GRG Remuneration Insight 110

$5,000 Salary Sacrifice Share Plan Basics

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Introduction

This is one of a series of GRG Remuneration Insights dealing with general employee equity plans (GEEPs). These plans are made available to the majority of full-time employees (and part-time in some cases); and often operate on a salary sacrifice basis with matching by the company.

GRG undertook extensive research in to market practices in relation to GEEPs and have published the outcomes in GRG Remuneration Insights available on a complementary basis on our website: www.grg.consulting.

There are four basic GEEPs:

- Share Save Plan (SSP) – see GRG Remuneration Insight 109,
- $5,000 Salary Sacrifice Share Plan (SSSP) – this GRG Remuneration Insight 110,
- After Tax Employee Contribution Plan (ATECP) - see GRG Remuneration Insight 111, and
- $1,000 Tax Exempt Plan (TEP) - see GRG Remuneration Insight 112.

This GRG Remuneration Insight provides an outline of the main design features of the SSSP.

Outline

Modelling Assumptions

The model used to illustrate the operation of the plan is based on the following assumptions which were designed to simplify calculations:

- Share price at commencement is $2.00,
- Share price grows at 14.5% per annum,
- Share price after year 3 of $3.00,
- Cash Dividends are declared each year and represent a yield of 4%,
- Dividends are 50% franked,
- Company tax rate of 30%,
- Employee marginal tax rate (including Medicare Levy) of 39% unless otherwise indicated,
- Salary Sacrifice Plan Shares and Matching Plan Shares are acquired at commencement,
- Holding period of 3 years following which the shares are sold, and
- Dividends are applied to acquire more shares which are also sold after the first 3 years.

Only the first year's acquisitions are used in the model. However, additional holdings will further accumulate if a participant continues to add to their 1st year acquisitions.

Outline

Most of the features of the SSSP are prescribed in the relevant ESS taxing provisions. However, there are some aspect that may be varied by companies. The following represents a typical plan design.

1. Employees apply to join the SSSP and nominate the amount of salary to be sacrificed each pay period. The maximum amount is $5,000 per employee but because this example uses 1:1 matching the maximum would be $2,500 per employee. As an example, the following table shows the amount of net salary that will be forgone to fund a salary sacrifice of $200 per month for a year (i.e. pre-tax).

Aspect	Individual on 32.5% Marginal Tax Rate + Medicare Levy (Income >$37,000 - $87,000)		Individual on 37% Marginal Tax Rate + Medicare Levy (Income >$87,000 - $180,000)		Individual on 45% Marginal Tax Rate + Medicare Levy (Income >$180,000)	
	Before Salary Sacrifice	After Salary Sacrifice	Before Salary Sacrifice	After Salary Sacrifice	Before Salary Sacrifice	After Salary Sacrifice
Annual Salary	$80,000	$77,600	$150,000	$147,600	$250,000	$247,600
Salary Sacrifice Amount	**$0**	**$2,400**	**$0**	**$2,400**	**$0**	**$2,400**
Monthly Salary	$6,667	$6,467	$12,500	$12,300	$20,833	$20,633
PAYG Tax	$1,596	$1,527	$3,844	$3,766	$7,561	$7,467
Net Salary	$5,071	$4,940	$8,656	$8,534	$13,272	$13,166
Change in Monthly Cash Flow		**-$131**		**-$122**		**-$106**

2. The amount of salary sacrifice is used to acquire shares in the Company (Shares).
3. Shares acquired must be subject to specified disposal restrictions and in this example it is assumed that the disposal restriction period is 3 years. The disposal restriction must be set when the Shares are acquired and cannot be changed. When the disposal restrictions cease taxation arises on the then market value of the Shares.
4. The Acquisition Price of each Plan Share is the volume weighted average price (VWAP) at which Company Shares were traded on the Australian Stock Exchange (ASX) over the period of salary sacrifice. Over the first year the participant will have acquired 1,200 Plan Shares ($200 x 12 months ÷ $2.00).
5. The Company provides Matching Plan Shares that vest after 2 years of service on a one for one basis. Thus, after the first year the participant will have been granted 1,200 Matching Plan Shares.
6. Dividends are reinvested into additional Plan Shares.
7. If the Participant leaves the Shares in the SSSP and continues to Salary Sacrifice the number of Shares held within the SSSP will continue to grow.
8. The taxing point arises on the earlier to occur of:
    a. Cessation of disposal restrictions for Salary Sacrifice Shares,
    b. Cessation of disposal restrictions and vesting conditions for Matching Shares,
    c. Cessation of employment with the company for Salary Sacrifice and Matching Shares, or
    d. Elapse of 15 years from the acquisition of Salary Sacrifice and Matching Shares.
9. After three years, the participant will have accumulated 2,620 shares which are sold for a value of $7,859 netting $5,022 (after tax is deducted) based on an initial salary sacrifice amount of $2,400.
10. Important points to note include:
    a. The net of tax benefit from the SSSP is lower than from the SSP (see GRG Remuneration Insight 109).

b. The maximum amount that may be contributed to the SSSP is capped at $5,000 whereas the SSP is not subject to a cap.

c. The tax deferral period (period of disposal restrictions) needs to be set at the time the Shares are acquired under the SSSP whereas under an SSP the employee has flexibility as to when Plan Shares may be withdrawn which triggers the taxing point.

d. For tax deferral to apply to SSSPs it is necessary that at the time of the grant 75% of permanent part-time and full-time employees in Australia have received offers under an ESS operated by the company. This condition does not apply to SSPs, which gives the company greater flexibility in terms of selection of participants.

e. Down side risk protection is not available in relation to SSSP acquisitions, but this can be added to SSPs.