

30 October 2000

Assistant Commissioner
Law Design and Development (Entities)
PO Box 900
CIVIC SQUARE ACT 2608

Attention: Mr Mike Buckley

Business Tax Reform Proposals and Implications for Employee Share Ownership

Dear Mr Buckley,

The Australian Employee Ownership Association (AEOA) has undertaken a review of the Federal Government's Exposure Draft Legislation of the *Business Tax System (Entity Taxation) Bill 2000*.

The AEOA has already made several representations about the deleterious impact of entity taxation on employee share plans. The representations have been made to the Federal Government, to the Ralph Review of Business Taxation, and, more recently, to the inquiry into employee share plans conducted by the House of Representatives Standing Committee on Employment, Education and Workplace Relations.

Notwithstanding, we note that the Exposure Draft Legislation does not indicate whether employee share plan trusts will be exempt from the entity taxation regime.

Perhaps the recommendations of the September 2000 report of the above-mentioned Committee should be taken into consideration:

That the Government clarify the taxation treatment of trust arrangements that are used to operate *bona fide* employee share plans ... and legislate specifically to exempt such trusts from proposed entity taxation provisions. (*Shared Endeavours: an inquiry into employee share ownership in Australia*, September 2000, p.129).

It should also be noted, in taking this recommendation into account, that it has the support of a large number of leading companies operating in Australia - both companies listed on the ASX and subsidiaries of foreign parent companies - which are members of this Association. All these companies use trusts as the fundamental building block for the employee share plans they operate under Division 13A of the Income Tax Assessment Act. The judgment of these many major businesses, and of their Association, should not be ignored.

Taxing ESOP trusts as companies

It is of very grave concern to the AEOA that Employee Share Ownership Plan (ESOP) trusts could be taxed as if they were companies. A large and growing number of ESOPs use trust structures. Shares are often held in trust for employees until various conditions - for example, vesting provisions and performance criteria - are met. If, however, these trusts were taxed as companies, a number of serious implications could arise.

- Shares presently held for the benefit of employees in a trust would need to be treated as the legal and beneficial property of the company which provided them. Employees,

therefore, would lose their legal interest in, or rights to, shares which, morally and legally, should be held for their benefit.

- Distributions by ESOP trustees of shares to employees could represent a capital disposal subject to capital gains tax and payable by the trustees.
- To accommodate dividends received by an ESOP trust would require the establishment of separate dividend imputation and franking credit accounts for each of its beneficiaries. This would be expensive and burdensome to the trustee, and to the sponsoring company, and would be certain to discourage the implementation of ESOPs.
- If receipt of a distribution from an ESOP trust to an employee were treated as a dividend payment, then the employee would be subject to tax at the marginal rate.

These apparent consequences of taxing ESOP trusts as companies would subvert some of the measures presently provided under Division 13A of the Income Tax Assessment Act to promote ESOPs. In particular, the tax-exemption extended to certain employee shares could be nullified.

In sum, the proposal to tax companies as trusts seems to contradict the Government's advocacy of employee share ownership and to undermine existing ESOP-favourable tax measures.

A more detailed account of the problems posed by taxing ESOP trusts like companies is set out at Attachment A.

Recommendation

This Association requests that the Federal Government be advised to preserve the integrity of present employee ownership policies and legislation by including in the *Business Tax System (Entity Taxation) Bill 2000* a specific exemption of ESOP trusts from entity taxation.

Yours sincerely,

(Gary Scarrabelotti)
Executive Consultant