Deutsches Aktieninstitut

Employee Share Ownership as Pivotal Part of the Capital Markets Union

Abandon obstacles for employee share ownership plans – create a level playing field for cross-border implementation

Position Paper, 16 March 2017

Employee Share Ownership: Additional Action required for the Capital Markets Union Project

In 2014, the European Commission stressed in its communication on Long-term Financing of the European Economy the benefits of employee share ownership.[1] In the same year the European Parliament called on the political authorities of the Member States to put more emphasize on the dissemination of employee share ownership.[2] According to these statements, enabling employees to participate in the company's capital improves the competitiveness and corporate governance of companies and contributes to growth, employment and wealth within the European Union.

The European legislative bodies need to act. Employee share ownership should become a further action point of the Capital Markets Union project. As the European Commission in its Green Paper rightly stated retail investors' appetite for investing directly into capital markets unfortunately is generally small across the EU.[3] Employee share ownership however is a well-suited instrument to unlock retail savings cross-border for share investments financing jobs and growing businesses. It is especially an excellent starting point for a deep-rooted equity culture in companies and among employees.

Employee shares contribute to overcoming widespread reluctance among retail investors to spend their savings into shares, which is due to a lack of knowledge about the benefits of share investments and how to deal with the risks involved. Therefore, employee share ownership offers a good opportunity for the majority of the EU population to get a first insight into saving via shares. It is very likely that people, after gathering experience with holding shares of their own company, are willing to invest in other company stock and diversify their portfolio.

Besides, there are many further benefits of employee share plans. For retail investors, employee share ownership presents an excellent opportunity to escape from the continuing phase of low interest rates, which leaves a deep mark in wealth formation and retirement plans.

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1 Communication from the Commission on Long-Term Financing of the European Economy SWD (2014) 105, p. 12.
2 See European Parliament resolution of 14 January 2014 on financial participation of employees in companies' proceeds (2013/2127(INI)).
3 Green Paper European Commission from 18 February 2015, Building a Capital Markets Union, SWD (2015) 13 final, p. 19.

For companies, broad share based compensation plans increase motivation of employees as well as productivity. At the same time, providing employee share ownership, firms become more attractive as employers.

Finally, employee share ownership helps to stabilise the European economy as a whole. Studies from the US clearly show that companies offering their employees a stake of the business capital create more jobs than companies that do not have the same instruments in place. Employee shareholders accumulate more assets for retirement purposes, get better wages and are less likely to become unemployed compared to other employees. As income of private households currently depends highly on wages, employee shareowners benefit from raising capital incomes, which decreases wealth inequality in the society.[4]

4 See Bernstein, Jared: Employee Ownership, ESOPs, Wealth, And Wages, January 2016 (http://esca.us/wp-content/uploads/2016/01/ESOP-Study-Final.pdf) and Rosen, Corey: The Impact of Employee Ownership and ESOPs on Layoffs and the Costs of Unemployment to the Federal Government, July 2015 (http://www.nceo.org/assets/pdf/articles/Employee-Ownership-and-Unemployment-2015.pdf).

Action Plan for Employee Share Ownership

There are strong reasons why more European companies regardless of their size should be encouraged to offer own shares to their employees.

The European legislator should promote employee share ownership:

1. **Rules already harmonised on EU level:** Scrutinise existing European legislation posing obstacles for the implementation of employee share plans.

2. **Create an EU wide level playing field:** Abandon bureacracy and facilitate cross-border implementation of employee share plan across Europe.

Obstacles under existing European law

Existing complexity of setting up employee share plans is a main reason why companies refrain from the implementation of mentioned plans. Simplification is the order of the day. The European legislator should decrease bureaucracy and reduce the burden related to employee stock plans. This for example applies to the following transparency issues, which the legislator should address proportionally in providing exemptions for employee share plans, where needed:

The **Directive on Consumer Rights (Directive 2011/83/EU)** obliges companies to provide information for distance and off-premises contracts. The respective rules apply in Germany to financial services. This leaves German companies in the uncertainty whether their employee share programmes are within the scope of the Directive under certain conditions, in particular, when companies issue the shares for their employees via electronic portals. In order to avoid legal uncertainty many companies comply with the requirements and provide an additional information document. These extra efforts increase complexity of employee share plans and decrease its attractiveness. Nor is it beneficial from a consumer point of view, as employees already receive an information document according to the existing prospectus regime. Furthermore, as employees usually know the specific characteristics of their own company very well, the information provided – like the identity of the firm –is of low value.

Another example is the **Market Abuse Regulation (Regulation 596/2014/EU)**. Art. 5 exempts the trading of own shares in buy-back programmes from the rules regarding insider dealing and market manipulation if they meet obligations for employee share ownership programmes. As this exemption so far only covers the acquirement of shares, an extension to the transfer of the shares to the employees is necessary. In order to comply with the insider dealing prohibition, companies have to raise awareness among employees whether they are insider or not, although the insider rules are relevant just for a small number of employees. Nevertheless, it is likely that many employees – although far away from the scope of the insider dealing rules – feel uncertain regarding their status and refuse to take part in the share program. As a counterproductive effect, the participation rate decreases. Therefore, it is necessary to exempt the transfer of employee shares from the market abuse rules, too. This would be proportionate as the contributions for the purchase of employee stock are in general low and not suitable for significant gains from insider trading. Furthermore, as a rule companies grant employee shares associated with vesting periods from many years. Accordingly, it is not possible to benefit from insider information to make short-term profits.

Facilitate cross-border implementation of employee share programs

By a cross-border implementation of employee share ownership plans staff from different company locations benefits of its advantages. However, cross-border implementation increases complexity significantly. Given the additional cost burden, it is not surprising that only some larger companies equipped with the required resources, offer employee shares globally or throughout the European Union.

The following example clearly shows the different obstacles companies have to face in the cross-border context of employee share plan:

A multinational company offers its employees the opportunity to purchase own shares at market value and to get matching shares after a vesting period of three years. The money invested in the shares is procured alternatively within a monthly saving plan of one year or a lump sum at the start of the program. The company offers the employee shares in Germany, United Kingdom, Spain, Croatia and Italy.

Even the first step of the implementation requires additional efforts by the company, as many countries require a specific registration, e.g. the local tax authorities HM Revenues and Customs in the United Kingdom.

In addition, the remaining administration of the program necessitates compliance with legal or tax provisions differing from country to country.

This applies e.g. for the tax treatment of the matching shares provided to the employees after the vesting period:

- In Germany the tax base relates to the German valuation standard. The respective value is the „Niedrigstkurs“ (lowest value) on the day of the transfer.
- In United Kingdom it is the daily closing price.
- In Italy tax authorities refer to the „Italian Normal Value“.

These different valuation methods increase the administrative burden for the companies and as well for the banking partners involved in depositing the shares in the employee’s security account.

Croatia is another example for obstacles of employee share plans. Local tax authorities require companies to qualify the discount granted by the company on a net basis. However, for the calculation of the income tax the discount must refer to the gross basis („gross up“). The additional burden to comply with this requirement is the main reason for companies to refrain from the implementation of employee stocks for the Croatian employees. Instead, the provision of virtual shares („phantom stocks“) is common, thereby failing elemental aims of employee shares.

Finally, it is almost impossible that employees benefit from the tax incentives granted in the EU Member States due to the different rules. For example, the “UK SIPS” provides companies the opportunity to offer matching shares free of taxes and social contributions. Nevertheless, compliance with local requirements, e.g. mandatory cash-based saving plan, the specific way of safekeeping the money in local trusts or binding vesting periods of at least five years, would be extreme costly and would require a specific program for the British staff exclusively. Therefore, most foreign companies refrain from complying with the respective requirements. As a result, British staff cannot benefit from the tax incentives.

These examples show that a minimum coordination of rules on European level is necessary in order to decrease implementation costs of cross-border implementation significantly. Especially for smaller and medium-sized companies a level playing field is a prerequisite to provide employee shares EU-wide.

A first step in the right direction has been that the European Parliaments called on the Member States to consider transnational obstacles facing both companies offering schemes to employees in several Member States, the usefulness for gradual convergence of existing financial participation schemes and the related national legislation. The European Parliament proposes to consider a 29th regime in order to overcome these difficulties.[5]

Also the European Commission in its Communication on "The Capital Markets Union – Accelerating Reform" from 14 September 2016 rightly stressed the importance that the European Commission takes action to encourage Member States to address tax issues, as taxation regimes can present barriers to the development of cross-border capital markets.[6]

We very much appreciate this approach. We are aware that tax issues are difficult to deal with among the Member States. Therefore, what we propose leaves the amount of tax incentives untouched. Our approach focuses merely on a better coordination of the details regarding tax incentives, e.g. in terms of registration, vesting periods or other issues.

In order to dismantle cross-border hurdles for the implementing of employee share plans a 29th regime should include the following high-level principles. For plans rolled out in the United Kingdom, it is of utmost importance to implement effective agreements reflecting these principles after the departure from the European Union:

- **Current state of registration – mutual recognition:**
  As mentioned above some member states require the separate registration of employee share plans. An EU passport regarding the implementation of employee share plans would decrease bureaucracy of multiple registration requirements. Once the program is implemented in one Member State, there is no need for further registration in other Member States.

- **Coordination of tax base features:**
  A better coordination of the methods to determine the tax base and the respective valuation methods is of utmost importance. Alternatively, it should be allowed that the tax regime of the respective member state is applied where the employee is located when the vesting periods end and the matching shares are transferred to the employee. So far, companies have to consider the specific tax regime of the country where the employee currently works. As many employees are very mobile and work in different countries during their employee shares vesting periods, the company has to consider two or three different tax regimes in the calculation of the tax liability, which is highly bureoucratic. It would be more simple if the tax burden was to be determined according to the tax

5 See European Parliament resolution of 14 January 2014 on financial participation of employees in companies' proceeds (2013/2127(INI)), No. 1, 3 and 17.
6 See European Commission communication of 14 September 2016 on Capital Markets Union – Accelerating Reform, COM (2016) 601 final.

regime of the country where the employee lives at the end of the vesting period. This would also minimize the risk of double taxation which is very high when employees work in different countries during the vesting period.

- **Coordination or mutual recognition of vesting periods etc.:**
  Cross-border implementation of employee share plans would become much more attractive if employees could benefit from the tax incentives granted in the respective country. In order to reduce the administrative burden rules regarding vesting periods and the administration, e.g. regarding the safekeeping of the contributions, should be better coordinated. An alternative approach would be that all Member States, where the employee share plan is implemented, recognise the requirements in terms of vesting periods and administration of the Member State, where the parent company is established.

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