



MEMO

To: Board of Directors
From: Company Secretary
Subject: **EMPLOYEE SHARE SCHEMES**

Introduction

1. An employee share scheme (“Plan”) can cover either:
 - a. the acquisition of shares by employees (“ESAP”)
 - b. the granting of options (over shares) to employees (“ESOP”)in the company/group (ie: including parent company/subsidiaries) in which they are employed.
2. Plans must comply with the company’s Constitution, Corporations Act (“CA”), Tax Act and, for listed companies, the ASX Listing Rules. The legislation/regulation effectively lumps ESAP and ESOP together so the rules and requirements for both are largely the same.
3. Most common Plans are ESOP, principally because that’s usually the “cheapest” way for an employee to get an equity interest in the company.

Constitution

4. The Constitution may require shareholder approval (at a general meeting) for a Plan. Otherwise directors may decide by resolution at a board meeting (unless required/preferred for listed companies in certain circumstances).
5. If a company doesn’t have a Constitution and is operating under the Replaceable Rules in CA it will need a general meeting (Sec. 245D). This doesn’t apply to listed companies because they must have a Constitution.
6. Some companies, in any case, let the decision be made at a general meeting so that everything is seen by employees/shareholders to be “out in the open”.

Corporations Act

7. A number of CA sections and ASIC regulations (or parts thereof) cover and/or are relevant to Plans. These include:
 - Sections: 245D, 260C(4), 708
 - Class Orders: 00/220, 00/221, 00/222, 00/223, 00/224
 - Policy Statements: 49, 56, 151
 - Information Releases: 00/020, 00/039



8. The CA does not specifically require approval of Plans at a general meeting except in certain circumstances (see above re Constitutions and below).
9. For a proprietary company issues of shares or options to employees do not count towards the 50 shareholder limit – Sec. 113(1).
10. Employees include officers which, under the Sec. 9 definition, also covers Directors and the Company Secretary.
11. IR 00/039 broadens the definition of “employees” to include casuals (employed for more than 1 year) and contractors (employed for more than 1 year and earning at least 80% of their income from the employer) – when specifically approved by ASIC on a case-by-case basis.
12. There are no CA requirements for minimum employment periods, minimum time before entitlements are available, minimum holding times or restrictions on trading. However, Plans may include these.
13. If any company is providing financial assistance for the purchase of shares under a Plan it must have the Plan approved at a general meeting - Sec. 260C(4) and comply with PS 49.24(g).
14. Under PS 49 & CO 00/220 listed companies do not need a prospectus to issue options or shares under a Plan provided a number of conditions are fulfilled. These include:
 - a. shares must be the same class as already listed on ASX and can only be allotted and/or options granted if the company has been listed for 12 months (but a shorter period may be considered – see IR 00/039)
 - b. total shares/options on offer plus any others issued under any Plan over the last 5 years do not exceed 5% of the issued capital
 - c. options must only be granted for nil or nominal consideration
 - d. the Plan must be in a written document given to employees and lodged with ASIC - PS 49.24(f) - and ASX.
15. A prospectus is required for all unlisted companies, unless the issue falls within one of the CA exemptions (Sec. 708) – see below. This applies whether shares or options are issued/granted and regardless of the value of consideration (IR 00/039).
16. Where a prospectus is required (whether for a listed or unlisted company) then some procedural relief from the full/normal provisions may be available under PS 49.33 ff.



17. A prospectus will be required if options are granted for other than nil or nominal consideration, even if a listed company - PS 49.28 & CO 00/220 B(d). "Nominal" is taken to be the lesser of 1¢ per option or 1% of the exercise price – CO 00/220 D(5).
18. ASIC will generally not allow partly paid shares to be issued under an ESAP (but see IR 00/039) – but such issues to Directors may be specifically approved by ASIC on a case-by-case basis PS 49.24(c).
19. Under Sec. 708(12) shares and/or options may be issued/granted to "executive officers" of any company (or their associates) outside of any Plan arrangement and without a prospectus. An "executive officer" is one "who is concerned in, or takes part in, the management of" a company and includes a Director – Sec. 9.
20. Shares and options may also be issued/granted for any company without a prospectus (and outside a Plan) if shares are issued for nil consideration – Sec. 708(15) – or options granted for nil consideration with no exercise price. However, IR 00/039 questions whether there can be no "consideration" for employees as such may be in some other form (eg, as a term of an employment contract).
21. Similarly no prospectus is required if shares/options are issued/granted under Sec. 708(1); ie, 20 acceptances within 12 months for up to \$2 million. But using this exemption for employees may, of course, limit the scope for other capital raisings.
22. Trading in shares or options ("secondary sales") by employees of unlisted companies could also require a prospectus, although some relief may be available (PS 49.43 ff).

ASX Listing Rules

23. A listed company does not require a general meeting to institute a Plan unless its Constitution says otherwise.
24. However, no shares or options can be issued to a director or associate, under a Plan or otherwise, without a general meeting (L/R 10.14).
25. Unless the Plan is approved/ratified at a general meeting under L/R 7.2(9) any shares issued under it will count towards the 15% limit for new issues in a 12 month period (L/R 7.1).



Tax Act

26. The applicable tax legislation is complex and the following is a summary of possible tax consequences. Appropriate specialist advice needs to be obtained.
27. Division 13A, Part III grants some tax concessions to employees provided certain conditions are met. These include:
- there is a formal Plan in place
 - the Plan must be available to at least 75% of permanent employees with at least 3 years service
 - no employee holds more than 5% of the company.
28. Where shares are acquired (or options exercised) under a complying Plan and an election is made to have any benefit taxed in that year a special deduction of up to \$1,000 may be available to the employee. If no election is made any "profit" may be taxed in full on disposal. Whether tax is on income or capital gains will also depend on the treatment.
29. An employee who receives shares or options other than under a complying Plan may be taxed on any discount between the acquisition price and the market value at the time of acquisition (whether or not a listed company) – Sec.139B(2). For an unlisted company an appropriate valuation must be obtained from an approved valuer.
30. From the company's perspective no FBT should be payable in relation to shares/options issued/granted under a complying Plan. Otherwise FBT may be payable on the value to employees.

Other

31. Amongst other things, most States/Territories now include the value of shares/options issued to employees to be included in the value of wages on which Payroll Tax is calculated.

DISCLAIMER

The comments in this memo reflect some commercial aspects and observations on the matter experienced or observed by the writer in practice as he understands them. The information is given as a guide only and does not represent a definitive or legal view of any of the issues raised, covered or referred to and the reader is urged to seek his own professional advice on all aspects of, or pertaining to, this and any related matter.