

GRG Remuneration Insight 111

After Tax Employee Contribution 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) – see GRG Remuneration Insight 110,
- After Tax Employee Contribution Plan (ATECP) - this 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 ATECP.

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 3 year 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,
- Shares acquired with after tax contributions 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

The following represents a typical design of an ATECP.

1. Employees apply to join the ATECP and nominate the amount of after tax salary to be deducted each pay period. For example, an employee may choose to pay \$122 per month. Because the deduction is from after tax salary the cash flow impact on the individual is the full \$122. As the employee's marginal tax rate is 39% the before tax cost to the employee is \$200, which is the same as the salary sacrifice (before tax) cost in the examples provided in relation to the SSP and the SSSP (see Insights 109 and 110).
2. The amount of contribution is used to acquire shares in the Company (Shares).
3. Shares acquired are generally not subject to specified disposal restrictions as it is the employee's own money and could have been used to buy Shares on a stock exchange.
4. The Acquisition Price of each Plan Share is the price paid on the Australian Stock Exchange (ASX).
5. Over the first year the participant will have acquired 732 Shares ($\$122 \times 12 \text{ months} \div \2.00).
6. The Company provides Matching Share Rights that vest after 2 years of service on a one for one basis. Each Share Right is an entitlement on exercise after vesting to one Share. Thus, the Participants would be granted 732 unvested Matching Share Rights.
7. If the Participant leaves the Shares in the ATECP and continues to make contributions which are matched, the number of Shares and Share Rights held within the ATECP will continue to grow.
8. The taxing point on Matching Share Rights arises on the earlier to occur of:
 - a. Cessation of disposal restrictions and vesting conditions,
 - b. Cessation of employment with the company, or
 - c. Elapse of 15 years from the acquisition of Matching Share Rights.
9. After three years the participant will have accumulated 799 shares which are sold for a value of \$4,593 netting \$3,585 (after tax is deducted) based on an initial pre-tax cost of \$2,400.
10. Important points to note include:
 - a. The net of tax benefit from the ATECP is lower than from the SSP and the SSSP (see GRG Remuneration Insights 109 and 110).
 - b. Like the SSP the ATECP does not involve a cap on the value of contributions or matching.