planners, says private companies would need to create and maintain a registry or trust which could be expensive. And in an unlisted environment, there was the problem of valuing the entity. For many private companies, the only ways to do that was by having buybacks, or by having a liquidity event such as an IPO or trade sale.

This means that the bulk of Australian businesses were unlikely to have broad employee share schemes. “It’s a relatively complex task to have employee share ownership programs operating effectively in most private companies,” Crichton says.

So if employee share schemes are so complicated, why are they becoming more popular? Research prepared by the Centre for Corporate Law and Securities Regulation in 2009 shows that while tax concessions were a key consideration in framing employee share schemes, human resources issues were the deciding factor. The three most popular reasons for implementing a plan were “showing employees the company values them”, “sharing financial success with employees” and “aligning employee interests with shareholder interests”.

Professor Ramsay says: “We started off wondering how important the tax concessions were and I am not suggesting they are unimportant but in terms of what motivates the company, it seems to be more about HR rather than tax issues that drive companies to offer employee share schemes.” The research showed that these schemes were more often found in companies that had a centralised human resources capability, along with growth over the previous 12 months.

Despite the growth of employee share schemes here, it is still a relatively undeveloped market, especially when compared to the United States. According to a US General Social Survey in 2006, 17.5 per cent of the private

sector workforce in the US held shares in their company and 9.3 per cent held options. And in contrast to Australia, the vast majority of US employee share schemes were found in unlisted companies. Similarly in Europe, a survey of EU member states found that just under one third (31 per cent) of organisations with more than 200 employees had a share ownership scheme.

### **Share ownership**

Despite the low take up of employee share schemes in Australia, they have proven to be highly popular for public and private companies. Some of Australia's biggest companies have successful schemes in place. The Lend Lease 2009 annual report shows that employees own 7.85 per cent of the company. Like many entities, Telstra has put its employee share scheme in a trustee subsidiary, ensuring the scheme operates at arm's length from the company. Telstra's 2009 report shows that Telstra ESOP Pty Ltd is listed among Telstra's top 20 shareholders, owning 0.31 per cent of Australia's dominant telco. Employees have been offered interest free loans by Telstra to acquire certain shares. In some cases, employees become entitled to certain extra shares and loyalty shares as a result of participating in the plans. OneSteel offers its employees tax-deferred and tax-exempt plans that allow employees to make salary sacrifice contributions to buy shares on-market every month. Under both plans, the company also grants to contributing participants a parcel of fully paid ordinary shares to the value of \$125 per year for employees participating in the tax-exempt plan and \$250 per year for employees participating in the tax-deferred plan.

With the tax-exempt plan, the shares need to be held in the plan for a minimum of three years while the employee remains at OneSteel. For the tax-deferred plan, employee contribution shares must be held in the plan for a minimum of 12 months, and company contribution shares must be held in the plan for 24 months. Listed furniture retailer Fantastic Holdings offers shares to all employees. It provides 11 matching shares for every 100 shares acquired by the employee. Effectively, that amounts to a discount of 10 per cent to the market value of the shares. There has been a 25 per cent take-up rate of the share plan. Over 1 per cent of the company's issued capital is now owned by employees. About 2 per cent of listed metals miner Perilya is owned by employees through an Employee Share Acquisition Plan (ESAP). The ESAP ranks among Perilya's Top 10 Shareholders. The company's entire workforce accepted Perilya shares at the 2006 ESAP launch and 60 per cent of employees now actively invest in it through salary sacrifice. The scheme gifts shares to the value of 10 per cent of an employee's salary as an introduction and then matches dollar for dollar any further contribution made by the employee. The entire workforce of listed optometry company Eyecare Partners own shares or options in the company, and 35 per cent of its employees elect to take advantage of the salary sacrifice arrangements to add to their holdings.

Employee share schemes are also used by private companies. Food and energy business Gardner Smith has four schemes covering its workforce in Australia and New Zealand. Gardner Smith employees with more than 12 months service now participate in employee share plans and 9.1 per cent of

the issued capital of the firm is targeted for employee ownership. Another company which has an employee share scheme is advertising agency Clemenger BBDO. According to Clemenger's 2009 annual report, 469 of the company's 1500 employees are majority shareholders.

They own 53.3 per cent of Clemenger. The rest is owned by New York based BBDO which is in turn owned by advertising and marketing behemoth Omnicom Group. The report says that 50 per cent of the year's after tax profit is distributed as fully franked dividends for its shareholders.

### **Vested interest?**

Significantly, companies were reluctant to discuss the schemes and explain how they handle people management and tax issues. Klaas Woldring, the secretary of the Australian Employee Ownership Association, says one of the problems highlighting the importance of the schemes and encouraging other businesses to adopt them was getting companies to talk about them openly, as more mature businesses would do in America and Europe.

But the real problem of getting the schemes adopted here was the industrial relations climate, he said. Woldring, a former professor in management at Southern Cross University, says the adversarial industrial relations climate was strongly ingrained in Australian society.

"There is a good deal of suspicion among union leaders about employee share ownership because they argue it turns the employee into a little capitalist," Woldring says.

What happens, for instance, if the union calls a strike? The share owning employees might be less likely to walk. They might feel this would be against the interests of the company they part own. "We have difficulty getting unions onside because the unions feel share ownership schemes in business gives power to the workers in their own business but it undermines the power of unions outside it," Woldring says.

He says that increasing the uptake of employee ownership schemes requires governments and unions to work closer together. "The unions and the government need to think about this because the record shows that employee share ownership in the United States and Europe has been absolutely positive, not just in terms of the reduction of strikes but also in terms of productivity and the satisfaction of workers," he says.

Tax and remuneration experts have expressed some concerns about the changes implemented by the government. These changes allow the deferral of tax for up to \$5000 worth of shares under some salary sacrifice-based employee share schemes. However, they also allow the federal government to tax options that are out-of-the-money, or where there is no gain to the employee as they are taxed at vesting, rather than exercise. If a five year package vests at 20 per cent per year, that 20 per cent becomes taxable each year.

Sally Morton, a Deloitte tax partner, says this could make certain schemes less palatable. “Some will be less attractive than they used to be but there are still many opportunities and areas that are attractive,” she says. “You can’t say it’s all bad news.

“It does mean that companies need to be reviewing the plans and see whether any changes are needed to align with the new rules.”

But Crichton says many HR managers will struggle in the new environment. “It’s a whole new ball game. There will be a period of time where HR practitioners will be ill-equipped to deal with the changes because all their precedents are redundant,” Crichton said. “There will be a period of time when new precedents are established and created and new practices are tested.” He says the standard “common garden” employee share scheme used prior to 30 June 2009 is no longer appropriate.

Crichton says: “The plain vanilla schemes will be riddled with tax traps so anybody who offers a plain vanilla option plan that was common in the years before 30 June will find themselves in trouble if they offer a similar plan post 30 June.

“They have to offer a plan that doesn’t incorporate tax traps which means the plan will change fundamentally and the complexity of the offer may change fundamentally, particularly for unlisted companies. Whereas one size might have fitted all previously, it’s buyer beware now.”

That means HR practitioners will need to get advice and Crichton warns they will have to do better than just turning to tax lawyers. “It’s more complex and most of the tax lawyers are not that creative, they are more responsive,” Crichton says. “What you need is something that gets the HR alignment you are looking for so you need to do your design very carefully.

“The plan has to meet the HR design requirements written in such a way so as not to offend the taxing issue. And if the taxing issue does offend the HR design, then you may have to amend the design.

“Whether they go to tax lawyers or practitioners, they need to be extremely careful now.”

Shares up	1979	2004
Employees receiving shares as a benefit	1.3%	5.9%

**Where shares register**

Company	% company owned by employees
Lend Lease	7.85
Telstra	0.31
Fantastic Holdings	+1.00
Perilya	2.00

**Source:** *HR Monthly*, March 2010, pp 28-33