EMPLOYEE SHARE OWNERSHIP PLANS – A COMPARATIVE REPORT

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This report outlines the taxation and corporate law frameworks of employee share ownership plans ('ESOPs') in Australia, the United Kingdom ('UK') and the United States ('US'). The US is characterised by a much greater breadth and depth of employee share ownership than any other country. This appears to have been facilitated by a relatively flexible regulatory regime of long standing. In contrast the UK scheme of tax concessions was established fairly recently and offers an example of recent public policy thinking and legislative reform in this area.

This report examines the different ways in which these three jurisdictions utilise tax and regulatory advantages to encourage employee share ownership and achieve other policy goals, such as the promotion of investment in start-up companies. The effectiveness of the UK and US regimes in achieving these aims is assessed by comparison with the Australian approach.

Part I of this report provides a brief discussion of the breadth and depth of employee ownership in Australia, the UK and the US. Part II sets out the manner in which ordinary (non tax-advantaged) employee share schemes are taxed. Part III outlines the requirements for the various statutory tax-advantaged schemes operating in each of these jurisdictions. Part IV considers the non-tax regulatory requirements for establishing and administering employee share schemes, and the impact these requirements have on the level of employee share ownership. The final part of this report analyses the effectiveness of the UK and US regimes at encouraging employee share ownership by comparison with Australia.

I THE INCIDENCE OF EMPLOYEE OWNERSHIP IN AUSTRALIA, THE UNITED STATES AND THE UNITED KINGDOM

In an earlier report we noted that there were few quantitative studies into employee ownership in Australia.[1] It did appear, however, that although the incidence of employee ownership in Australia remained lower than the UK and the US, employee ownership was increasing.[2] It is therefore useful to compare the level of employee ownership in Australia with other countries. We have chosen the US on the basis that it has a long history of employee ownership and a strong tradition of encouraging the practice. We have chosen the UK because it has recently implemented measures to encourage employee share ownership.

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[1] Ingrid Landau et al, 'Employee Share Ownership in Australia: Theory, Evidence, Current Practice and Regulation' (2007) 25 *Pacific Basin Law Journal* 25, 27.

[2] Ibid 64.

There are, however, significant difficulties in comparing data on employee share ownership drawn from different countries.[3] First, even if countries do measure the incidence and nature of employee share ownership, they often employ very different indicators. In the US, for example, statistics tend to measure the percentage of adult employees participating in ESOPs, whereas those in the UK focus on the percentage of workplaces with ESOPs. Secondly, countries have very different ESOP forms and structures, which significantly undermine any efforts to compare national findings. In the US, for example, there are a number of schemes or plans through which employees may own shares in the company for which they work, and different surveys include different plans. In this paper, the Employee Stock Ownership Plan ('US ESOP'), Employee Stock Purchase Plan ('ESPP')[4] and the Incentive Stock Options ('ISO') scheme[5] will be discussed. Similarly in the UK, there are four main plans or schemes and statistics often relate to different types of plans. The four main plans to be discussed in this report are the Share Incentive Plan ('SIP'),[6] Save As You Earn Option ('SAYE') Scheme,[7] Company Share Option Plan ('CSOP')[8] and the Enterprise Management Incentives ('EMI') scheme.[9]

Despite these difficulties, the framework for analysis adopted in this section will focus on the 'breadth' and 'depth' of employee share ownership in the three jurisdictions. The 'breadth' of employee share ownership deals with the incidence or *proportion of workplaces* that have some form of employee ownership scheme in place. The 'depth' of employee share ownership deals with the incidence or *proportion of employees* within such companies participating in employee share ownership schemes. An examination of 'breadth' and 'depth' also raises a number of other issues. First, there is an issue about whether certain types of companies (listed cf unlisted; larger companies cf smaller companies) are more likely to offer ESOPs. Secondly, there is an issue about whether employers offer shares (giving ownership rights in the company) or options (which give no ownership rights but have less risk attached). Thirdly, the characteristics of the employees receiving shares are also relevant. This may indicate whether plans are broad based and open to all employees, or whether plans are selective and only available to executives. Fourthly, and probably the most difficult to ascertain, is why employers offer employee share ownership schemes. The attitude of employers towards these schemes is likely to assist in identifying the likely uptake of and barriers to employee share ownership implementation.

While it is possible to get some indication of the breadth and depth of employee ownership, some of the related issues raised above will remain uncertain given the inherent difficulties in collecting information of this nature across the three jurisdictions.

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[3] Ibid 71.
[4] IRC § 423 (1994).
[5] Ibid § 422.
[6] *Income Tax (Earnings and Pensions) Act 2003* (UK) c 1, pt 7 ch 6.
[7] Ibid pt 7 ch 7.
[8] Ibid pt 7 ch 8.
[9] Ibid pt 7 ch 9.

A *Australia*

There are few quantitative studies into employee share ownership in Australia. However, we can draw several broad observations from the existing data. First, while the incidence of employee share ownership in Australia remains lower than in the UK and the US, it is clearly on the increase ('breadth'). A 2004 survey carried out by the Employee Share Ownership Developmental Unit ('ESODU') indicated that approximately 10% of Australian businesses had some form of employee share ownership plan.[10] As the incidence of Australian workplaces offering ESOPs is increasing, the number of Australian employees holding shares as a form of employment benefit is also increasing ('depth'). In 2004, this proportion was 5.9% of Australian employees, rising from a mere 1.3% of Australian employees in 1979.[11]

A few other observations may be made. First, according to the ESODU survey, of the ESOP companies in Australia, the majority of them do not offer 'broad based' plans (that is, plans open to 75% or more of employees). Only 44% of businesses had a broad based plan indicating that there may be significantly more executive share plans in operation in Australia.[12] In relation to the type of equity offered, 62% offered shares, while 31% offered options.[13] Second, ESOPs are much more likely to be found in larger publicly listed companies, companies with offices overseas and in particular industry sectors. A 2003 KPMG survey found that 80% of public listed companies had at least one ESOP scheme,[14] but only 8% of private companies had ESOPs.[15] Thirty percent of large companies (characterised as 100 or more employees) had ESOPs compared with 9% of small businesses (characterised as 5–19 employees).[16] Larger companies were also found to be more likely to have broad based ESOPs.[17] Firms in the manufacturing sector had the highest incidence of employee share ownership (22%), followed by finance and insurance (19%).[18] Finally, from the data collected by the Australian Bureau of Statistics, we can observe that employee share ownership is more common among full-time employees and among employees with higher weekly earnings: 7% of full-time employees receive shares as an employment benefit, compared with 3.4% of part-time employees.[19] The fact that employees who participate in ESOPs generally have higher earnings than those that do not may reflect the large proportion of employees participating in ESOPs in high earning industries. Employee share ownership participation is also higher in certain occupations. Managers and administrators were the occupations with the highest proportion of employees who held shares as benefits.[20] Further insight into the extent and nature of

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[10] TNS Social Research, 'Employee Share Ownership: Summary of Awareness, Attitudes and Endorsement' (Research report for the Department of Employment and Workplace Relations, 2004) 21 ('ESODU Report').
[11] Australian Bureau of Statistics, 'Spotlight: Employee Share Schemes' (Australian Labour Market Statistics, Cat No 6105.0, July 2005) 2 ('ABS 2005').
[12] ESODU Report, above n 10, 23.
[13] Ibid 24.
[14] KPMG, 'Employee Share and Option Schemes Survey Report' (August 2003) 3.
[15] ESODU Report, above n 10, 22.
[16] Ibid.
[17] Alison Morehead et al, *Changes at Work: the 1995 Australian Workplace Industrial Relations Survey* (Addison Wesley Longman, 1997) 222.
[18] ESODU Report, above n 10, 21.
[19] ABS 2005, above n 11, 2.
[20] Ibid 3.

broad-based employee share ownership in Australia, particularly in larger companies, can be gained from our survey conducted into employee share scheme practice in companies listed on the Australian Securities Exchange.[21] This study found that 57% 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 such 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% of plans), followed closely by shares (around 47% of plans).

The data, however, is fairly limited. A number of the earlier studies fail to differentiate between narrow and broad based ESOPs. Surveys have also tended to draw on a relatively small sample size. We still have very little understanding of how businesses in Australia (other than listed entities) are structuring their employee share ownership plans and how, if at all, they are integrating employee share ownership into their broader human resource management strategies.

B *United Kingdom*

Both the breadth and depth of employee share ownership appears to be higher in the UK as compared to Australia. In 2000, 23% of UK workplaces surveyed had some form of ESOP.[22] In respect of the depth of employee share ownership, it was estimated in 1999 by the Treasury Office that approximately 7% of UK employees held shares as a form of employment benefit.[23] This figure was estimated to have had increased to approximately 15% of the UK workforce in 2007.[24]

Several other observations may also be made. First, similarly to Australia, larger publicly listed companies appear more likely to offer ESOPs than proprietary companies. In a survey of the 100 largest companies by market capitalization listed on the FTSE 100, 89.3% of companies had some form of equity scheme.[25] This is in comparison to only 19.6% of private sector workplaces with five or more employees

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[21] 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.

[22] Colin Gill and Hubert Krieger, 'Recent Survey Evidence on Participation in Europe: Towards a European Model?' (2006) 6 *European Journal of Industrial Relations* 109, 124.

[23] Her Majesty's Treasury, 'Consultation on Employee Share Ownership' (1999), as cited in Adam Reynolds, 'Do ESOPs Strengthen Employee Stakeholder Interests? (2001) 13 *Bond Law Review* 95, 103.

[24] Margareta Pagano, 'Own Your Share of British Business' (2007) *Spectator* (June 9). Cf *Wealth and Assets Survey* (Office of National Statistics, 2008) where it was estimated 7.3% of households own shares or share options.

[25] Erik Poutsma et al, 'The Relationship between Financial Participation and Other Forms of Employee Participation: New Survey Evidence from Europe' (2006) 27 *Economic and Industrial Democracy* 637, 649.

that have an ESOP present.[26] Second, it is unclear whether broad based plans are more common than selective. It does appear, however, that broad based plans are more likely to be found in larger companies where 51.8% of the 200 largest companies had a broad based equity scheme.[27]

Apart from these figures, the available data on other related aspects of ESOPs in the UK appear to be scarce. This may be due to the fact that the UK has only recently sought to actively promote reform in this area, albeit that legislative activity began in the 1970s. Further, data may also be scarce due to the inconsistent methods that have been employed in collecting information in this field. There is much uncertainty surrounding the reasons why businesses choose to implement ESOPs, the industry sector in which ESOPs are more likely to be found in and the type of employees (ie, full time, part time, high income, low income) more likely to participate in ESOPs.

C *United States*

It is widely recognised that the US has the highest proportion of employee share ownership. As of 2009, it was estimated that approximately one-third of the US workforce own equity in their employer through one kind of employee ownership arrangement or another.[28] Together, they control assets worth over $US900bn.[29] This is significantly higher than the proportion of the workforce that participates in ESOPs in both Australia and the UK combined. Those 25–30 million US employees who own equity in their employers have grown from only one million employees, forty years ago.[30]

In respect of the type of equity offered, the US General Social Survey in 2002 found that 21.2% of the private sector workforce holds shares in the company for which they work, while 13.1% hold options.[31] The same survey conducted in 2006 found that the percentage of the private sector workforce holding shares and options had declined to 17.5% and 9.3% respectively.[32] This may indicate the increasing varieties of statutory and non-statutory employee ownership arrangements that are being implemented in the US.

It is difficult to compare the incidence of broad based and selective plans in the US as compared to Australia. Generally speaking, however, it appears that larger companies are more likely to offer broad based employee ownership arrangements. According to

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[26] Workplace Employment Relations Survey 2004, as cited in A Pendleton, 'Employee Share Ownership Plans in the UK' (presentation given at the University of Sydney).
[27] Ibid.
[28] National Centre for Employee Ownership, 'A Brief Overview of Employee Ownership in the US' (2009) and National Centre for Employee Ownership, 'A Comprehensive Overview of Employee Ownership' (2009).
[29] Ibid.
[30] Ibid.
[31] General Social Survey 2002 and National Organisations Study 2003, as discussed in Joseph Blasi and Douglas Kruse, 'The Political Economy of Employee Ownership in the United States: From Economic Democracy to Industrial Democracy' (2006) 16 *International Review of Sociology* 127, 135–6 ('General Social Survey 2002').
[32] General Social Survey 2006, as discussed in National Centre for Employee Ownership, 'Data Show Widespread Employee Ownership in US' (2006) and in National Centre for Employee Ownership, A Statistical Profile of Employee Ownership' (2010).

the General Social Survey, the incidence of broad based plans rises from 20% of companies with 50–99 employees to 47% of companies with more than 2000 employees.[33]

It appears, however, that while larger public companies offer employer ownership arrangements to a wider variety of employees, the proportion of company assets owned by employees is larger for smaller proprietary companies. Public stock market company employee ownership is generally below 10%, with only a modest number of public firms having significant employee ownership.[34] Private company employee ownership, however, is heavily concentrated in significant and majority employee ownership.[35] Interestingly, in contrast to Australia, the vast majority of ESOPs in the US are found in unlisted businesses. Private sector companies are more likely to offer ESOPs than public companies. Public companies account for only 12% of all companies with employee share ownership.[36] This is a significant difference compared with Australia and the UK. This may perhaps indicate that the costs and barriers for implementing ESOPs remain too high for smaller unlisted companies in these countries.

There do not appear to be any differences in the likelihood of various types of employees participating in employee share ownership arragements. Twenty per cent of blue-collar workers, 22% of professionals and 23% of other white collar workers participate in ESOPs in the US.[37] Differences in respect of income and whether employees are full time or part time remain unclear.

As noted previously, the available data, however, must be treated with caution. There are a variety of different mechanisms through which workers in the US may hold shares in the company for which they work, and different studies include or exclude particular plans.

II Taxation on Receipt of Securities where No Concessions

The receipt of shares or rights to shares as a result of employment will generally give rise to a tax liability. The main issue that needs to be considered is the *timing* of any tax liability relating to the receipt of securities in connection with employment. This relates to whether tax liability accrues on receipt, when securities vest, or upon exercise or disposal in respect of options and shares. It is also necessary to consider how the value of the benefit is calculated. A further issue is whether any benefit is taxed as income or capital.

A *Australia*

[33] General Social Survey 2002 above n 31.
[34] Joseph Blasi et al, 'An Assessment of Employee Ownership in the United States with Implications for the EU' (2003) 14 *International Journal of Human Resource Management* 893, 899.
[35] Ibid.
[36] Ibid 900.
[37] General Social Survey 2002, above n 31, 137.

The default position in Australia is that shares or rights received in respect of the provision of services will be subject to tax on *receipt*.[38] The amount to be included is the discount given in relation to the interest. There are two situations in which the tax liability can be deferred. The first is if there is a real risk of forfeiture of the share or right and the second is where there is an eligible salary sacrifice arrangement. In both cases, there are a number of conditions that must be satisfied.

1 *General rule*

A discount given in relation to the acquisition of an employee share scheme ('ESS') interest is included in the employee's assessable income for the income year in which the interest is acquired unless the conditions for deferral are met.[39] An ESS interest is defined to mean a beneficial interest in a share in a company or a right to acquire a beneficial interest in a share in a company.[40] The discount is calculated by deducting any consideration paid or payable by the employee from the market value of the ESS interest. The ordinary meaning of market value is used to determine the value of ESS benefits but in some cases the ordinary meaning may be affected by statutory rules.[41] In determining the market value of a non-cash benefit, anything that would prevent or restrict conversion of the benefit to money is disregarded.[42] If the regulations specify an amount for market value, that amount must be used instead.[43] The Board of Tax has released a report dealing with valuation issues in relation to employee share schemes. This report is discussed below.

2 *Real risk of forfeiture*

Taxation of the ESS interest is deferred and the discount is not taxed upfront if there is a real risk, under the conditions of the scheme, of the ESS interest being forfeited or lost (other than by disposing of it).[44] According to the Explanatory Memorandum there will be a 'real risk of forfeiture' if the interest is subject to reasonable performance targets or completion of a minimum term of employment but not if there is merely a temporal restriction on disposal.[45]

There are a number of conditions that must be satisfied for deferral and the conditions differ depending on whether the ESS interest is a share or a right. These conditions are discussed below under tax concessions for ESOPs.

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[38] The provisions dealing with taxation of shares or rights under an employee share schemes are contained in *Income Tax Assessment Act 1997* (Cth) Div 83A. These provisions were inserted into the Act in 2009, effective 14 December 2009.
[39] *Income Tax Assessment Act 1997* (Cth) s 83A-25(1).
[40] Ibid s 83A-10. It should be noted that Division 83A applies to stapled securities in the same way it applies to a share in a company, if at least one of the ownership interests that are stapled is a share in a company: Ibid s 83A-335(1).
[41] Section 83A-315(1).
[42] Ibid s 960-410.
[43] Ibid s 83A-315.
[44] Ibid s 83A-105(3).
[45] Explanatory Memorandum, Tax Laws Amendment (2009 Budget Measures No 2) Bill 2009 (Cth) [1.159]–[1.160].

Where taxation is deferred, an amount is to be included in assessable income for the first income year in which the ESS deferred taxing point occurs.[46] The deferred taxing point differs depending on whether the ESS interests are shares or rights. In the case of shares, it is the earliest of when: there is not a real risk of forfeiture and no genuine restriction preventing disposal; or when employment ceases; or seven years from when the interest is acquired elapses.[47] In the case of rights, it is the earliest of when: there are no restrictions on disposal of the right (ie on vesting); or there are no restrictions on exercising the right and disposing of the share; or employment ceases; or when the maximum seven year time period for deferral has elapsed.[48] In both cases there is a 30-day rule so that if the shares or rights are disposed of within 30 days of one of the other deferral times, the disposal is treated as the deferral time.[49]

The amount to be included in these cases is the market value of the ESS interest at the deferred taxing point reduced by the cost base of the ESS interest.[50]

3 *Salary sacrifice arrangements*

Taxation of the ESS interest is also deferred if the ESS interest was acquired under a salary sacrifice arrangement. A salary sacrifice arrangement is where the interest is provided in return for a reduction in an employee's salary; or where it is part of a remuneration package in circumstances where it is reasonable to conclude that an employee's salary would be greater if the interest was not made part of the package.[51] The discount on the ESS interest must equal the market value of the ESS interest at the time of acquisition, so that the employee must not provide any consideration.[52] Further, the total market value of ESS interests acquired by the employee during the year in the employer company and its holding company (if any) must not exceed $A5000.[53]

The deferred taxing point and the amount to be included in the assessable income is the same as above.[54]

4 *Tax on disposal*

If the employee disposes of the ESS interest within 30 days of the earliest deferred taxing point, the time of disposal becomes the deferred taxing point.[55] This means that the difference between the market value and the cost base of the ESS interest will be assessed as an income gain under Division 83A. If disposal does not occur within 30 days of the earliest deferred taxing point, however, the gain on disposal will be taxed as a capital gain. In such circumstances, an ESS interest is taken to have been acquired for its market value rather than its discounted value.[56] The capital gain on

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[46] *Income Tax Assessment Act 1997* (Cth) s 83A-100.
[47] Ibid s 83A-115.
[48] Ibid s 83A-120.
[49] Ibid s 83A-115(3) and s 83A-120(3).
[50] Ibid s 83A-110(1).
[51] Ibid s 83A-105(4).
[52] Ibid s 83A-105(4)(b).
[53] Ibid.
[54] Ibid s 83A-110(1).
[55] Ibid ss 83A-115–120.
[56] Ibid s 83A-30.

disposal is the difference between consideration on disposal and market value. Net gains are included in assessable income and taxed at the individual's marginal rate (potentially 46.5%).[57] If the interests have been held for more than 12 months, the employee should be eligible for the CGT discount and will only include 50% of the nominal gain in assessable income.[58]

B *United Kingdom*

The position in the UK depends on whether the employee receives shares or options. Shares are generally subject to tax on acquisition although there are different rules depending on whether shares are restricted or convertible securities. Options[59] are generally only subject to tax on exercise.

1 *General Rule*

Where an individual acquires shares or options 'by reason of [their] employment', and the shares are readily transferable,[60] tax (and corresponding National Insurance Contribution)[61] is imposed at the time of receipt.[62] The amount to be included is the market value less any consideration provided.[63] This amount is treated as earnings and is taxed at the individual's marginal rate.[64]

2 *Restricted securities*

Generally, there is no initial tax charge on the acquisition of 'restricted securities'.[65] A 'restriction' is defined as being (a) where the securities are at risk of compulsory forfeiture, where disposal will be for less than the full market value; (b) there is a restriction on the freedom to retain or dispose of securities, or to exercise rights; or (c) there is a potential disadvantage in respect of the securities.[66] Rather, tax liabilities arise upon occurrence of post-acquisition 'chargeable events'.[67] Chargeable events occur when the restrictions on securities are removed or modified or when the securities themselves are disposed of for consideration.[68] There are exceptions to this rule, however, where the securities are subject to forfeiture for misconduct or for

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[57] Ibid s 102-5.
[58] Ibid div 115.
[59] *Finance Act 2006* (UK) c 25, s 92(2).
[60] *Income Tax (Earnings and Pensions) Act 2003* (UK) c 1, s 702.
[61] *Social Security Contributions and Benefits Act 1992*. This is a compulsory government-run insurance program. It insures predominantly against unemployment and illness. It is similar in nature to the 1.5% Australian Medicare Levy.
[62] *Income Tax (Earnings and Pensions) Act 2003* (UK) s 62; see also *Weight v Salmon* (1935) 19 TC 174.
[63] *Income Tax (Earnings and Pensions) Act 2003* (UK) c 1, ss 428–30.
[64] Ibid c 1, s 9.
[65] Ibid s 425.
[66] Ibid s 423.
[67] Ibid ss 426–7.
[68] Ibid s 427.

other permitted reasons; or where tax avoidance is the main purpose in which case tax may be imposed on acquisition.[69]

Employees may elect for the provisions relating to restricted securities not to apply.[70] This means that they may elect, contrary to the general rule, that the restricted securities be taxed upon acquisition (thereby eliminating the problem of unknown future tax liabilities).

3 *Convertible securities*

Convertible securities confer on the holder an entitlement to convert them into securities of a different description.[71] When convertible securities are first acquired, liabilities to tax will arise in the ordinary manner (ie on receipt), whether as ordinary earnings,[72] as taxable benefits[73] or as securities acquired pursuant to an option.[74] However, in each case, for the purpose of any tax liabilities, the market value of the securities is determined as if they were not convertible.[75] In addition, a further post-acquisition tax charge will be included in the individual's employment income, upon occurrence of a 'chargeable event'.[76] Chargeable events are:[77]

- The conversion of the securities into securities of a different description;
- The disposal for consideration of the securities;
- The release for consideration of the entitlement to convert the securities into securities of a different description; or
- The receipt by an associated person of a benefit in money or money's worth in connection with the entitlement to convert the securities.

The taxable amount is calculated by taking the difference between any gain realised on occurrence of a chargeable event and the amount of consideration given to convert the security.[78]

4 *Options*

Generally, no liability to income tax arises in respect of the acquisition of an option.[79] A qualification to this rule is where 'approved share options' are acquired at a discount.[80] Further, where securities are acquired pursuant to an option, liability to tax will only arise upon occurrence of certain chargeable events.[81] These are (a) the acquisition of securities pursuant to the option, ie the exercise of the option; (b)

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[69] Ibid s 424.
[70] Ibid s 431.
[71] Ibid s 436.
[72] Ibid pt 3 ch1.
[73] Ibid pt 3 ch 10.
[74] Ibid pt 7 ch 5.
[75] Ibid s 437.
[76] Ibid s 438.
[77] Ibid s 439(3).
[78] Ibid s 440.
[79] Ibid s 475(1).
[80] Ibid s 475(2).
[81] Ibid s 476.

assigning or releasing of the option where the assignment is for consideration and not to another associated person; and (c) the receipt of a benefit in connection with the option.[82] The taxable amount is the difference between the gain realised on occurrence of a chargeable event and any deductable amounts (ie consideration given or expenses incurred).[83] In practice, tax liability will usually arise upon exercise of the option as this is the most common form of chargeable event.

It should also be noted that where securities are acquired pursuant to an option, a charge may arise where the market value has been artificially enhanced or depressed by more than 10% over the previous seven years or if the securities have been acquired for less than market value.[84] These provisions, however, are primarily aimed at penalising tax avoidance.

5 *Tax on disposal*

On the sale of shares or options acquired by the employee, there will generally be a liability to capital gains tax based on the difference between the sale price and the amount paid to acquire the shares plus any amount on which income tax has already been paid.[85] However, individuals are entitled to an annual exemption (currently £10,100) before capital gains tax applies.[86] Gains above this amount will be subject to capital gains tax at 28%.[87]

C *United States*

The position in the US also depends on whether the employee receives shares (the taxonomy adopted in the US is 'stock') or options. Although employment benefits are generally subject to tax on receipt, there are special rules for 'restricted stock' and for options, which effectively mean that there is no tax liability until the rights vest.

1 *General Rule*

The general rule is that any property (including stock or options) granted to an employee in connection with the performance of services is taxable to the employee as ordinary income in the year of *receipt* provided it is transferable and not subject to a substantial risk of forfeiture.[88] This rule does not apply if an employee sells or otherwise disposes of such property in an arm's length transaction before rights become transferable or not subject to a substantial risk of forfeiture.[89] Property is subject to a 'substantial risk of forfeiture' if full enjoyment of such property is conditional upon future performance of substantial services.[90] The grant of an option

[82] Ibid s 477.
[83] Ibid s 478.
[84] Ibid chs 3A–D.
[85] *Taxation of Chargeable Gains Act 1992* (UK) c 12, s 2.
[86] Ibid s 3.
[87] Ibid s 4.
[88] IRC § 83(a).
[89] Ibid.
[90] Ibid § 83(c)(1).

that does not have a readily ascertainable fair market value ('FMV') is also not subject to the general rule.[91] This is discussed further below.

It is important to remember that the rules dealing with concessional treatment for employment related stock and options apply first. These rules are referred to as statutory schemes and the requirements for such schemes are discussed below. If these requirements are not satisfied, the above general rule becomes the default position. These arrangements are referred to as non-statutory schemes. The advantage of such schemes is that they can still be eligible for tax deferral and the employer is entitled to a deduction for the cost of the scheme.

2 *Restricted Stock*

Restricted stock is stock that is granted to the employee for no or nominal consideration and is subject to restrictions on transfer, vesting or repurchase or subject to forfeiture for a period of time. Restricted stock is subject to tax as soon as the property is substantially vested (ie when the stock is transferable or where there is no longer a 'substantial risk of forfeiture').[92] On vesting, the FMV (determined without regard to any restriction other than a restriction that will never lapse) must be included in assessable income, less any amount contributed to it by the employee. An employee is able to elect to include the FMV of the restricted stock at the time of receipt.[93]

3 *Publicly Traded Options*

As mentioned previously, if an employee receives options (and the statutory rules do not apply) in return for services, he or she is assessed on the FMV of those options at the first time they are transferable[94] or are not subject to 'substantial risk of forfeiture' less any amount paid.[95] However, the employee may elect to include this amount at the time of receipt; he or she is not required to wait until they are transferable.[96] The employee does not pay tax on the actual exercise of the option.

4 *Non-Publicly Traded Options*

For companies whose options are not publicly traded, the same rules as above apply except that it is difficult, although not impossible, for the FMV requirement to be satisfied.[97] The FMV requirement will be satisfied if the option is:

- transferable;
- able to be exercised immediately in full;

[91] Ibid § 83(e)(3).
[92] Ibid § 83(a).
[93] Ibid § 83(b).
[94] This is defined as occurring only if the rights in the ESOP are not subject to a substantial risk of forfeiture: Ibid § 83(c)(2).
[95] Ibid § 83(a).
[96] Ibid § 83(b)(1).
[97] Ibid § 1.83-7(b)(1).

- free from any restriction or condition which has a 'significant effect' on the FMV;
- FMV is 'readily ascertainable', considering the ability to ascertain a value, the probability of that value changing and the length of the period during which the option can be exercised.[98]

More often than not, these strict requirements mean that there is no FMV and therefore tax is not paid until the point of exercise.

5 *Tax on disposal*

On disposal of the stock or option the employee is assessed on the selling price less the 'basis' price. This difference is realised as a capital gain.[99] The amount of tax payable depends on a variety of factors, including the time the stock/option has been held, the amount of ordinary income the taxpayer has earned and the way in which the taxpayer chooses to file his or her tax return (eg single, married filing jointly, married filing separately).[100] Broadly speaking, if the taxpayer has held the stock or option for a year or less, he or she is assessed at his or her top marginal tax rate (similar to the Australian approach). However, if the taxpayer has held the stock or option for more than a year, he or she is not assessed at all if he or she has a top marginal rate of 10% or 15%.[101] If the taxpayer has a top marginal rate of 25% or more, and the stock or option has been held for more than a year, he or she is assessed at a flat rate of 15%.

III TAX CONCESSIONS FOR EMPLOYEE SCHEMES

A *Australia*

Australia provides two tax concessions. The first concession is called a reduction concession and provides up to $A1000 of discount per employee per year.[102] The second concession is the ability to defer tax liability for up to seven years.[103] In some cases, the scheme must be offered to all employees but in some cases the scheme may be selective. If the ESS interest is shares, the scheme (or another scheme) must be broad based, but a scheme that only offers options may be offered selectively.

1 *Reduction concession*

Where an employee is assessed on a discount received on an ESS interest upfront, a $A1000 exemption applies if the employee's adjusted income is $A180 000 or less and a number of other conditions are satisfied at the time of acquisition.[104] Adjusted taxable income is the sum of taxable income, reportable superannuation contributions, reportable fringe benefits and net investment losses.

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[98] Ibid § 1.83-7(b)(2)-(3).
[99] IRC §§ 1221–2.
[100] Ibid § 1(h).
[101] These rates apply to ordinary income of up to US$33 950 if single or married filing separately or US$6 ,900 if married filing jointly.
[102] *Income Tax Assessment Act 1997* (Cth) sub-div 83A-B.
[103] Ibid sub-div 83A-C.
[104] Ibid s 83A-35.

The conditions are:

- The employee is employed by the company offering the shares or one of its subsidiaries;[105]
- The ESS interests offered under the scheme relate to ordinary shares;[106]
- The predominant business of the company is not the buying and selling of securities;[107]
- The employee does not receive more than 5% ownership of the company, or control more than 5% of the voting rights of the company, as a result of participating in the scheme;[108]
- The scheme is offered in a non-discriminatory way to at least 75% of resident permanent employees with at least 3 years service;[109]
- The shares or rights are not at real risk of forfeiture;[110]
- The shares or rights must be held for a minimum 3 year period or until employment ceases.[111]

2 *Deferral concession*

As previously noted there are two situations in which tax liability may be deferred for up to seven years. The first is where there is a real risk of forfeiture and the second is where there is an eligible salary sacrifice scheme.[112] The requirements differ depending on whether the ESS interest relates to a share[113] or a right to acquire a share.[114]

(a) Shares

- The first four conditions above apply;[115] and
- The scheme (or another scheme) is available to at least 75% of permanent employees with at least three years of service;[116] and
- There is a real risk, under the conditions of the scheme, of forfeiture or loss of the interest other than by disposal;[117] or
- The interest is provided under a salary sacrifice arrangement where no consideration is provided and the scheme rules state that deferred taxation applies and the employee receives a maximum of $A5000 worth of shares per annum.[118]

(b) Rights

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[105] Ibid s 83A-35(3).
[106] Ibid s 83A-35(4).
[107] Ibid s 83A-35(5).
[108] Ibid s 83A-35(9).
[109] Ibid s 83A-35(6).
[110] Ibid s 83A-35(7).
[111] Ibid s 83A-35(8).
[112] Ibid s 83A-105.
[113] Ibid s 83A-115.
[114] Ibid s 83A-120.
[115] Ibid s 83A-105(1)(b).
[116] Ibid s 83A-105(2).
[117] Ibid s 83A-105(3)(a).
[118] Ibid s 83A-105(4).

- The first four conditions above are satisfied;[119] and
- There is a real risk under the conditions of the scheme, of forfeiture or loss of the interest other than by disposal or exercise or letting the right lapse; or if the right is exercised, of forfeiture or loss of the share other than by disposal.[120]

As already noted if the conditions for deferral are met, liability to tax is deferred until the earliest of when the restrictions are lifted or conditions met;[121] or when employment ceases;[122] or seven years from acquisition has elapsed.[123] If the shares or rights are disposed of within 30 days of the original deferred taxing point, the date of disposal is taken to be the deferred taxing point.[124]

B *United Kingdom*

The UK offers four tax-advantaged share schemes. The two most common schemes are Share Incentive Plans[125] and Save As You Earn Schemes.[126] They must both be offered to all employees. The other two schemes, Company Share Option Plans[127] and Enterprise Management Incentives,[128] may be offered to selected employees.

1 *Share Incentive Plans ('SIPs')*

(a) Features

A SIP is a plan under which shares in the employer are offered to all employees.[129] The shares are held in a trust (the SIP Trust). It must have as its purpose the provision of benefits to employees in the nature of shares which give them a continuing stake in the company; it must not have features which are neither essential nor reasonably incidental to that purpose.[130] If the SIP conditions are met, there is no initial tax charge on the receipt of shares,[131] and, provided certain other conditions are met, the shares may be tax-free.

Under a SIP, employees may acquire four kinds of shares:
- 'Free Shares': employees may be given rights for up to £3000 worth of shares each year as part of their salary. The provision of such shares may discriminate among employees, for example, making them conditional on

[119] Ibid s 83A-105(1)(b).
[120] Section 83A-105(3)(b).
[121] Ibid ss 83A-115(4), 83A-120(4).
[122] Ibid ss 83A-115(5), 83A-120(5).
[123] Ibid ss 83A-115(6), 83A-120(6).
[124] Ibid ss 83A-115(3), 83A-120(3).
[125] *Income Tax (Earnings and Pensions) Act 2003* (UK) c 1, pt 7 ch 6.
[126] Ibid pt 7 ch 7.
[127] Ibid pt 7 ch 8.
[128] Ibid pt 7 ch 9.
[129] Ibid sch 2 paras 8, 14–7.
[130] Ibid sch 2 para 7.
[131] Ibid s 490.

employee performance.[132] The shares cannot be withdrawn from the trust for three years and will not be subject to income tax if held in the trust for five years.[133] If the shares are sold while in the trust no capital gains tax is payable. If the shares are withdrawn from the trust and then sold within three years, capital gains tax will be payable.

- 'Partnership Shares': employees may purchase up to £1500 per year (or 10% of their salary if less) worth of shares out of their pre-tax earnings. The shares can be withdrawn from the trust at any time but tax will be payable unless the shares remain in the trust for five years.[134]
- 'Matching Shares': the company may award up to two additional free shares for each Partnership Share purchased. They must be on the same terms and carry the same rights as the Partnership Shares as well as be appropriated at the same time and offered to all employees on the same basis. The shares cannot be withdrawn from the trust for three years and will not be subject to income tax if held in the trust for five years.[135]
- 'Dividend Shares': dividends paid on shares in the trust may be used to acquire up to £1500 worth of additional shares per year. The shares cannot be withdrawn from the trust for three years. Once the three years have passed there is no income tax charge on these shares. If the holding rules are broken the dividend becomes taxable.[136] The shares will be subject to tax when they are withdrawn from the trust.

The SIP scheme is seen as providing great flexibility. Employers can choose which of the shares to offer their employees. For example, companies can opt to award Free Shares only, Partnership Shares only, or a combination of both; they can also choose whether to offer Matching Shares and Dividend shares and, if so, in what proportion (up to the relevant limits). The maximum total share value that can be acquired is £9000 per annum.

(b) Eligibility and Conditions

All eligible employees must be able to participate in the scheme and on similar terms.[137] This does not prevent discrimination, however, on the basis of remuneration level, length of service or performance based targets.

The employee must not have a 'material interest' in a company whose shares may be awarded under the SIP or a company controlling such a company. A material interest exists where there is control of more than 25% of the ordinary share capital.[138]

Only fully paid up, non-redeemable, ordinary shares can be used in a SIP.[139] However, employers may impose certain kinds of restrictions: shares may be non-

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[132] Ibid sch 2 paras 38–42.
[133] Ibid sch 2 para 36.
[134] Ibid sch 2 paras 43–57.
[135] Ibid sch 2 paras 58–61.
[136] Ibid sch 2 paras 62–8.
[137] Ibid sch 2 paras 8–9.
[138] Ibid sch 2 paras 19–24.
[139] Ibid sch 2 paras 25–8.

voting, subject to forfeiture in certain circumstances and subject to pre-emption rights on the part of the employer where the employee ceases employment through retirement, ill health or redundancy.[140]

In summary, in order to obtain the tax-advantages, Free, Partnership and Matching Shares must be held in the trust for at least five years[141] and Dividend Shares must be held for at least three years.[142]

2 *Save As You Earn ('SAYE') Option Schemes*

(a) Features

Under the SAYE Option Scheme, employees of companies enter into contractual savings contracts with banks or building societies. Employees agree to save between £5 and £250 per month over three, five or seven years and, at the end of this period, the employee receives a tax-free bonus (the culmination of interest) as well as the repayment of their savings.[143] Concurrently, employees are granted fixed-price options using these savings (and bonuses) to acquire shares in their employer company. The options may be granted at a discount of up to 20% off the market value.[144] Generally, these options cannot be exercised until the relevant savings period has ended, but must be exercised within six months of this date to obtain the tax advantages.[145] To prevent any disadvantage if the share price falls, employees are under no obligation to exercise the options, and can choose to take their savings (and the bonus) as a lump-sum payment.

No tax liabilities arise on the acquisition of SAYE options.[146] If the conditions of the SAYE scheme have been met, the employee is not assessed on the exercise of the options either.[147] In addition, and unlike any other scheme, no tax charge will arise with respect to the discount off the market value (up to the maximum of 20%). There is therefore no tax on the grant of the options or on their exercise. When the option is exercised and shares are acquired, the shares will be subject to capital gains tax on disposal.

(b) Eligibility and Conditions

All eligible employees and full-time directors must be given the opportunity to participate in the SAYE Scheme.[148] Employers may restrict eligibility only to those employees who have been with the firm for a certain period of time (up to five years).[149] In addition, persons who have a 'material interest' in a close company are

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[140] Ibid sch 2 paras 30–3. These factors are listed as 'good leavers', but a distinction should be drawn with 'bad leavers' (ie, fired, going for another job etc) to guide forfeiture rules.
[141] Ibid ss 505–6, sch 2 paras 36–7.
[142] Ibid sch 2 para 67.
[143] Ibid sch 3 para 25.
[144] Ibid sch 3 para 28.
[145] Ibid sch 3 para 30.
[146] Ibid s 475.
[147] Ibid s 519.
[148] Ibid sch 3 paras 6–10.
[149] Ibid sch 3 para 6.

prevented from participating in the scheme.[150] This includes obtaining more than 25% of the company's issued share capital.[151]

Every employee that participates in the scheme must actually do so on 'similar terms'.[152] In other words, all those with a certain length of service must be treated the same. However, employers may discriminate as to rights to obtain and exercise options, on the basis of remuneration level, length of service or any similar factors.

Only ordinary, fully paid-up, non-redeemable shares can be used in a SAYE scheme.[153] The shares must be either (a) quoted; or (b) of an independent company (ie not owned or controlled by another entity); or (c) of a subsidiary of a quoted company that is not closely controlled.[154] The shares must be of one class only. Alternatively, the majority of the shares in the class used for the scheme must be either employee-control shares or open market shares.[155] The shares must also be unrestricted unless all shares in that class are restricted.[156] The only restrictions permitted are those imposed by the company's articles requiring employees to dispose of their shares at the end of their employment.

3 *Company Share Option Plans ('CSOPs')*

(a) Features

Under a CSOP, employers can grant options to employees up to a value of £30 000 per employee.[157] The scheme may be offered selectively but no employee may own more than 25% of the company.[158] The company establishing the scheme must apply to HMRC for approval in writing. Generally, no tax liability arises on the acquisition of CSOP options.[159] However, where the amount of consideration given for the option and the price payable under it is less than the market value of the shares at that time, the discount is treated as income tax in the year of the grant.[160] Further, no liability arises on the exercise of the option provided it is exercised not less than three years or more than 10 years after grant.[161] Capital gains tax will arise upon disposal of the shares based on the difference between the full cost of the option shares and the disposal proceeds.

The CSOP is a simple, discretionary option scheme that offers very significant tax and other advantages. It is extremely flexible and provides a method through which employers can give incentives to employees by attaching conditions to the award of shares (such as loyalty, performance or length of employment). The scheme must not

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[150] Ibid sch 3 para 11–6.
[151] Ibid sch 3 para 12.
[152] Ibid sch 3 para 7.
[153] Ibid sch 3 paras 18, 20.
[154] Ibid sch 3 para 19.
[155] Ibid sch 3 para 22.
[156] Ibid sch 3 para 21.
[157] Ibid sch 4 para 6. Under the previous scheme, the limit was £100 000 (or four times the individual's salary, whichever was greater).
[158] Ibid sch 4 para 10.
[159] Ibid s 475.
[160] Ibid s 526
[161] Ibid s 524.

contain features that are neither essential nor reasonably incidental to the purpose of providing benefits for employees and directors.[162] If any of the conditions are not met, tax charges will arise in the ordinary way as for unapproved share schemes.

(b) Eligibility and Conditions

To be eligible to participate, individuals must be full-time directors, or full-time or part-time employees working a minimum of 25 hours per week.[163] Anyone with a material interest in the share capital or assets of a close company whose shares may be acquired must be excluded.[164] The company must be independent, that is, it must not be owned or controlled by another company.[165]

As mentioned above, in order to obtain the tax benefits, the options must be exercised within 3 and 10 years.[166] However, the tax exemptions remain if the options are exercised within three years of the grant date if the employee is a 'good leaver', that is, leaves the organization due to injury, disability, redundancy or retirement and exercises the options within six months of leaving.[167]

The securities acquired as a result of exercising the option must be fully paid-up, non-redeemable ordinary shares.[168] They must be shares in either a company listed on a recognised stock exchange or not in a close company.[169] The only restriction permitted is that the company's constitution may require that the shares be disposed of at the end of employment.[170] However, the shares may have restricted voting rights.[171]

4 *Enterprise Management Incentives ('EMIs')*

(a) Features

The EMI scheme is a share option scheme targeted particularly at small start-up companies. It is the most flexible, the simplest to implement and administer and offers the largest potential tax benefits of the four tax-advantaged schemes.

The scheme is entirely discretionary: companies are free to enter agreements with eligible employees on an individual or collective basis and different conditions may be imposed on different employees or groups of employees.

Each eligible employee may be granted up to £120 000 worth of options.[172] Once these options have been exercised or have lapsed, a further grant of options over

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[162] Ibid sch 4 para 5.
[163] Ibid sch 4 para 8.
[164] Ibid sch 4 para 9.
[165] Ibid sch 4 para 2.
[166] Ibid s 524.
[167] Ibid sch 4 paras 24–5.
[168] Ibid sch 4 paras 16, 18.
[169] Ibid sch 4 para 17.
[170] Ibid sch 4 para 19(2)–(4).
[171] Ibid sch 4 para 23.
[172] Ibid sch 5 para 5.

shares of up to £120 000 may be issued, provided at least three years have elapsed since the previous grant.[173] There is no limit on the number of employees that may be granted EMI options, but the total value of options issued at any one time must not exceed £3 000 000 per company.[174]

A major benefit is that no tax liabilities arise on either the acquisition or exercise of EMI options,[175] provided that the options are granted at market value[176] and are capable of being exercised within 10 years of the grant date.[177] There is, however, capital gains liability on sale of the shares.

If the option was granted at a discount (ie the exercise price is lower than the market value), the amount of that discount will be included in the employee's assessable income but not until exercise.[178] The company may grant options at a price above market value if it wishes.

(b) Eligibility and Conditions

The EMI scheme is available only to independent[179] trading[180] companies with gross assets of less than £30 000 000[181] and fewer than 250 full-time equivalent employees.[182] The trading activities of the company must be carried out in the UK[183] and must not consist of certain kinds of excluded activities (such as dealings in land, providing financial services, farming or legal advice).[184] The receipt of substantial sums from royalties or licence fees will generally disqualify a company.

Individuals can participate in an EMI scheme only if they are 'employees',[185] who work on average at least 25 hours a week (or if less, 75% of their working time)[186] and do not hold more than 30% of the issued capital of the relevant company (defined as a 'material interest').[187]

If a 'disqualifying event'[188] occurs, then unless the EMI option is exercised within 40 days, the option will be treated as an unapproved option and income tax liabilities arise.[189] Disqualifying events essentially cover any events that would render a company or individual ineligible to participate according to the conditions listed

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[173] Ibid sch 5 para 6.
[174] Ibid sch 5 para 7.
[175] Ibid s 475.
[176] Ibid s 530.
[177] Ibid s 529.
[178] Ibid ss 476, 531.
[179] Ibid sch 5 para 9.
[180] Ibid sch 5 paras 13–4.
[181] Ibid sch 5 para 12.
[182] Ibid sch 5 para 12A.
[183] Ibid sch 5 para 15.
[184] Ibid sch 5 para 16.
[185] Ibid para 25.
[186] Ibid sch 5 paras 26–7.
[187] Ibid sch 5 paras 29–33.
[188] Ibid s 533.
[189] Ibid s 532.

above.[190] This includes the loss of independence (ie becoming a 51% subsidiary of another company) or ceasing to meet the correct trading activities requirements or eligible employee requirements. So as not to penalise companies if they grow, the following are deemed not to be disqualifying events:[191]

- the company's gross assets exceed £30 000 000 following the grant of options;
- the company acquires a subsidiary that would not otherwise qualify under the scheme.

Only options that relate to fully paid-up, non-redeemable ordinary shares qualify as EMI options.[192] The options must be capable of exercise within 10 years from the date of grant,[193] in writing[194] and non-assignable.[195] There are no rules, however, directing the conditions under which the shares may be issued, that is, they may be non-voting or subject to pre-emption rights. This serves to protect the company's independence.

5 *Anti-Avoidance*

The UK has also enacted provisions designed to prevent tax avoidance through the manipulation of values 'otherwise than for genuine commercial purposes'. Special rules apply for securities artificially enhanced or depressed by more than 10% of market values,[196] securities acquired for less than market value[197] and securities disposed of for more than market value.[198] Any tax advantages gained under an approved scheme will be rendered void if 'the avoidance of tax … is the main, or one of the main purposes of the arrangement under which the option was granted or is exercised'.[199] Securities will be taxed according to the actual market value, or on the entire enhanced amount respectively. Options granted under an avoidance scheme will potentially be charged at the time of grant. If so, the option will be treated as a convertible security, and the charge based on the value of the shares to be acquired on exercise, not the value of the option.[200]

Further, additional anti-avoidance rules apply for the acquisition of shares or options. Tax benefits will not be available if the main purpose (or one of the main purposes) of the arrangements under which the right or opportunity to acquire employment-related securities is for the avoidance of tax or national insurance contributions.[201]

C *United States*

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[190] Ibid ss 533–9.
[191] Ibid sch 5 pt 6.
[192] Ibid sch 5 para 35.
[193] Ibid sch 5 para 36.
[194] Ibid sch 5 para 37.
[195] Ibid sch 5 para 38.
[196] Ibid chs 3A–B.
[197] Ibid ch 3C.
[198] Ibid ch 3D.
[199] Ibid ss 489(4), 505(4A), 506(4A), 524(1)(c), 519(1)(c); *Finance Act 2004* (UK) c 12, s 88.
[200] *Income Tax (Earnings and Pensions) Act 2003* (UK) c 1, ss 446B, 475(2), 476.
[201] See, eg, *Income Tax (Earnings and Pensions) Act 2003* (UK) c 1, s 424(2).

There are many different employee ownership vehicles in the US. This paper will analyse three such schemes. First, the Employee Stock Ownership Plan (US ESOP)[202] is the principal legal vehicle for meaningful (ie greater than 5%) employee stock ownership in the US.[203] Company stock is not purchased, but rather, granted to workers. Its main advantage is that company cash or stock contributions to a US ESOP are tax deductible even if financed by a loan. Second, the Employee Stock Purchase Plan (ESPP)[204] is a scheme that offers stock or rights to stock and must be offered to all employees, but can take different forms. Third, the Incentive Stock Option Plan (ISO)[205] offers options that can be granted on a discretionary basis. In general, if the ISO or ESPP requirements are met, the taxpayer is not taxed when he or she receives or exercises his or her option.[206] Instead, the employee is taxed *only* at the point of sale, applying the US capital gains tax regime. However, the employer does not get a deduction for the provision of these tax-advantaged schemes.[207] By contrast, the US ESOPs offer much more generous tax incentives, but corporations must be fair and equitable in distributing benefits to most workers.

1 *Employee Stock Ownership Plan ('US ESOPs')*

(a) Features

A US ESOP is a kind of employee benefit plan where a company sets up a trust fund, into which it contributes new shares of its own stock or cash to buy existing shares.[208] Alternatively, the US ESOP can loan money to buy new or existing shares, with the company making cash contributions to the plan to enable it to repay the loan. This is called a leveraged ESOP.

Shares in the trust are allocated to individual employee accounts, which is tax sheltered until vesting.[209] Workers typically obtain stock according to their relative salary. As employees accumulate seniority with the company, they acquire an increasing right to the shares in their account, a process known as vesting.

When an employee who has at least ten years of participation in the US ESOP reaches age 55, he or she must be given the option of diversifying his or her US ESOP account up to 25% of the value.[210] The option continues until age 60, at which time the employee has a one-time option to diversify up to 50% of his or her account.

Employees receive the vested portion of their accounts at either termination, disability, death or retirement. The company buys back the employee's stock at fair market value (unless there is a public market for shares).[211] These distributions may be

[202] IRC § 401(a).
[203] US ESOPs were established in 1974 in the *Employee Retirement Income Security Act of 1974* (US).
[204] IRC § 423 (1994).
[205] Ibid § 422.
[206] Ibid § 421(a)(1).
[207] Ibid § 421(a)(2).
[208] Ibid §§ 401(a), 4975(e)(7).
[209] Ibid § 408(p)(3).
[210] Ibid § 401(a)(28)(B).
[211] Ibid § 409(h).

made as a lump sum or in instalments over a period of years.[212] Upon disability or death, employees or their beneficiaries will immediately receive the vested portion of their US ESOP accounts. Employees must be 100% vested within 3 to 6 years, depending on whether vesting occurs all at once or gradual.[213]

There are two main types of US ESOPs: C Corp ESOPs[214] and S Corp ESOPs.[215] An S Corp ESOP is a trust that holds shares of an S corporation. An S corporation is a non-public, closely held corporation that is taxed as a pass-through entity (ie similarly to partners in a partnership). S corporations are not subject to corporate income tax. Instead, all items of income, gain, loss or expense pass through pro-rata to the shareholders. In contrast, C corporations are subject to two levels of taxation – the entity and the shareholders. Most companies in the US are C corporations.

For company contributions to C and S Corp ESOPs, these contributions are deductible by up to 25% of eligible pay.[216] This also extends to dividends that are paid directly to employees or used to repay loans to buy stock.[217] Importantly, this can include principal and interest on a loan to buy the company. In C corporations, the interest on payments on an ESOP loan does not count towards the 25% limit, whereas in S corporations, it does.

Eligible pay is defined as the pay of all the participations in the plan up to $US200,000 in 2002 dollars, to be indexed by inflation, and rounded to $5000 increments.[218] The limits on annual additions to employee accounts are generous. The combination of employer contributions cannot exceed 100% of an employee's eligible pay in any one year. This contribution, however, cannot exceed $US49,000 (as of 2009, indexed for inflation).[219]

There are many tax advantages for employees participating in such schemes. Workers pay no tax on the contributions to their US ESOP accounts while the shares are granted and accumulate. Only upon distribution of their accounts will employees pay tax, and even then, at potentially favourable rates. This permits the worker to defer taxation on the unrealised appreciation of employer securities until the stock is actually sold.

Employees can roll over their distributions into other tax shelters, such as IRAs or other retirement plan. If the distributions are rolled over, the employee pays no tax until the money is withdrawn, at which point it is taxed as ordinary income. [220] Rollovers from ESOP distributions to IRAs are available for distributions of stock or cash over periods of less than 10 years.

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[212] Ibid § 409(o).
[213] Ibid § 411.
[214] Ibid ch 1, sub ch C.
[215] Ibid ch 1, sub ch S.
[216] Ibid § 404(a)(3)(A)(i).
[217] Ibid § 404(a)(12).
[218] Ibid § 415(c)(1).
[219] Ibid § 415(c)(2).
[220] Ibid § 402(e)(4).

Upon distribution, amounts contributed by the company are taxable as ordinary income but any capital appreciation is taxable as capital gains. The income tax portion of the distributions, however, may be subject to a 10% penalty if it is made before normal retirement age.[221]

(b) Eligibility

There are minimum participation standards in order for eligibility. Employees may join the plan and begin receiving allocations if they are older than age 21 and have completed one year of service with the company.[222] One year of service is defined as where an employee as worked at least 1000 hours in any one year.[223] A US ESOP may not exclude from participation, on the basis of age, employees who have attained a specified age.[224]

US ESOPs must also meet certain minimum coverage requirements.[225] In general, the plan must benefit at least 70% of employees who are not highly compensated employees. Further, contributions or benefits provided under the plan must not discriminate in favour of highly compensated employees.[226] This aims to keep the plans as broad-based, and not limited to executives. 'Highly compensated employee' means any employee who was a 5% owner at any time during the year, or, for the preceding year, had compensation from the employer in excess of $US80,000 and was in the top paid group of employees for such preceding year.[227]

When a business incorporates, unless an S Corp election is made, a business will automatically be registered as a regular corporation. This is a C Corp. In order to elect treatment as an S Corp, there are certain eligibility requirements that must be met.[228]

An S corporation is a domestic small closely held business. It can only have 100 shareholders, and the ESOP counts as one. There can be no alien non resident shareholders. Further S corporations can only have one class of stock. A single exception exists for having voting and nonvoting common shares. The company cannot be a member of an affiliated group. Financial institutions, foreign corporations, insurance companies and domestic international sales corporations are not eligible.

2 *Employee Stock Purchase Plans ('ESPPs')*

(a) Features

The ESPP is a scheme that provides that options are to be granted only to employees of the employer corporation to purchase stock in the corporation.[229] The plan entitles

[221] Ibid § 4978(b).
[222] Ibid § 410(a)(1)(A).
[223] Ibid § 410(a)(3).
[224] Ibid § 410(a)(2).
[225] Ibid § 410(b).
[226] Ibid § 401(a)(4).
[227] Ibid § 414(q).
[228] Ibid § 1361. See also Form 2533.
[229] Ibid § 423(b)(1).

employees to be granted an option to purchase up to $US 25 000 of fair market value worth of their corporation's stock at a discount, without attracting any income tax.[230] The value of the stock is determined at the time that the option is granted. Interestingly, most plans in practice limit employee contributions to no more than 10–15% of total compensation and over 70% of plans impose limits on purchases.[231]

Under the terms of the ESPP, options are to be granted to all employees.[232] Employer companies, however, may be able to discriminate and exclude employees who have been employed less than two years;[233] employees whose customary employment is less than 20 hours per week or less than 5 months in a calendar year;[234] and highly compensated employees.[235] While the corporation has a general discretion to discriminate, it is interesting to note that 98% of plans allowed employees with less than two years service to participate and 68% of plans allowed part-time employees to operate.[236]

The appeal of ESPPs is that the options are not subject to income tax on acquisition or upon exercise;[237] rather, they are taxed only on capital gains when the securities are sold. However, like ISOs, employers are not entitled to any deductions.[238]

Under the ESPP, the option exercise price must be between 85% and 100% of the fair market value of the stock. For such options, if an employee sells or otherwise disposes of his or her option, he or she is assessed on the lesser amount of either: (i) the excess of the FMV of the share at the date of disposition (or death) over the amount paid for the share under the option;[239] *or* (iii) the excess of the FMV of the share at the grant date over the option price.[240]

(b) Eligibility

To qualify for the tax concession, the stock must not be disposed of within two years from the date the option was granted nor within one year after the option was exercised.[241] Only individuals that are employees of the relevant corporation between the grant date of the option and three months before the exercise date qualify to receive ESPP options.[242]

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[230] Ibid § 423(b)(8).

[231] Gary Engelhardt and Brigitte Madrian, 'Employee Stock Purchase Plans' (Working Paper No BWP2004-5, Boettner Center for Pensions and Retirement Research, The Wharton School, University of Pennsylvania, 2004) 4.

[232] IRC § 423(b)(4) (1994).

[233] Ibid § 423(b)(4)(A).

[234] Ibid § 423(b)(4)(B)–(C).

[235] Ibid § 423(b)(4)(D). 'Highly compensated employees' are classified as employees that own more than 5% of the corporation at any time during the year or the preceding year; or, in the preceding year, had an income of greater than $US 105 000: Ibid § 414(q)(1)(A)–(B). Note that this value of $US 105 000 is as of 2008 and is subject to annual adjustments based on the 'cost-of-living': Ibid § 415(d).

[236] See generally Ryan Weeden et al, *Current Practices in Stock Option Plan Design* (National Centre for Employee Ownership, 2nd ed, 2001).

[237] IRC § 421(a)(1) (1994).

[238] Ibid § 421(a)(2).

[239] Ibid § 423(c)(1).

[240] Ibid § 423(c)(2).

[241] Ibid § 423(a)(1).

[242] Ibid § 423(a)(2).

A number of prerequisite conditions must be met before the ESPP tax advantages operate:

- The plan must be made up of only employees of a corporation (eg a plan which includes employees' family fails this requirement);[243]
- There must be shareholder approval within 12 months before or after the plan is adopted;[244]
- In order to prevent abuse by large shareholders in small companies, any employee that holds more than 5% of the total combined voting power or value of all classes of stock is ineligible to participate in the plan;[245]
- The options must be granted to all employees in the corporation subject to some exceptions; the main exceptions are short-term, part-time, casual, contract or highly compensated workers;[246]
- With the exception of the amount able to be purchased, all relevant employees must have the same rights and privileges under the plan. The plan may also provide that no employee may purchase more than a maximum amount of stock fixed under the plan;[247]
- The option price must be greater than or equal to 85% of the FMV of the stock at the time such option is granted or at the time such option is exercised. In other words, there is a maximum discount rate of 15%;[248]
- Any option must be exercised within five years from the date such option was granted. If the FMV requirement cannot be determined, however, the option must be exercised within two years and three months from the grant date;[249]
- The option is non-transferable such that employees cannot give or sell the right to purchase the stock at a discount to a friend or family member.[250]

3 *Incentive Stock Options ('ISOs')*

(a) Features

The ISO is a discretionary stock option scheme where selected employees may be granted up to $US100 000 in fair market value of options,[251] free from income tax. The fair market value of any stock shall be determined as at the time the option is granted. The $US100 000 per year limitation will be met, however, if the failure to meet the fair market value requirement was not due to bad faith.[252]

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[243] Ibid § 423(b)(1).
[244] Ibid § 423(b)(2).
[245] Ibid § 423(b)(3).
[246] Ibid § 423(b)(4).
[247] Ibid § 423(b)(5). In order for this requirement to be satisfied, there must be a fixed maximum amount of stock that can be purchased.
[248] Ibid § 423(b)(6).
[249] Ibid § 423(b)(7)(A). Note, however, that if the 85% FMV requirement cannot be determined, the time limit is reduced to two years and three months: Ibid § 423(b)(7)(B).
[250] Ibid § 423(b)(9). An exception may exist for transfer by will or the laws of descent and distribution upon death of the employee.
[251] Ibid § 422(d)(1).
[252] Ibid § 422(c)(1).

The major benefit of an ISO is that tax is delayed until the point of sale (at which point the options or shares are subject to CGT).[253] Further, options or shares are taxed at a discounted rate, but they must be held for a longer period of time in order to receive this additional tax benefit. The key disadvantage of ISOs, however, (and the major incentive to grant employees non-statutory options) is that employers are not entitled to a deduction for their provision.[254] This is similar to ESPPs.

(b) Eligibility and Conditions

To qualify for the tax concession, no disposal of shares may be made within two years from the date of the grant of the option, nor within one year after the option is exercised.[255]

This tax concession is only available to those individuals who have been employees at all times between the grant date and three months before the exercise of the options.[256] An exception to this, however, is if the employee is disabled. Such persons only have to be employees within the period of up to 12 months before the exercise date.[257]

A number of prerequisite conditions must be met before the ISO tax advantages operate:

- There must be shareholder approval given within 12 months before or after the grant date;[258]
- The option must be granted within 10 years from the earlier of the date the plan is adopted or the date the plan is approved by the shareholders;[259]
- The option cannot be exercised more than 10 years after the grant date;[260]
- The option price must be equal to or greater than the FMV of the stock at the grant date.[261] This requirement is also met if the failure to meet FMV was not due to bad faith;[262]
- The option cannot be transferred to anyone else and is exercisable only by the employee;[263]
- The employee cannot own more than 10% of the total combined voting power of all classes of stock of the corporation at the grant date.[264] An exception to this rule exists if the option price is greater than or equal to 110% of the FMV of the stock and the option is not exercisable after the expiration of five years from the grant date.[265]

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[253] Ibid § 421(a)(1).
[254] Ibid § 421(a)(2).
[255] Ibid § 422(a)(1).
[256] Ibid § 422(a)(2).
[257] Ibid § 422(c)(6).
[258] Ibid § 422(b)(1). The plan must include the aggregate number of shares which may be issued under options and the class of employees eligible to receive options
[259]Ibid § 422(b)(2).
[260] Ibid § 422(b)(3).
[261] Ibid § 422(b)(4).
[262] Ibid § 422(c)(1).
[263] Ibid § 422(b)(5).
[264] Ibid § 422(b)(6).
[265] Ibid § 422(c)(5).

An option that meets the requirements as outlined above shall be treated as an ISO notwithstanding that:[266]

- The employee may pay for the stock with stock of the corporation granting the option; or
- The employee has a right to receive property at the time of exercise of the option; or
- The option is subject to any condition not inconsistent with the above pre-requisites.

4 *Anti-Avoidance*

In the US, there are no general anti-avoidance rules such as in Australia[267] or specific anti-avoidance provisions like the one in the UK as previously mentioned.

IV DEDUCTIONS FOR THE EMPLOYER

A *Australia*

A limited specific deduction is available to employers that provide discounts on ESS interest under an employee share scheme.[268] The employee must be eligible for the reduction concession, disregarding the adjusted income test.[269] The amount of the deduction is equal to the reduction up to a maximum of $A1000.

If the employer provides money or property to another entity such as an employee share trust, the deduction for the employer is delayed until the ESS interest is acquired by the employee.[270]

B *United Kingdom*

The general rule is that the cost of setting up an employee share scheme is regarded as capital expenditure and hence not deductible. However, an exception has been created for the costs in setting up certain employee share schemes. Specific tax deductions are available only for Save As You Earn Option Schemes and Company Share Option Plans.[271] The costs of establishing Share Incentive Plans and Enterprise Management Incentives, the two other employee share schemes, are not tax deductible for the employer.

C *United States*

[266] Ibid § 422(c)(4).
[267] See *Income Tax Assessment Act 1936* (Cth) pt IVA.
[268] *Income Tax Assessment Act 1997* (Cth) sub-div 83A-C.
[269] Ibid s 83A-205.
[270] Ibid s 83A-320.
[271] *Income Tax (Trading and Other Income) Act 2005* (UK) c 5, s 94A. This provision was recently inserted by *Taxation (International and Other Provisions) Act 2010* (UK) c 8, sch 7 para 28.

US ESOPs provide very generous deductions for employers. First, any contributions of stock or cash by the company is tax deductible up to 25% of eligible pay.[272] This provides companies with a current cash flow advantage when they issue new shares to the US ESOP. This can be used to establish liquidity for future use or to buy shares from current owners.

Second, leveraged US ESOPs provide significant tax benefits. Contributions used to repay a loan that the US ESOP takes out to buy company shares are tax deductible.[273] Since these contributions are tax deductible, a corporation which repays an ESOP loan in effect gets to deduct principal as well as interest from taxes. This significantly cuts the cost of financing to the company, as it reduces the number of pre-tax dollars that is required to repay the principal. Further, dividends paid on ESOP stock passed through to employees or used to repay an ESOP loan or reinvested by employees in company stock are tax deductible if the ESOP sponsor operates as a C corporation.[274] Dividends may still be used to pay off ESOP debt in an S Corp ESOP, but there is no tax deduction as the S corporation pays no corporate income tax.[275]

Third, sellers in a C corporation can get a tax deferral.[276] This advantage is not available to S Corp ESOPs.[277] An owner of a C corporation can defer capital gains tax on stock he or she sells to an ESOP if (i) the ESOP owns 30% or more of each class of outstanding stock or of the total value of all outstanding stock, excluding non-convertible, non-voting preferred stock; and (ii) the owner reinvests ('rolls over') the sale proceeds into qualified replacement property (stocks or bonds of domestic operating companies) during the period from 3 months before to twelve months after the sale.[278]

Fourth, in S corporations, when an ESOP trust, which is a tax exempt entity, is a shareholder of an S corporation, its pro-rata share of the S corporation sponsor's income is not subject to federal income tax.[279] Rather, the profits are divided among employee shareholders who pay individual taxes. This means that there is no income tax on 30% of the profits of an S corporation with an ESOP holding 30% of its stock. Equally, there is no income tax payable at all on the profits of an S corporation that is wholly owned by its ESOP. This is a significant tax benefit and many C Corp ESOPs have sought to convert to S Corp ESOPs. It should be noted, however, that the ESOP still must get a pro-rata share of any distributions the company makes to its owners.

Employers may not claim any deductions for the provision of securities under either of the ISO or ESPP statutory schemes.[280] However, a major incentive for corporations to give shares, restricted shares or non qualifying options is that their provision,

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[272] IRC § 404(3)(A).
[273] IRC § 404(a)(9).
[274] Ibid § 404(k).
[275] Ibid § 404(k)(1).
[276] Ibid § 1042.
[277] Ibid 1042(c)(1)(A).
[278] Ibid § 1042(c)(3).
[279] Ibid § 501.
[280] Ibid § 421(a)(2).

unlike the tax-advantaged schemes, does give rise to a deductible expense and is treated similar to paying wages.[281]

V Regulatory Requirements

A Australia

The *Corporations Act 2001* (Cth) ('the Act') contains a number of requirements relating to disclosure that are relevant to employee share schemes. Although the Act does contain some relevant provisions, it does not provide for different treatment of employee share schemes. For this reason it is necessary to consider the conditional relief granted by the regulatory authority, the Australian Securities and Investments Commission (ASIC), from specific disclosure and other requirements.

Companies seeking to offer their employees shares must comply with the general disclosure requirements in the Act unless there is specific relief granted by ASIC.[282] This generally means that the issuer must prepare a prospectus or other permitted form of disclosure document. The disclosure requirements are primarily intended to ensure that investors in newly issued securities of a company have access to the information which a reasonable investor would require for the purpose of making an investment decision.[283] There are two exemptions from the need to provide disclosure that may be relevant for companies wishing to establish employee share schemes. First, the small scale offering exemption — this is limited to personal offers to no more than 20 investors and no more than $A20 000 000 may be raised.[284] Although this may be of use to companies with a small number of employees it is unlikely to be of use to larger companies establishing an ESOP. A second potential exemption is where shares are issued at no cost.[285] The exemption refers to the issue of securities for no consideration and ASIC takes the view that where continued employment is a condition of the grant of securities, consideration has been provided.[286] Finally, where a body is seeking to raise no more than $A10,000,000 the company may use a simpler form of disclosure document (the Offer Information Statement).[287] However, this is also likely to have limited utility for small to medium enterprises ('SMEs') owing to the requirement to include a copy of an audited financial report with a balance date in the last 6 months.[288] This is likely to be a considerable expense for an SME.

ASIC has issued a Class Order (CO 03/184) and a Regulatory Guide (RG 49) that provide conditional relief to companies seeking to establish employee share schemes — but the relief only applies to listed companies. The requirement that the company is listed is thought to be necessary to ensure adequate disclosure to investors. There is also a 5% limit on the number of shares that can be issued under an eligible employee

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[281] Ibid §§ 83(h), 162.
[282] *Corporations Act 2001* (Cth) s 706.
[283] Ibid s 710.
[284] Ibid ss 708(1)–(8).
[285] Ibid ss 708(15)–(16).
[286] John Sartori, 'Employee Share Ownership Plans – Issues Confronting ASX Listed Companies' (2005) 23 *Company and Securities Law Journal* 71, 76.
[287] *Corporations Act 2001* (Cth) s 709(5).
[288] Ibid s 715.

share scheme (to ensure that the purpose of the scheme is not fundraising). There is also a requirement that options are issued for no or nominal consideration.

Annual reporting
An important feature of the 2009 tax 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.[289] Collection of this data is primarily for compliance purposes[290] 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.

B *United Kingdom*

1 *Approval*

If a company wishes to operate one of the tax-advantaged schemes, it must first obtain the written approval of Her Majesty's Revenue & Customs ('HMRC').[291] Approval will be granted if HMRC is satisfied that the conditions of the scheme have been met. There is no set form of application, but HMRC will require all relevant documents, including declarations that the company will comply with the requirements of the scheme.

An exception to this rule, however, is provided for the establishment of an EMI scheme. This is because it is designed specifically to be a simple scheme to assist start-up companies. Therefore, no prior notice is required. Instead, notice of options issued must be given to HMRC in the approved form within 92 days from the date of grant.[292] If notice is not given within this time, the options will not qualify and will be taxed in the ordinary manner. Once notice of an option has been received, HMRC has 12 months in which it can make enquiries into any irregularities (for example, employee's minimum commitment of working time), although it can also make enquiries at any time if it believes the information provided was false or misleading in any material respect.[293]

If HMRC decides that the requirements of the scheme have not been met, it must notify the company in writing;[294] the employer and employee have a statutory right to appeal to the Income Tax Tribunal against such a finding.[295]

2 *Disclosure Requirements*

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[289] Division 392 in Schedule 1 to the *Taxation Administration Act 1953* deals with employee share scheme reporting.
[290] Explanatory Memorandum to the *Tax Laws Amendment (2009 Budget Measures No 2) Bill 2009*, para 1.281.
[291] *Income Tax (Earnings and Pensions) Act 2003* (UK) c 1, ss 488, 516, 521.
[292] Ibid sch 5 para 44.
[293] Ibid sch 5 para 46.
[294] Ibid sch 5 para 47.
[295] Ibid sch 5 para 50.

The general rule in the UK is that an approved prospectus must be published before there is a public offering of transferable securities.[296] Contravene is a criminal offence.

The Financial Services Authority ('FSA') has provided guidance on what constitutes a transferable security under the prospectus requirements.[297] It does not require a prospectus for the issue of non-transferable options, either at the date of grant or when the option is exercised and the underlying security is acquired. This is because at the time of exercise there is not a public offering but rather the fulfilment of a contractual entitlement. The FSA also does not consider that the provision of shares for no consideration falls within the prospectus provisions, as there is no purchase or subscription for those shares.[298]

For all other share offerings, the general rule applies so that companies establishing such a scheme will be required to publish a prospectus, unless one of the following exemptions applies:[299]

- offers to existing or former employees of transferable securities which are already quoted on an EU recognised exchange, provided a document is made available containing information on the number and nature of the securities offered, the reasons for and details of the offer; or
- The offer is made to or directed at 'qualified investor' only; or
- The minimum consideration which may be paid by any person for transferable securities acquired pursuant to the offer is at least €50 000; or
- The offer is to fewer than 100 persons in each EU jurisdiction; or
- The total consideration for the securities offered is less than €100 000; or
- The securities are included in an offer, the total consideration of which is less than €2 500 000.

There are several requirements for the contents of the prospectus if required. Generally, a summary must be included, which conveys, in brief and non-technical language, the essential characteristics of and risks associated with the issuer, any guarantor and the transferable securities to which the prospectus relates.[300]

3 *Annual Reporting Requirements*

Regardless of the type of share scheme, all employers are required to comply with detailed reporting requirements.[301] HMRC provides forms for each of the approved share schemes, and another for unapproved schemes, which must be completed by 7 July each year (penalties may apply if the deadline is not met). Employers now have the option of filling these forms out online.

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[296] *Financial Services and Markets Act 2000* (UK) c 8, s 85.
[297] Financial Services Authority, *Prospectus Rules*, Rule 1.2.3.
[298] Ibid, Rule 1.2.2.
[299] *Financial Services and Markets Act 2000* (UK) c 8, s 86.
[300] *Financial Services and Markets Act 2000* s 87A.
[301] Financial Services Authority, *Disclosure and Transparency Rules*.

C *United States*

1 *Approval*

To obtain the tax benefits under an ISO or ESPP companies must obtain shareholder approval 12 months before or after the plan is adopted.[302] If shareholder approval is not given at all or not given within the relevant time, then any tax advantages are automatically lost. US firms do not need prior approval from the revenue authority (the Internal Revenue Service). As shown below, however, the Securities Exchange Commission ('SEC') has the power to prevent the offering of securities via stock plans under certain circumstances. It should also be noted that the SEC also has a general authority to exempt in relation to any of the requirements in the *Securities Act* of *1933* where it is appropriate or necessary in the public interest and is consistent with the interests of investors.[303]

2 *Disclosure Requirements*

The general rule is that a registration statement (similar to a prospectus) is required when a company sells or offers to sell securities.[304] 'Security' is defined very broadly and includes, but is not limited to, shares and options.[305] Given this broad definition, the prospectus regime applies to employee share and option plans.[306] However, if an employee provides no consideration for the stock or options, the SEC does not regard this as requiring a prospectus. In the case of options, however, an employee is typically required to provide consideration equal to the value of the exercise price in order to acquire the shares. Therefore, in practice, options which have an exercise price less than market value are generally subject to the prospectus requirements at the time the option is offered.

Even if some form of consideration is provided, there may be exemptions available from the prospectus requirement. An exemption is available for compensation plans to employees of private companies.[307] This is subject to volume limitations and also certain disclosure obligations.

A further exemption is available for public listed companies.[308] Although a prospectus is not required, companies must complete Form S-8 where there are detailed disclosure requirements that apply to qualifying and non-qualifying schemes.[309] These requirements include:

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[302] IRC §§ 423(b)(2), 422(b)(1).
[303] *Securities Exchange Act of 1933* 15 USC § 28.
[304] Ibid §§ 7, 10.
[305] Ibid § 2(a)(1).
[306] See, eg, the definition of 'Employee benefit plan' in 15 USC § 230-405: 'The term employee benefit plan means any written purchase, … option, … or written compensation contract solely for employees…'. Presumably, this would mean that only the purchase or the option to purchase stock would fall under this definition, whereas the mere giving of stock would not satisfy this requirement.
[307] General Rules and Regulations Promulgated under the *Securities Act of 1933* 15 USC rule 701.
[308] *Securities Exchange Act of 1934* 15 USC § 12(g)(2).
[309] Note that the disclosure requirements are enunciated in *Securities Act of 1933* 15 USC sch A paras 1–27, but that the SEC has the legal ability to add to or omit any requirements it deems fit, giving due

- General plan information including the title of the plan and the name of the registrant; the general nature and purpose of the plan, its duration, and any provision for its modification, early termination or extension; and information regarding the plan's administrators (eg, trustees or managers) such as their capacities, functions, relationship with employees and the company, selection and removal;[310]
- The total amount of securities to be offered under the plan;[311]
- The class of employees that may participate in the plan and the basis upon which such employees may participate;[312]
- The period of time, price and amount at which securities may be purchased pursuant to the plan;[313]
- The time and the manner in which employees may purchase securities;[314]
- Any minimum/maximum amount of money, or percentage of salary, that can be contributed to the plan;[315]
- The nature and frequency of any reports to be made to participating employees regarding the amount and status of their options or stock;[316]
- Whether securities are to be purchased on the stock market or otherwise;[317]
- Any resale restrictions on the securities;[318]
- The tax effects on employees of participation;[319]
- The terms under which an employee may terminate the plan and whether the rights in the plan are assignable;[320] and
- Every event in which the employee may be subject to penalty, forfeiture, charges, deductions or liens.[321]

The purpose of these regulations is to help employees come to an informed decision as to whether to take part in any purchase plan at all or whether to convert their options into stock. If the SEC has reason to believe that the prospectus has not been filed, omits any material fact or includes any untrue statement of a material fact, it has the power to prevent or suspend the prospectus and hence, the offer of the securities.[322]

When a company issues stock as a result of an employee exercising an ISO or an option under an ESPP, the two tax-advantaged schemes in the US, it must issue a 'return' to the employees.[323] These returns require companies to provide employees

regard to what is 'necessary or appropriate in the public interest or for the protection of investors': 15 USC §§ 10(a)(4), (c).

[310] Securities Exchange Commission, *Form S-8, Part 1* (1)(a).

[311] Ibid (1)(b)(1).

[312] Ibid (1)(c).

[313] Ibid (1)(d).

[314] Ibid (1)(d)(2).

[315] Ibid (1)(d)(3).

[316] Ibid (1)(d)(5).

[317] Ibid (1)(d)(6).

[318] Ibid (1)(e)

[319] Ibid (1)(f)

[320] Ibid (1)(h)(1)-(2).

[321] Ibid (1)(i)-(j).

[322] *Securities Exchange Act of 1934*, 15 USC § 10(b).

[323] IRC § 6039(a) (1994).

with an annual notice with 'sufficient information to enable them to calculate their tax obligations', purchase/exercise price and a number of other matters.[324] From 2010 onwards, companies must also file these reports with the IRS (while they do not need to seek approval, they need to keep a record of such share transfers).[325]

VI Comparison with Australia

The analysis of the UK and US regimes relating to employee share schemes indicates that there are some key differences between those regimes and Australia. Those differences can be dealt with under the following headings:

- taxing point for shares and for options
- valuation issues
- concessions including quantum and conditions
- small business concessions
- capital gains tax treatment on disposal
- disclosure requirements.

A *Taxing point for shares*

In Australia, the default taxing point is on receipt of the shares.[326] This will apply unless the shares are subject to a 'real risk of forfeiture' or where there is an eligible salary sacrifice arrangement. Where there is a real risk of forfeiture or eligible salary sacrifice arrangement, taxation of the ESS interest is deferred.[327] The deferred taxing point differs depending on whether the ESS interest is a share or right. In both cases, the maximum deferral period is 7 years, however, the taxing point may be earlier if restrictions are lifted or employment ceases.[328]

In comparison, the default position in the UK is that for restricted securities no tax will arise upon receipt of the securities, but rather tax will arise only upon the occurrence of a post-receipt 'chargeable event'.[329] A 'chargeable event' occurs if the restrictions on the securities are removed or modified or the securities are disposed of for consideration.[330] The notion of restricted security is that there is a risk of compulsory forfeiture where disposal will be for less than full market value; or there is a restriction on the freedom to retain or dispose of the securities, or exercise rights; or there is a potential disadvantage in respect of the securities.[331] This appears to be a broader definition than 'shares subject to a real risk of forfeiture', which has been adopted in Australia. Furthermore, employees in the UK retain a choice as to the

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[324] United States, Internal Revenue Service, *Federal Register: Rules and Regulations*, 17 November 2009, vol 74, no 220, p 59088 <http://edocket.access.gpo.gov/2009/pdf/E9-27451.pdf>.
[325] Ibid.
[326] *Income Tax Assessment Act 1997* (Cth) div 83A.
[327] Ibid s 83A-115.
[328] Ibid s 83A-100.
[329] *Income Tax (Earnings and Pensions Act) 2003* (UK) c 1, ss 425–6.
[330] Ibid s 427.
[331] Ibid s 423.

timing of tax. If employees wish to be taxed upon receipt of securities, rather than the default position of tax upon a chargeable event, they may elect to do so.[332]

The default position in the US is that stock acquired under a statutory scheme is not taxed upon acquisition.[333] This includes stock that is issued for no or nominal consideration and is either subject to restrictions on transfer, vesting or repurchase or subject to forfeiture. In these circumstances, the taxing point occurs when the stock substantially vests (ie, when the stock is transferable or where there is no longer a 'substantial risk of forfeiture'). As in the UK, an employee is able to elect to be taxed at the time of acquisition.[334]

From the comparison of the three jurisdictions, it is clear that the taxing point for shares occurs at the earliest point in Australia, that is, upon receipt of the securities. In both the US and UK, the default position is that tax arises only upon the occurrence of a post-receipt event. Further, Australian employees are not able to elect their desired taxing point, unlike the US and UK. This may create a disincentive for the use of employee share schemes.

B *Taxing point for options*

Under Australian law, no distinction is made between options or shares for taxing point purposes. Shares and options are classed as ESS interests.[335] Like shares, the default taxing point under Div 83A for options is also on receipt.[336] Similarly, tax liability may be deferred in circumstances where there is either a real risk of forfeiture of the option.[337] As a general rule the taxing point will be when the option vests.

In comparison, the position in the UK is that special rules apply for options. Generally, no tax liability will accrue upon the acquisition of the option.[338] Instead, liability to tax will arise upon occurrence of certain post-acquisition 'chargeable events'.[339] In most cases, the 'chargeable event' is the exercise of the option, that is, the acquisition of securities pursuant to the option. Chargeable events may also occur if the option is assigned to another person for consideration or if a benefit is received in connection with the option. Employees may also elect, if they so desire, to pay tax upon receipt of options.[340]

The position in the US is that the taxing point depends on whether employee receives stocks or options. Employees will only generally be subject to tax, not upon receipt of the option, but rather when the option is substantially vested. This occurs when the option becomes transferable or is no longer subject to a substantial risk of forfeiture (similar to Australia).[341] The employee does not pay tax on the actual exercise of the

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[332] Ibid s 431.
[333] IRC § 421(a)(1) (1994).
[334] Ibid § 83(b).
[335] *Income Tax Assessment Act 1997* (Cth) s 83A-10.
[336] Ibid s 83A-25(1).
[337] Ibid s 83A-125.
[338] *Income Tax (Earnings and Pensions Act) 2003* (UK) c 1, s 475(1).
[339] Ibid s 476.
[340] Ibis s 431.
[341] IRC § 83(a) (1994).

option. The employee can also elect to include an amount in taxable income upon receipt, rather than vesting. [342]

In general, the taxing point under the UK and US position is at a much later stage than under Australian legislation. This is due to a distinction being drawn in those respective countries between treatment of shares and options. Taxing in Australia occurs prima facie upon receipt, whereas in the UK and US, taxing occurs at a later stage, usually when the option is exercised or when it vests. In both jurisdictions the employee may elect to be taxed on acquisition.

C *Valuation issues*

In Australia, assessable income includes an amount equal to the discount given in relation to the share or option. [343] The discount is calculated by deducting any consideration paid or payable by the employee from the market value of the share or option.

In this regard the term market value is said to have its ordinary meaning although the legislation states that the regulations may specify some other amount. [344] This is potentially problematic in the case of shares and rights that are not listed on a securities exchange because the absence of a market means that some sort of individual valuation exercise is required and this can be costly. Further there is a real issue about whether any restrictions imposed on the shares and rights affect their value. Clearly from a market perspective, any restrictions on disposal will affect the price that a person would be prepared to pay, yet the legislation specifically directs that such restrictions not be taken into account in valuing the shares or options for tax purposes.[345]

The Board of Taxation recently considered the issue of valuation of employee share scheme securities. 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 statutory valuation tables. In this regard the Board recommended that the factors underlying the statutory valuation tables be reviewed and updated.[346] The government has accepted this in principle but warned that any review will take time. The Board also recommended that the Commissioner of Taxation provide further guidance on acceptable valuation methodologies for employee share schemes.[347] The current position in relation to valuation is that there is no clear guidance on valuing unlisted shares or rights and a valuation that does not take into account restrictions imposed is likely to overvalue the benefit.

In the UK, if the taxing point occurs at the time of receipt of the share or option, the amount included as income tax is calculated by taking the difference between the

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342 Ibid § 83(b)(1).
343 *Income Tax Assessment Act 1997* (Cth) s 83A-25.
344 Ibid s 83A-315(1).
345 Ibid s 960-410.
346 See Board of Taxation 'Review into Elements of the Taxation of Employee Share Scheme Arrangements – A Report to the Assistant Treasurer' February 2010.
347 Ibid.

market value and any consideration provided.[348] The market value, for the purposes of *Income Tax (Earnings and Pensions) Act 2003* (UK) c 1, Part 7, is the same as it is for capital gains tax purposes.[349] Therefore, the value of a block of share is the price which those shares might reasonably be expected to fetch on a sale in the open market.[350]

If the taxing point occurs upon the happening of a chargeable event, the amount included as income tax is calculated by taking the difference between any gain realised on occurrence of the chargeable event and any deductable amounts (ie, consideration given or expenses incurred).[351] At this point, there is no need to calculate the market value. Therefore, while there may be similar difficulties in assessing market value in Australia, this only applies to a far more limited class of case in the UK. This is because most of the ESOP securities are taxed post-receipt.

In the US, employees are not subject to income tax upon acquisition of a stock or option.[352] Instead they are taxed only on capital gains when the securities are substantially vested, which usually occurs when they are sold. When an employee disposes of his or her security, capital gains is calculated on the *lesser* amount of either the excess of the fair market value of the security at the date of disposition (or death) over the amount paid; *or* the excess of the fair market value of the security at the date of grant over the amount paid.[353] How is fair market value calculated? As in Australia, there is no statutory definition of fair market value or clear guidance as to how it is to be calculated. Limited guidance is given in that FMV of a ISO stock is to be assessed at the time the option with respect to such stock is granted.[354] Further, no regard is to be had to any restrictions, other than a restriction, which by its terms, will never lapse.[355] It is likely that the difficulties in assessing market value in Australia equally apply to assessing FMV in the US. However, it may be likely that FMV upon disposal will in most cases be the price at which the share was disposed for.

D *Concessions including quantum and conditions*

Australia provides two forms of tax concessions. The first is a ‘reduction concession’, which entitles employees to $A1000 of tax-free ESS interests.[356] The second concession is the ability to defer tax liability for up to seven years.[357]

In contrast, the UK provides four different schemes for tax-concessions: Share Incentive Plans, Save As You Earn Option Schemes, Company Share Option Plans and Enterprise Management Incentives. Under the SIP scheme, the maximum total share value that can be acquired tax-free is £9000 per employee per year.[358] Under the

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348 *Income Tax (Earnings and Pensions) Act 2003* (UK) c 1, ss 428–30.
349 Ibid s 421.
350 *Taxation of Chargeable Gains Act 1992* (UK) c 12, s 272(1).
351 *Income Tax (Earnings and Pensions) Act 2003* (UK) c 1, s 478.
352 IRC § 421(a) (1994).
353 Ibid § 423(c).
354 Ibid §§ 422(d)(3).
355 Ibid § 422(c)(7).
356 *Income Tax Assessment Act 1997* (Cth) sub div 83A-B.
357 Ibid sub div 83A-C.
358 *Income Tax (Earnings and Pensions) Act 2003* (UK) c 1, pt 7 ch 6.

SAYE option scheme, employees agree to save between £5 and £250 per month over three, five or seven years and, at the end of this period, the employee receives a tax-free bonus on the culmination of the interest as well as the repayment of their savings.[359] Concurrently, employees are granted options (which may be granted a discount of up to 20% off the market value) using the savings to acquire shares in the employer company. There is no limit on the quantum of this tax exemption. No income tax will arise on either the grant or exercise of the option. Under the CSOP, employees may receive options up to a value of £30000 tax-free.[360] This is a significant tax advantage, especially complemented by the fact that no tax liability will generally arise on the exercise of the option. The EMI plan offers the largest potential for tax benefits, where each eligible employee may be granted up to £120 000 worth or options tax-free.[361] Once these options have been exercised or lapsed, a further grant of £120000 worth of options may be issued.

There are several schemes in the US that will qualify for concessional treatment. The maximum tax-free thresholds in the US are far higher than compared to Australia. Under US ESOPs, companies can contribute up to $US49000 in stock or cash tax free. Further, under the ESPP, employees are entitled to purchase up to $US25000 worth of their corporation's stock subject to no income tax.[362] ISOs are even more generous, permitting employees to be granted up to $US100000 worth of options, free from income tax.[363] Further, US ESOPs provide employers with the greatest tax advantages. Leveraged ESOPs provide companies with a cost effective way of financing their employees acquisition of stock, because both the principal and interest from the loan is tax-free. Under C Corp ESOPs, sellers may defer gains made from the sale of stock to the ESOP if the ESOP owns 30% of all shares in the company and if the seller can reinvest the proceeds of the sale in other securities.[364] Perhaps the greatest tax advantage is found in S Corp ESOPs. In S corporations, the percentage of ownership held by the ESOP is not subject to any corporate income tax.[365]

From this analysis, it appears that, compared to Australia, there are more tax concessions available in the UK and the US. Further, the tax concessions in both the UK and US appear to be far more generous. The maximum tax-free limit in every scheme in the UK and US greatly exceed the $A1000 tax-free ceiling imposed in Australia.

There also appears to be greater flexibility in implementing the tax concessions in jurisdictions other than Australia. Generally, access to the tax concessions in Australia requires that the scheme be broad based, that is offered to at least 75% of all permanent employees with at least three years service.[366] An exception to this rule is permitted for the deferral concession where the ESS interest acquired is options rather than shares or where there is another scheme that is broadly available.[367] In the UK,

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[359] Ibid pt 7 ch 7.
[360] Ibid sch 4 para 6.
[361] Ibid sch 5 para 5.
[362] IRC § 423(b)(8) (1994).
[363] Ibid § 422(d)(1).
[364] Ibid § 1042.
[365] Ibid § 501.
[366] *Income Tax Assessment Act 1997* (Cth) s 83A-35(6).
[367] Ibid s 83A-120.

SIPs and SAYE schemes must be offered to all employees,[368] but EMIs and CSOPs may be offered selectively to any employee. This provides great flexibility to companies to enter agreements with employees on an individual or collective basis and to impose different conditions on different employees. In the US, the ESPP must be offered to all eligible employees on substantially the same terms.[369] However, employers may permit different employees to purchase different amounts. The ISO, on the other hand, is an entirely discretionary stock option scheme.

The conditions imposed on the grant of concessions appear to be more onerous in Australia. An employee may only access the $A1000 tax concession in Australia if his or her adjusted income is less than $180000.[370] The availability of tax concessions in the UK and US, however, are not made subject to an employee's income. Further, in Australia, the employee cannot receive more than 5% ownership of the company or control more than 5% of the voting rights of the company as a result of participating in the scheme.[371] This is similar to the requirement under the ESPP scheme in the US where employees that hold 5% or more of the voting power or shares are ineligible to participate.[372] In the UK in contrast, employees are excluded from participation in the schemes if they have a 'material interest' in a company whose shares may be awarded under the scheme. A material interest is defined as control of more than 25% of the ordinary share capital.[373] Under the EMI scheme, however, this limit is relaxed to 30% of the issued capital of the company.[374]

It seems that the time limits for holding interests to qualify for the tax concessions are less stringent in Australia than in the UK. To obtain the reduction concession in Australia, shares or options must be held for a minimum period of three years or until employment ceases.[375] In the UK, in order for the tax advantage to apply, SIP shares must generally be held in the trust for at least five years,[376] SAYE options can only be exercised until the relevant three, five or seven year saving period has ended,[377] CSOP options must not be exercised before three years[378] and EMI options are capable of exercise within 10 years.[379] Time limitations are even less stringent in the US. Under both the ISO and ESPP, to qualify for the tax concession, shares must not be disposed of within two years from the date the option was granted or one year after the option was exercised.[380]

E *Small business concessions*

Neither Australia nor the US has an employee share scheme designed specifically for small businesses. ESPPs and ISOs in the US and the tax concessions available in

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[368] *Income Tax (Earnings and Pensions) Act 2003* (UK) c 1, sch 2 para 8, sch 3 para 7.
[369] IRC § 423(b)(4) (1994).
[370] *Income Tax Assessment Act 1997* (Cth) s 83A-35.
[371] Ibid s 83A-35(9).
[372] IRC § 423(b)(3) (1994).
[373] *Income Tax (Earnings and Pensions) Act 2003* (UK) c 1, sch 2 para 20, sch 3 para 12, sch 4 para 10.
[374] Ibid sch 5 paras 29.
[375] *Income Tax Assessment Act 1997* (Cth) s 83A-35(8).
[376] *Income Tax (Earnings and Pensions) Act 2003* (UK) c 1, sch 2 para 36, sch 2 para 61.
[377] Ibid sch 3 para 30.
[378] Ibid s 524.
[379] Ibid s 529.
[380] IRC §§ 422(a)(1), 423(a)(1).

Australia do not make any distinction based on the size of the business. In comparison, the UK's EMI scheme is targeted particularly at small start-up companies. The scheme is wholly selective and offers the largest potential tax benefits of the four tax-advantaged schemes in the UK, with eligible employees able to be granted up to £120000 worth of tax-free options.[381] Moreover, the EMI scheme is available only to independent trading companies with gross assets of less than £30,000,000 and fewer than 250 full-time employees.[382] In order to encourage the growth of small businesses, companies are not excluded from participating in the EMI scheme if their gross assets subsequently exceed £30,000,000 following the grant of options, or if the company acquires a subsidiary that would not otherwise qualify under the scheme.[383] The SIP scheme may also be aimed at private firms and smaller businesses, hence the capability of using nonvoting shares to avoid loss of control.

F *Capital gains tax treatment on disposal*

In Australia, where an ESS interest is disposed within 30 days of the earliest deferred taxing point, the difference between the market value of the interest and the cost base will be assessed as income.[384] If disposal does not occur within 30 days of the earliest deferred taxing point, however, the gain on disposal will be taxed as a capital gain. These gains are taxed at the individual's marginal income rate.[385] In certain circumstances, the CGT discount may apply so that only 50% of the nominal gain is included.[386]

In the UK, when a share or option is disposed of, capital gains tax will only arise if the assessable amount is above £10,100.[387] Any gains above this amount will be subject to capital gains tax of 28%.[388] Tax is assessed by taking the difference between the sale price and the amount paid to acquire the share or option, including any income tax that has already been paid.[389]

In the US, when a stock or option is disposed of, capital gains tax is payable, assessed on the selling price less the basis price. Generally, the amount of capital gains tax payable depends on the time that a stock or option has been held for.[390] If the stock or option has been held for less than a year, CGT is assessed at the employee's top marginal tax rate (similar to the Australian approach). If the stock or option has been held for more than a year, concessional rates apply.

G *Disclosure requirements*

[381] *Income Tax (Earnings and Pensions) Act 2003* (UK) c 1, sch 5 para 5.
[382] Ibid sch 5 paras 12, 12A.
[383] Ibid sch 5 pt 6.
[384] *Income Tax Assessment Act 1997* (Cth) ss 83A-115–120.
[385] Ibid s102-5.
[386] Ibid div 115.
[387] *Taxation of Chargeable Gains Act 1992* (UK) c 12, s 3.
[388] Ibid s 4.
[389] Ibid s 2.
[390] IRC § 1(h) (1994).

Generally speaking, it appears that the disclosure requirements in Australia are more burdensome, leading to higher compliance costs for companies with employee share schemes.

In Australia, the default position is that companies seeking to offer their employees shares must generally prepare a prospectus.[391] There are three exceptions to this rule. First, 'small scale offerings', defined as personal offers to no more than 20 investors and no more than $20,000,000 raised, are exempt from the disclosure requirement.[392] A second exception is for shares issued for no consideration.[393] It has been suggested that ASIC will take a narrow interpretation of 'no consideration' and hold that where continued employment is a condition of the grant of securities, consideration has been provided.[394] This means that few companies will be able to avail themselves of this exception. Third, ASIC may provide very limited conditional relief for listed companies that offer no more than 5% of their shares or options for no consideration. While not a complete exception from disclosure, where a body seeks to raise no more than $10,000,000, the company may use a simpler form of disclosure document as compared to a prospectus.[395] In practice, however, this document also entails considerable costs given that an audited financial report in the last six months is required.[396]

The default position in the UK is also that a prospectus must be issued whenever there is a public offering for transferable securities.[397] The exceptions to this rule, however, appear wider than in Australia. Non-transferable securities, such as options, do not require a prospectus.[398] Securities provided for no consideration are also excluded. Further, the UK's version of Australia's 'small scale offerings' is much broader. No disclosure is required if the offer is to fewer than 100 persons in each EU jurisdiction or the total consideration for the securities offered is less than €100,000.[399] There is also a less onerous disclosure requirement for offers to existing or former employees of transferable securities which are already quoted on an EU recognised exchange. While a prospectus is not required, a simpler disclosure document must be provided.[400]

In the US the default position is that a prospectus is required when a company sells or offers to sell securities under the ESPP or ISO, unless an exception applies.[401] Securities offered for no consideration are an exception to this rule. While a prospectus is not required, less onerous disclosure requirements are available for private companies and public listed companies offering securities to employees.[402]

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[391] *Corporations Act 2001* (Cth) pt 6D.2.
[392] Ibid s 708(1)–(8).
[393] Ibid s 708(15)–(16).
[394] Sartori, above n 286, 76.
[395] *Corporations Act 2001* (Cth) s 709(5).
[396] Ibid s 709(4) note 2.
[397] *Financial Services and Markets Act 2000* (UK) c 8, s 85.
[398] Financial Services Authority, *Prospectus Rules*, Rule 1.2.3.
[399] *Financial Services and Markets Act 2000* (UK) c 8, s 86.
[400] Ibid s 87A.
[401] *Securities Exchange Act of 1933* 15 USC §§ 7, 10.
[402] General Rules and Regulations Promulgated under the *Securities Act of 1933* 15 USC Rule 701; *Securities Exchange Act of 1934* 15 USC § 12(g)(2).

It appears that the disclosure requirements in Australia are more onerous than the US and UK. While exceptions to requiring a prospectus do exist, they are framed much more narrowly than in the UK. The availability of less stringent disclosure requirements do not apply to as broad a range of companies as in the US. This means that companies in Australia seeking to establish an employee share scheme face greater costs in complying with the disclosure requirements.

VII CONCLUSION

The analysis of the US and UK regimes indicates that significant differences exist between the regulation and taxation of employee share schemes in those two countries, and the schemes operating in Australia. Most relevantly, it appears that in Australia the taxing point for shares and for options is at an earlier stage, the valuation of tax is more onerous, tax concessions relating to quantum and capital gains treatment on disposal are less generous, the conditions for obtaining tax concessions are more difficult and disclosure requirements are more burdensome. These factors lead to the conclusion that the regulatory framework in which Australian employee share schemes operate do not create an incentive to establish such schemes compared to the US and UK.