GRG Remuneration Insight 112

$1,000 Tax Exempt Plan Basics

Authors: Chris Godfrey & James Bourchier

Contributors: Denis Godfrey, Nida Khoury & Peter Godfrey

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 practice 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) - see GRG Remuneration Insight 111, and
- $1,000 Tax Exempt Plan (TEP) - this GRG Remuneration Insight 112.

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

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,
- 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 TEP are prescribed in the relevant ESS taxing provisions. However, there are some aspect that may be varied by companies.

1. Employee receives an offer of 500 Shares (valued at $1,000) and accepts it. There is no cost to the employee.
2. 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 statutory minimum disposal restriction is until the earlier of the 3rd anniversary of the acquisition and termination of employment. The disposal restriction must be set when the Shares are acquired and cannot be changed.
3. The Acquisition Price of each Share is the market value of a Share on the date of acquisition. In the example the share price at acquisition is $2.00.
4. The taxing point arises when the Shares are sold which has been assumed to be after 3 years. The initial $1,000 remains tax free, tax is paid on dividends each year and CGT applied to the growth in value of the shares between acquisition (deemed to be at their market value of $1,000) and sale.
5. After three years the participant will have accumulated 544 shares which are sold for a value of $1,632 netting $1,529 (after tax is deducted).
6. Important points to note include:
    a. TEP is very tax efficient,
    b. The cap of $1,000 on the amount of tax exempt benefit that may be provided severely limits the plan,
    c. For tax deferral to apply to TEPs it is necessary that the grant be made on an egalitarian basis. This means that 75% of permanent part-time and full-time employees, who have completed 3 years of service, in Australia receive the same offer.