mantra, Beijing has repeatedly used

grow, its interest in preserving

rises. The assets include extensive

maritime rights and power a top

fellow at the Institute of Southeast Asian Studies in Singapore.

Long, hard look needed at employee share schemes

Employee share schemes are still at risk because of rushed legislation, writes Ann O'Connell.

Last Friday the federal government released draft legislation to reform the taxation of employee share schemes. The legislation is subject to a "two-track" public consultation process — a two-week period for public consultation and a Board of Taxation "interactive dialogue" with industry over technical issues. The entire process seems to be one of unseemly haste.

Although the Assistant Treasurer noted that "the Rudd government's support for such schemes has always been clear", the general tenor of the proposed changes appears to be more about perceived misuse of the tax concessions than encouragement of the concept of employee ownership. The release of the draft legislation is the culmination of a process that started with a surprise announcement on budget night, was followed by a quick Treasury consultation then a bit of a backflip. In the meantime, there has been a Senate inquiry that has divided on party lines, and not a lot of movement from the government on many of the features of its original proposal. It seems likely that although interested parties will not be happy with the draft legislation, the government is determined to press ahead.

The Employee Share Ownership Project was established in 2006 and is based at the Melbourne Law School, University of Melbourne. The project has been considering the existing regulatory regime for employee share ownership plans (or ESOPs) in Australia in tax, corporate and labour law. We have been examining the present incidence and forms of ESOPs in Australia, the diversity of objectives that such schemes serve, the extent to which existing corporate, tax and labour law inhibits ESOPs, and the case for reform of the regulatory framework.

Key findings of our research include the following:

❑ Current Australian regulation (both tax and corporate) favours listed entities compared with unlisted entities. There are many unlisted companies that find it extremely difficult to comply with the regulations.

❑ There is a mismatch between the corporate regulatory scheme, which treats employee share schemes as an investment decision, and tax regime, which views the schemes as another form of non-cash remuneration.

❑ The complexity of the present regulation affects the design of such schemes as well as the decision whether to implement them. The more complex the rules, the less likely employers are to offer such schemes.

❑ There is a lower incidence of employee share ownership in Australia than in the United States and United Kingdom, and it is also clear that both the US and UK offer more generous tax treatment to employee share schemes.

The danger of the draft legislation being implemented is that it may be a very long time before the issues are addressed again.

We welcome the government's decision to review the taxation arrangements surrounding employee share schemes, as our research has shown that the existing rules are complex and costly. We commend the extension of the concessions to contractors and the clarification of the provisions in relation to "rights".

However, there are still significant issues that go to the viability of such schemes in the future and also to the integrity of the rules. If the requirements under the legislation are too onerous and the benefit that can be obtained is fairly minimal, employers are unlikely to offer such schemes in the future. In particular, there are issues about the test set down for deferral of tax liability — a "real risk" of forfeiture. Some of the examples given demonstrate quite clearly that this test will not be an easy one to apply. There are also issues about employers determining eligibility for the $1000 concession, particularly if the employee (or contractor) has income from more than one source. The amount of the concession is also an issue, as the same dollar amount has been used since 1997. It may be that employers will decide that it is simply too hard to offer shares to employees.

The draft legislation aims to ensure integrity by requiring that schemes be non-discriminatory, but this requirement applies only to shares (and not options) and can be satisfied if there is at least one scheme that is non-discriminatory (suggesting that you can have one scheme for the workers and another, more generous scheme for the executives). This requirement has simply been lifted from the existing provisions. Several other matters have been repeated from the existing laws without clear consideration of their purpose. Examples are the restriction of such schemes to ordinary voting shares and the 5 per cent limit on acquisition.

In our view it would be preferable for the government to wait until the Board of Taxation has completed its inquiry in relation to unlisted entities and our project has a chance to draw together the threads of our research. The government should allow the existing rules to continue until a thorough examination of all the issues has been undertaken. We also believe that any review of the tax rules should give consideration to reforming the Corporations Act in relation to ESOPs. The danger of the draft legislation being implemented is that it may be a very long time before the issues are addressed again.

■ *Ann O'Connell, associate professor of law at the University of Melbourne, is chief investigator in the Employee Share Ownership Project. The other chief investigators are professors Ian Ramsay and Richard Mitchell.*

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