

KEEPING TO PLAN

Employees with shares in a company are more likely to work hard and stick around.

By Manda Trautwein and Bryony Vandeppear

Employee share-ownership plans are one mechanism for satisfying Generation Y employees who are both increasingly in-demand and demanding. The theory is that, by offering young talent a shareholding in a company, it will be more motivated and productive, and less likely to be lured away by competitors.

Many types of ESOPs are available for both public and private enterprises. The best plan in any given situation depends on the nature of the business, its objectives and its broader remuneration strategy. Other factors are the importance of employees' access to tax concessions and the conditions attached to the plan.

ESOPs, which can be offered to all employees or a select group, fall broadly into two categories: qualifying and non-qualifying. Qualifying plans offer employees certain tax concessions, but the plans must satisfy the requirements of Division 13A of the Tax Act. Non-qualifying plans don't have the same concessions, but they are more flexible and still provide an opportunity to gain from the growth of a company through participation in equity.

Small to medium-size private companies, in particular, need to consider additional issues such as the Corporations Act and accounting standards, which apply to any company considering an ESOP, whether it is listed or unlisted, public or private. In many cases, compliance requirements for unlisted companies deter them from implementing ESOPs. They don't have a liquid market for their shares, which creates the need for a valuation mechanism and adequate capital to buy out departing employee shareholders. The company may be required to disclose information about its ESOP to employees

Common employee share-ownership plans

PLAN TYPE	SUMMARY	ADVANTAGES	DRAWBACKS
QUALIFYING PLANS			
Tax exempt	Employees can receive up to \$1,000 worth of free shares per tax year. Shares can't be disposed of for a minimum of three years or until cessation of employment.	Shares qualify for tax concessions. Relatively simple to understand and administer.	Shares must be qualifying shares under Division 13A of the Tax Act. Shares can't be forfeited. Restrictions on disposal. The plan must be operated on a non-discriminatory basis.
Tax deferred	Allows employees to acquire shares through bonus or salary sacrifice arrangements or to obtain free shares. Tax is deferred on the value of the shares granted for up to 10 years.	Shares qualify for tax concessions. Shares can be forfeited in certain situations.	Shares must be qualifying shares under Division 13A of the Tax Act. Shares are restricted until the earlier of 10 years or cessation of employment.
NON-QUALIFYING PLANS			
Loan plan	Allows employees to acquire shares financed by loans provided by the company. The loan is typically non-recourse, interest-free and repaid through dividends payable on the shares and their eventual sale.	No immediate financial outlay for employees. Where there is no discount on the shares, employees have to pay capital gains tax only on any gains realised on the ultimate share disposal.	If a discount is offered, employees are subject to taxation on the discount at their marginal income tax rate in the year the shares are acquired. Negative connotation with the term 'loan'. Long term. Employer may be subject to fringe benefits tax if the loan is non-recourse.
Post-tax contribution	Money is deducted from the employee's post-tax salary monthly or fortnightly and held until the shares are acquired, usually monthly, quarterly or annually.	Simple, easy to operate and low cost. Provides a structured mechanism for employees to buy shares over time. Where there is no discount on the shares, employees have to pay capital gains tax only on any gains realised on the ultimate share disposal.	Limited benefit to employees if shares are offered without discount. If a discount is offered, employees are subject to taxation on the discount at their marginal income tax rate in the year the shares are acquired.



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NON-QUALIFYING PLANS			
Option plan	Employees have a right or 'option' to purchase shares in the company at a specified time in the future for an agreed price. Options are mostly used for senior employees and generally have conditions attached.	No financial outlay by the employee when the options are granted. Performance conditions can be used to drive certain employee behaviour. Focus on share price growth.	Taxation can be complex. The incentive value of options is lost if the company's share price falls below the exercise price of the options. Under current accounting standards, the company needs to value and show the cost of the options as an expense.

in a prospectus, although a number of exemptions are available in relation to prospectus requirements.

For companies that decide that an ESOP is inappropriate, short-term incentive plans—such as profit sharing, gain sharing, or bonus or commission schemes—may still be worth considering.

About 20 per cent of Australian workers are Generation Y (born in or after 1978), and the proportion is expected to double over the next five years. The attractiveness of ESOPs for motivating and retaining young talent can only increase. ❌

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