EN

COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, December 18, .2003

Report

of the High Level Group of independent experts, on cross-border obstacles to financial participation of employees for companies having a transnational dimension

EN EN

TABLE OF CONTENTS

Executive summary 4

1. INTRODUCTION 11

2. A CLASSIFICATION OF EMPLOYEE FINANCIAL PARTICIPATION PLANS IN THE EU 13

2.1. Profit sharing and gain sharing 13

2.2. Employee share ownership 16

2.3. Influences on the choice of a financial participation plan 19

2.4. Conclusion 22

3. ANALYSIS OF OBSTACLES TO CROSS-BORDER FINANCIAL PARTICIPATION PLANS 22

3.1. Identification and classification of transnational obstacles 24

3.2. Obstacles per type of plan 30

3.3. The main barriers: the view of employers 50

3.4. Conclusion 52

4. STEPS THAT WOULD HELP TO ELIMINATE THE BARRIERS AND PROMOTE FINANCIAL PARTICIPATION 52

4.1. Community policy on financial participation 52

4.2. The impact of barriers on different cross-border plans 53

4.3. Recommendations 54

4.4. Conclusion 64

ANNEX 1 Experts 65

ANNEX 2 Terms of reference 67

ANNEX 3 List of hearings 69

ANNEX 4 Survey 70

ANNEX 5 Obstacles per type of financial participation plan 81

ANNEX 6 Brief history of a European saving plan 82

ANNEX 7 Employee Shares in the DaimlerChrysler Group 86

ANNEX 8 Royal Dutch/Shell Group's Global Employee Share Purchase Plan 91

SUMMARY

of the report of the High-Level Group

on cross-border obstacles

to financial participation by employees

in enterprises established in several Member States of the European Union

In July 2002, the Commission of the European Union adopted a communication, ten years after the 1992 communication, in which it proposed a general framework for promoting financial participation in Europe. The communication stresses, in particular, the need to reduce, through concrete measures, the obstacles to the introduction of financial participation throughout the Union for enterprises established in several countries. It is against this background that a Group of seven independent experts was set up in September 2002. Their report is made up of three parts.

1. The various forms of financial participation used in the European Union

In order to reduce the obstacles to the spread of financial participation across borders, it is necessary to analyse the various forms that such participation takes. Two basic categories emerge:

– On the one hand, **profit-sharing or gain-sharing**; this involves giving a bonus to all or part of the staff of an enterprise, generally on the basis of a pre-determined formula, which may or may not be negotiated with staff representatives; this bonus may be paid in cash or securities (shares or bonds), either immediately or after a holding period; profit-sharing is particularly developed in France, where more than five million employees benefit from it through both *participation* (compulsory in enterprises with over 50 employees) and *intéressement* (optional, but subject to the agreement of staff or their representatives); it is also widespread, largely due to tax reliefs, in the United Kingdom (originally through the "Approved Profit Sharing Plan", and now through the "Share Incentive Plan") and, through normal pay negotiations, hence without any specific incentives, in the Federal Republic of Germany. The cross-border aspects of these schemes are currently very limited;

– On the other hand, employee share ownership, which takes on three forms: firstly, the purchase by employees of shares of the enterprises that employ them, this purchase generally being made on favourable terms (at a discount to market value) and the shares themselves being subject to a holding period: share purchase plans, which make it possible for employees to benefit from rises in the stock market value of the enterprise, are often used by enterprises established in several countries and wishing to offer a common saving product on favourable terms to the employees of all their subsidiaries. Secondly, free distribution of shares by an enterprise to its staff; free share plans are widely used in the United Kingdom and Ireland. Lastly, share option plans, whereby employees of an enterprise are granted an option which entitles them to purchase its shares during a given period at a price fixed in advance, which will be profitable if the share price rises above this price during the period in which the option may be exercised: share option plan are sometimes linked to a

saving contract ("Save As You Earn" in the United Kingdom) and are often used by start-ups of "new economy" enterprises, and have also become a common form of remuneration and incentives for managers of large enterprises quoted on the stock exchange and established in several Member States of the European Union.

Financial participation is developing in Europe, albeit not to the same extent in all countries: it covers 19% of private sector employees in the four largest Member States of the Union, which is probably more than in the USA. The objectives pursued are both numerous and varied and may concern the enterprise or the employees, often both at the same time. Governments may also set general macroeconomic objectives, such as competitiveness and employment. Links between, and hybrid forms of, plans develop or are produced from the various possible forms of financial participation, which are themselves affected by innovations in the financial markets and by changes in markets conditions. Enterprises established in several countries increasingly wish to spread financial participation among the employees of their various subsidiaries in order to establish a common philosophy and improve their performance in the single market. However, their efforts to spread to other countries a financial participation plan initiated in the country in which they have their headquarters are fraught with obstacles.

2. The obstacles to cross-border spread of financial participation

Three monographs have been produced, two on large multinational enterprises (Shell and DaimlerChrysler) and one on a smaller enterprise with foreign subsidiaries (Steria). They show that the establishment of a cross-border share plan within a group requires considerable energy to overcome burdensome and costly complexity, without it being possible to guarantee legal security or to avoid the disparities in fiscal treatment from one country to another. This makes it very difficult for small and medium-sized enterprises to gain access to schemes of this kind.

The two studies that have been conducted — one in 1999 involving 500 European enterprises and the other in 2003 involving 900 European enterprises — confirm this state of affairs. Most of the enterprises that responded wish to be able to export to the employees of their subsidiaries the participation plans set up or to be set up in the country of their headquarters. All of them encountered difficulties due, in order of importance, to the differences in the legal framework for participation; the lack of fiscal or social security incentives in certain countries; the numerous formalities to be completed with each national stock exchange authority; the different rules for consideration of financial participation by labour law and collective labour relations; finally, the widely varying impact of social and cultural traditions, which, in some cases, are favourable and accustomed to financial participation, but, in others, are far more reticent in this respect. The obstacles to the spread of an existing plan are, firstly, the lack of tax incentives, followed by legal difficulties and, lastly, the cost and complexity of the operations to be carried out.

The list of obstacles and difficulties to be overcome is indeed considerable. A distinction should be made between the general obstacles, which apply in all cases, and the more specific obstacles, which apply to each type of plan.

a) *The general obstacles can be classified into six broad categories*

1. The diversity of the legal, fiscal and social framework in force in the various countries

   This diversity makes it difficult to implement a uniform financial participation plan in all the Member States of the Union: certain Member States have defined a legal framework, which, in some cases, provides incentives (France, United Kingdom, Ireland) and, in others, disincentives, due to the complexity of the arrangements (Belgium, Germany). In some cases, the lack of a legal framework constitutes an obstacle, if only because of the resulting legal insecurity and the lack of incentives (Luxembourg, Portugal, Sweden). Where national legal frameworks exist, they are based on different approaches and differ widely in several respects: whether they are compulsory — which is the exception[1] — or optional, whether the management of an enterprise has to obtain the agreement of the staff concerned or its representatives, the way in which participation is calculated, the scope of staff eligible, any rules on holding periods, and the saving instruments that may be used.

   There is no less variety in the rules on taxation and contributions to social security schemes, for, where they are defined, they range from complete exoneration to complete consideration as remuneration, with numerous specific intermediate systems; the time of taxation may also vary. In certain cases (especially share options), this may lead to double taxation, or to a complete lack of taxation, for employees who do not live in the country in which they work or who change their tax residence.

2. The variety of rules laid down by the stock exchange authorities of each of the Member States. This concerns the nature and extent of the information, often in national languages, that has to be provided to subscribers when shares are issued.

3. The many ways in which labour law takes account of financial participation. Labour law can make it compulsory for the trade unions or works councils to be consulted or for negotiations to be conducted with them; it can oblige enterprises to provide detailed information on the implementation of the plan and on the arrangements for managing the funds allocated to employees; it can lay down rules concerning the impact of participation on pension rights and on the rights of employees in the event of redundancy or a reduction in staff numbers.

4. The different conceptions of the governance of enterprises. In particular, national law on enterprises requires, or does not require, the approval of the general assembly of shareholders for the introduction of financial participation plans or the issue of new shares or options, depending on whether or not the enterprises concerned are listed on the stock exchange.

5. The wide variety of systems of industrial relations and of the cultural conceptions underpinning them. The role of negotiations between the social partners varies in importance between the Member States, and such negotiations may be formal or

[1] Only *participation* in France is compulsory.

informal in nature. Trade unions vary in their support for financial participation. There are differences in the extent to which employee share ownership is part of the culture of the country concerned and is encouraged by the public authorities, which affects the response rate of employees to the offers made to them.

6. The costs of implementing the participation plans. For all the reasons mentioned, these costs are high and constitute a real obstacle, especially for SMEs. These costs vary depending on the participation plan implemented and the strategy chosen by the enterprise. In any case, an enterprise has to devote time and resources to the plan, draw on a wide variety of skills (human resources, legal and fiscal advice) and conduct a major communication campaign in order to spread a plan that already exists in one Member State of the Union to all the other countries in which it is established.

b) *The various types of financial participation also all encounter specific obstacles*

– Profit-sharing or gain-sharing at cross-border level also encounters numerous obstacles: what definition of the group should be used and what level of performance should be measured (at group level or at national entity level). These plans are generally linked to tax and social security incentives with precise rules (such as blocking of funds, consultation or agreements of employees), which apply in one country but not in the others. That is why these plans operate almost exclusively at national level. Nevertheless, certain enterprises established in several countries are giving thought to a method for putting their plans on a European footing.

– Although the purchase of shares by employees is easier, it is hampered by a number of technical problems related to the differences in the company law applied in the various Member States, as well as by the general problems mentioned above: to what extent may an enterprise buy back its own shares? What collective investment instruments are available? What are the rules on holding periods and withdrawals? What role do the shareholder employees play in the governance of the enterprise?

– The free distribution of shares is often included in profit-sharing plans or employee share ownership plans and therefore comes up against the same obstacles.

– The spread of share option plans, which are the most widespread system for managerial staff, to all the subsidiaries of an enterprise is hampered primarily by the differences in business law referred to above concerning employee share ownership, but also by a specific taxation problem: while most Member States tax the option when it is actually exercised, certain Member States give beneficiaries the possibility of lower taxation when it is granted (Belgium) or as soon as it may be exercised (Netherlands). This leads to risks of double taxation or lack of taxation in the event of changes of residence, which, by nature, are frequent for staff in this category.

3. Proposals that would help to reduce the obstacles and promote financial participation at Union level

There are several reasons why it is essential for the Commission and the Member States to act to reduce the obstacles to the spread of financial participation across the Union. Firstly, there is a tendency for enterprises to “Europeanise” by acquiring, establishing and developing subsidiaries in the various Member States of the Union; accordingly, the obstacles identified

hamper an increasing number of enterprises and employees, and reforms carried out in one country have an indirect effect on the employees in the other countries; these reforms can therefore no longer be considered in isolation. At the same time, European enterprises face an increasing need to implement a common management and apply similar motivational programmes across the Union in order to compensate for an increasing diversity and heterogeneity at the social, managerial and cultural level. The shortcomings of the single market in the area of financial participation make European enterprises less competitive than enterprises in more unified economic areas such as the USA.

This is all the more regrettable since many studies have indicated that financial participation can improve the productivity, competitiveness, and profitability of enterprises and contribute to greater social cohesion. The development of financial participation can help to achieve the ambitious objectives of the Lisbon European Council of March 2000 and must be vigorously promoted.

To this end, seven recommendations are made, the first three being general in nature and intended to improve the consideration of financial participation by the Union, whereas the next four are concerned with action to combat existing obstacles.

General recommendations

1. *Firstly, it is necessary to improve the dialogue between Member States*

To this end, it would be desirable to set up, in the next Commission, an advisory committee on financial participation, to be made up of permanent representatives from all the Member States and the social partners. Its tasks would be to disseminate information, to monitor developments in the rules in each country, to commission research and to analyse the practices used with a view to recommending the best practices.

This committee, which would be run by a steering group, should, among other things, report to the Parliament, the Council of Ministers and the Economic and Social Committee at least once in each legislative period and organise an annual forum to present its work and a discussion on topical issues.

2. *Secondly, the social partners, employers and employees' representatives should attach greater importance to financial participation*

The social partners have an important role to play in educating their members and disseminating information on financial participation, all the more so since studies show that its impact on productivity is enhanced when employees are well informed and take part in the governance of the enterprise. For this reason, the social partners should put the question of promoting financial participation across Europe on the agenda of their working meetings. Since European works councils now exist, it would be conceivable, for example, for the question of the introduction of financial participation at group level to be mentioned on a regular basis, for example every five years.

3. *Thirdly, an informative website should be created*

In order to facilitate access to the information specific to each Member State and to lower the cost of such access, a website should be created by the Commission's Directorate-General for Employment and Social Affairs, for which it will need the corresponding budgetary resources.

This site would establish links with the sites of the Member States, would organise a network of government officials with responsibility for these areas in each Member State and would contain helpful examples of plans set up by enterprises across the Union.

Action to combat existing obstacles

4. Fourthly, reducing complexities through the Prospectus Directive

The Prospectus Directive should facilitate financial participation across the EU by bringing in a common approach to public offers of shares and in particular to the requirements of publishing a prospectus.

It is essential therefore for the Member States to take account of the current and potential obstacles to the spread of financial participation when they transpose this Directive into their legislation. In this connection, it would be desirable for the Commission to draw up guidelines in order to ensure that the provisions of this Directive actually reduce the current complexities and streamline future regulatory requirements.

5. *Fifthly, introducing an EU convention on the taxation of share options*

The Member States should consider the introduction of an EU-wide Convention that would agree on consistent rules on taxation and social security contributions that are clear and easy to apply for employees who change residence. This approach could equally apply to all types of financial participation, but as the concept of a share option is simple and options are frequently used, it justifies the signing of a fiscal convention between the Member States on share options before the Protocol to the OECD Model treaty is forthcoming.

6. *For the other forms of financial participation, a procedure for mutual recognition between Member States should be introduced*

A simplified form would involve allowing an employee who changes residence and becomes a resident of another Member State to continue to be covered by the initial fiscal and social arrangements for the remaining duration of the plan.

A more ambitious form of mutual recognition could be for Member States to recognise a plan drawn up under the laws of another Member State as equivalent to a plan drawn up under its own laws and provide equivalent benefits.

This voluntary cooperation would be facilitated by a special directive ensuring freedom of movement for bodies involved in the collective management of funds collected through financial participation; thus, the UCITS Directive guarantees freedom of movement only for undertakings for collective investment that are open to the public and that spread their risks, these conditions not generally being met by undertakings that manage funds collected through financial participation.

This form of mutual recognition obviously implies a high degree of cooperation between Member States. This is however already happening in the area of pensions. Mutual recognition could work, especially in Member States which already have considerable experience with financial participation and which could encourage the others by endeavouring to reduce the existing barriers between themselves through this procedure. Moreover, in the long term, this procedure should lead to gradual harmonisation of national law.

7. Finally, a European model should be developed

Instead of, or in addition to, the mutual recognition procedure proposed above, *a European model plan for financial participation* could be drawn up by the Committee on Financial Participation. This Community-wide instrument would serve to remove barriers and also promote cross-border financial participation.

As a first step, such a plan could however incorporate some or all the principles set out by the Commission in its communication and relevant Community-level law. The model plan would initially be adaptable in each Member State to cover national tax and social security law, in a similar way to the European Company Statute.

As a further step towards greater coordination, the model could incorporate a set of taxation and social security principles. These would determine whether income arising in a Member State was to be treated as employment or investment income or as a capital gain and when the incidence of the taxation arose. Member States would remain free to decide whether or not to offer enterprises that adopted the model plan any specific tax or social security rules or incentives.

As a next step, however, a Member State could decide to award the model plan "most favoured nation" status (this would mean that an enterprise adopting the model plan, and the employees participating in this, could not be treated any less favourably than that Member State treats its own nationals). If no national laws provide tax or social security benefits, Member State would then have to provide it for the model plan.

The model plan might streamline a blueprint for the main types of financial participation (- profit and gain sharing, share purchase, share award and share option-). It should be available to any enterprise, even if its activity is currently restricted to only one Member State, in order to prevent enterprises having to adapt their plans if they expand across the EU..

Conclusion

The Group believes that its recommendations would reduce many of the barriers and provide significant opportunities to align the benefits from financial participation across the EU. However, they recognise these cannot remove all of the fundamental differences between Member States where such differences arise from very different national policy considerations.

1. INTRODUCTION

On 5 July 2002, the Commission of the European Union (EU) adopted a Communication[2] in which it explains its policy framework for the promotion of employee financial participation in the EU.

Financial participation can be broadly defined as the involvement and participation of employees either by sharing in the profits or success of the enterprise at any level, such as the team, division or group in which they work, or by benefiting either directly or indirectly in the same way as shareholders.

The Communication illustrates the increasing interest of the Commission in the subject and it follows on from the work started in 1991 with the report on the "Promotion of Employee Participation in Profits and Enterprise Results" called Pepper I report, followed by the Recommendation of the Council of 27 July 1992[3] and by the Pepper II (1997) report which was referred to the action taken following the above Recommendation[4].

It is stated in the above Communication that the landscape of financial participation in the EU is undergoing rapid change. While it is a familiar concept in certain EU Member States, most notably in the UK and France, there are however enterprises in a number of other Member States that are increasingly interested in applying such schemes. As we move more to operating in a global environment, enterprises that have operations in several countries, regardless of whether or not these countries are members of the EU, increasingly look to set up financial participation plans that apply to all their employees. As national systems differ companies will have to cope with the multiplicity of different rules when they expand their financial participation plans outside the borders of their head office location. That is increasingly the case, as there have been a number of recent changes in national laws. At the same time, a number of developments at EU-level (in respect of regulatory and accounting changes) will have a significant effect on future share-based plans in the EU.

The Communication has the following three objectives:

- to provide an orientation framework for the development of employee financial participation policies in the Member States of the EU, by setting out a series of general principles, to ensure that companies and employees realise maximum benefits from financial participation plans operated;

---

2 Communication from the Commission to the Council, the European Parliament, the Economic and Social Committee and the Committee of the Regions, 2002 "*On a Framework for the promotion of Employee Financial Participation*" ((COM (2002) 364).

3 Council Recommendation n° 92/443/EEC of 27 July 1992 concerning the promotion of participation by employed persons in profits and enterprise results (including equity participation) *Official Journal L245, 26/08/1992 P. 0053 - 0055*

4 The Pepper I Report drafted by Milica Uvalic is published in the series Social Europe, Supplement 3/91 of the Commission of the European Communities Brussels and the Pepper II Report is published as COM (96)697 on 8/1/1997 from the Commission European Communities, Brussels. All these documents can be found at the following address: http://europa.eu.int/comm/employment_social/soc-dial/labour/index_en.htm

- to promote increased use of employee financial participation plans in the EU, by presenting a framework of Commission's action for the years 2002 to 2004;

- to tackle the transnational obstacles which currently block the establishment of employee financial participation plans on a EU scale, by putting forward concrete measures intended to surmount these obstacles.

This report considers the final point. The Communication states that during 2002, the Commission will set up a Working Party made up of independent experts. It will have as its mission, firstly identifying and analyzing in a deeper way the existing transnational obstacles and, secondly, studying the various possible solutions with a view to removing them. The experts of the Member States and the social partners will closely be associated with the work of this group. It should submit its final report and a series of recommendations in 2003. On the basis of this report, a decision will be taken regarding the new concrete actions to be implemented in 2004 and beyond.

It is in this context that the Directorate-General for Employment and Social Affairs set up, in September 2002, a Working Party made up of 7 independent experts. This group, the mandate and the composition of which appear in Annex I and II, had the following aims:

- firstly to identify the obstacles (tax, social, legal, cultural, etc) which hinder employee financial participation within the EU, and

- then to suggest solutions to help overcome these obstacles and to facilitate the introduction of financial participation at EU level, in the interest both of the employees and of the employers, whilst respecting the diversity of national arrangements.

The Working Party had 9 meetings between September 2002 and October 2003. It took note of the opinion of the Economic and Social Committee of 23 April 2003 (OJ C95/2003) on the Commission's Communication, and of the resolution of 24 April 2003 of the European Parliament covering the same subject. The Working Party held a number of hearings, the list of which is set out in Annex III. The Working Party benefited from the knowledge that its members could draw upon from their professional experience, and from the contacts they had in their respective countries. In addition, a survey was carried out and a questionnaire sent to approximately 900 enterprises operating in the EU, to gather information on the obstacles they perceived and encountered to offering financial participation plans to their employees; detailed information on the survey is in Annex IV.

The report comprises an introduction, three subsequent chapters and eight annexes.

- The first chapter details the main characteristics of various types of financial participation plans. There are numerous different types of plan and variations within each type. This means that there is some overlap and certain plans could fall into more than one classification. The Working Party recognised this but still felt it would be useful to try to set out some broad headings and descriptions, as the same obstacles may not apply to all plans.

- The second chapter identifies the various obstacles, which inhibit the expansion of employee financial participation plans within the EU and which seem to constitute an increasing problem for enterprises.

- The third chapter suggests a number of steps that would eliminate the obstacles to the development of financial participation and would help to perfect the internal market in this area. It recommends developing a better dialogue and information flow within the EU. It proposes possible solutions, which could be considered by Member States (mutual recognition of funds and plans, agreeing on common rules for tax and social security). It proposes also to place at the disposal of enterprises a Community-wide instrument to promote cross-border financial participation.

2. A CLASSIFICATION OF EMPLOYEE FINANCIAL PARTICIPATION PLANS IN THE EU

Two basic classifications of plans – "profit sharing" and "employee share ownership" - are at the core of the many different types of financial participation that has developed in enterprises across the EU. In practice there is a great deal of overlap between different plans, and some plans may fall within more than one classification. In addition, enterprises often use a variety of different plans at the same time to meet the differing needs of specific groups of employees or the multiple objectives of the enterprise or division. Government policy can also encourage enterprises to develop plans that support one or more national objectives.

A key difference in the way plans are operated is whether they are offered on an "all-employee" basis (sometimes referred to as a "broad-based plan") or on a "discretionary" basis. While the same or similar type of plan may be used for different purposes, an all-employee plan will typically be offered to the entire workforce, possibly subject to a qualifying period of service. Discretionary plans are used to incentivise and reward selected employees, for example, senior executives or key personnel. Discretionary plans are also more likely to contain performance objectives.

In some cases employee financial participation plans may be used as retirement plans. However this report does not consider any issues specific to such plans or any variation that may be made to financial participation plans for the purposes of providing retirement benefits. In addition the report does not consider financial participation for employees of the public services or of not-for-profit organisations.

2.1. Profit sharing and gain sharing

2.1.1. Profit sharing

This is described in Pepper II as "the sharing of profits by providers of both capital and income directly linked to profits or some other measure of enterprise results". Profit sharing plans are usually only offered on an all-employee basis, including all or most of the employees employed in the enterprise or in a unit of it.

The amount of profit that is shared may be calculated in a number of ways. For example, it could be based on a pre-determined formula set out in advance and possibly agreed with employees, the trade union, or other employee representatives. Plans where the profit share is pre-determined often fall within a specific legal provision and attract tax and social security benefits.

Alternatively, the profit share could be decided at the end of the period at the discretion of the enterprise's management or through collective bargaining. These plans tend to have more in

common with cash bonuses and are less likely to attract tax or social security benefits. Plans that do not attract tax or social security advantages are generally easier to put in place as they do not need to be drawn up to meet the requirements of the relevant legislation.

Profit sharing plans can pay out in cash or in shares or in a combination of the two. In addition, the profit share can be paid immediately or payment can be delayed for a period of time under a "deferred" plan invested in shares, bonds, or current accounts.

A typical difference between profit sharing plans and share ownership plans is that the period over which the profit share is determined will often be shorter than the participation period in a share plan. This is because profit sharing lends itself to a shorter time frame, say of six months or a year, as the optimal period to align the employee's "line of sight" with the enterprise or division's normal reporting cycle. That said, many employee share purchase plans now being introduced or operated in the EU are based on the US model under which employees may acquire shares in six month cycles.

The profit share may be paid directly to the employee or into a company savings plan and invested in either the company's shares or a wider basket of investments.

2.1.2. Gain sharing

Gain sharing is another form of financial participation and is similar to profit sharing. It can play an important part in encouraging increased productivity in an enterprise, while boosting employees' incomes. The forms of gain sharing can vary widely and, while it is not directly linked to an enterprise's overall financial performance, i.e. profits, but to other measures such as productivity, cost reduction or qualitative criteria (for example the level of customer complaints), it does ultimately contribute to profitability. It can also be described as a form of performance related pay, as rewards are typically paid in cash rather than shares.

The Commission's Communication states that gain sharing plans "are based on relatively broad performance measures and that if these measures are applied at a collective level, gain sharing can serve the function of financial participation. This is of particular relevance with regard to the public or not-for-profit sector, where standard forms of financial participation may not be applicable." While most gain sharing programmes are in enterprises, it is the most adaptable form of employee financial participation that could be applied to these other sectors.

2.1.3. Profit and gain sharing in the EU

Profit sharing plans are found across the EU and are predominantly broad-based[5].

The widest use of profit sharing is found in France where profit sharing plans are mandatory for any company with over 50 employees. There are two main types of plan – Intéressement[6],

---

[5] "Employee Share Ownership and Profit Sharing in the European Union": Pendleton, Poutsma, van Ommeren and Brewster for the European Foundation, 2001

[6] The voluntary cash-based *Interessement* was introduced in 1959 and currently covers approximately 3 million employees, who receive slightly more than € 4 billion (i.e. 3% of the wage bill). It is based on a pre-determined formula. This may result from collective bargaining with trade unions, or by agreement with the Works Council, or in a referendum of all employees held by the President of the enterprise. Bonuses resulting from the sharing of profits or productivity gains are redistributed to employees as

which is voluntary, and Participation[7] which is mandatory. Profit sharing can also be found in the UK although the Approved Profit Sharing Plan, which took the form of a deferred share-based plan, has now been replaced by the Share Incentive Plan. This new plan retains a voluntary profit sharing element[8]. Ireland also offers a plan similar to the UK's Approved Profit Sharing Plan. While profit sharing is also popular in Germany, (without tax or social security exemptions, see Appendix 6) Austria and the Netherlands, it is not frequently used in cross-border financial participation, although some of the larger French companies are attempting to develop Intéressement at an EU level. The slow spread of profit sharing plans may well be due to the fact that, as a mechanism, it is highly dependent on the legislative framework provided by the Member State in which the enterprise is based, as well as typically based on local rather than group profits.

While information on profit sharing plans is easily available, little is known about the incidence of gain sharing plans in the EU, possibly due to their lack of legal provision.

2.2. Employee share ownership

Participation by owning a share in the equity of the company is different from profit sharing in a number of key respects. Unlike profit sharing, here the link is to the share price of the

---

cash or are kept as savings in a company savings plans. The distributed amounts are deductible for corporation tax purposes and exempted from social security contributions. They are also exempted from income tax when hey are saved under a company savings plan for 5 years.

6 Under *Participation,* which was introduced in 1967, enterprises with more than 50 employees and whose profits exceed 5% of their own assets must distribute to their employees a fraction of these surplus profits[6]. These amounts are exempted from taxes and from social security contributions if they are "blocked" for five years. Distributed proportionally to wages, they are placed in current accounts of the company, invested in shares or bonds of the company, other independent companies or the government, by using in the latter case a "collective investment fund of company (FCPE: "fonds communs de placement d'entreprise")". Each year, 4 million beneficiaries receive approximately € 4,5 billion, accounting for more than 4% of their wage bill.

The "collective investment fund of company", also blocked for five years, is entitled to receive the funds allocated from the *interessement* or from the *participation*, but also the employees' own savings and additional amounts from the company which, within certain limits, are exempted from taxes and from social security charges. Indeed employees own savings may be matched by a contribution from the company (*abondement*) that may take the form of company shares. The bonus and other savings are invested in a portfolio of different securities.

The third vehicle is the PEE – *the Plan d'Epargne d'Entreprise –, which* is now the most important financial participation mechanism. The PEE can obtain funds from all fours sources referred to above – from *interessement* and *abondement* and from *participation* and the employee's own savings. Funds invested in a PEE can be invested in different types of securities in the names of employees or in a fund under the control of a supervisory board including representatives of both employer and employees. Subject to certain conditions, contributions into a PEE are tax free for the employer and employee and exempt from social security charges.

8 Under the UK *Approved Profit Sharing Plan*, companies could make cash payments to a trust which then used the money to acquire shares for employees and meet the trust's expenses. Contributions to the trust qualified for a corporate tax deduction. The trust would allocate to employees shares worth up to £3,000 a year and employees would pay no income tax or social security contributions at the time of allocation but had to agree to leave them in the trust for two years. If employees left their shares in the trust for at least 3 years, they would pay no income tax or social security contributions when the shares were released. Under the new *Share Incentive Plan*, a company has to put in place a SIP trust which can allocate shares worth up to £3,000 a year to every participating employee, but the shares must stay in this trust for 3 years. After 5 years the shares can be released completely free of income tax and social security contributions. If the employee keeps them in the trust until he decided to sell them, the shares are also exempted from any capital gains tax.

enterprise rather than its economic performance. Indeed share prices can be affected by many external events and price movements may sometimes bear little resemblance to the enterprise's underlying economic performance. Another difference is that the employees become (or have the right to become) part owners of the business and may benefit from cash dividends or through the growth of the enterprise's share price, rather than from its profits. As shareholders, employees may participate, directly or through representatives, in the corporate governance and influence the management of the company, either by voting at the shareholder meetings or in other ways.

Employees also may generally choose whether or not to sell the shares, although some plans insist on a "holding" or "blocking" period. For some enterprises there may not be a ready market for the shares, e.g. in the case of unlisted enterprises and other mechanisms will have to be provided to help employees sell their shares at a fair price.

Finally, if the employee decides to hold his or her shares, there is a risk that their value may go down, like any investment in the stock market. To reduce that risk, some plans combine the shares of the company with shares of other companies or with government bonds, creating a collective investment fund, but this may not be feasible under the domestic laws of some Member States.

There are three main ways of facilitating share ownership. All three types of plan can be offered on a broad basis to all the employees or on a discretionary basis to selected people. About half of all the employee share plans in the EU are broad-based9. Many of these will qualify for tax and social security benefits.

2.2.1. Share purchase

Under a share purchase plan the employee acquires the shares, either immediately or at the end of a period of savings. Typically, this may last anywhere between three and twelve months. Share purchases or savings to buy shares at a later date may be made directly from payroll or out of other personal savings. Because the employee is either immediately exposed to the risk of owning the shares, or may be committed to purchase them at the end of the savings period, it is common for the shares to be offered at a discount to their prevailing market price in order to encourage participation. In addition, enterprises may seek to further protect employees as well as offering them an incentive to participate by matching their purchase with a contribution from the enterprise in the form of extra shares at no cash cost or in the form of cash. In some circumstances this type of plan is also known as a "share savings plan".

If shares are offered at a discount or are matched with extra shares, the plan usually incorporates a holding period during which the employees cannot get access to their shares in order to sell them, although they remain fully entitled to any dividends and any increase in their capital value. Forfeiture provisions are often attached to matching shares which may be applied in certain circumstances, for example if the employee leaves the employment of the enterprise within a certain period or does not retain the original shares he or she purchased in respect of which the match of shares by the enterprise was based.

[9] "Employee Share Ownership and Profit Sharing in the European Union": Pendleton, etc op.cit.

Share purchase plans are growing in popularity across the EU and are frequently used as the basis of cross-border plans. For many years they have been used by EU-based subsidiaries of US corporations that have long–established share purchase plans for their US employees. In some cases, exactly the same plan will be extended to the non-US employees, whereas some enterprises will seek to adapt their US plan to benefit from local tax rules in a particular country.

An interesting development of the share purchase plan is the "leveraged" purchase plan, first introduced by a number of French and German-based companies10.

2.2.2. "Free" shares or share awards

Another type of employee share ownership plan is one based on "free" shares or the award of shares to employees. Unlike "bonus" shares that are distributed to existing shareholders in place of a cash dividend or as part of a change in an enterprise's capital structure, these shares are distributed without any payment by employees, regardless of whether they are existing shareholders or not. Sometimes, the distribution of shares to the employees is intended to recognise a service rendered (or to be rendered) by the employees in the enterprise. In other cases, the intention is purely to spread ownership of the enterprise among the employees.

Shares may be awarded to individual employees by the enterprise based on some success measure of the business. In this instance, they are in fact a form of profit or gain sharing using shares instead of cash. Alternatively, a number of shares may be awarded to employees according to other criteria, for example based on length of service, salary or the same allocation being made to every employee as part of a wider programme, for example on the occasion of a merger or the or on some other basis. In some cases the allocation may be made as part of a wider programme, for example on the occasion of a merger or the launch of a new corporate identity, or as an initial introduction to a new employee share ownership programme. A distribution of shares can also be used in conjunction with a company restructuring or privatisation. Awards of shares can be used to help employees accept new arrangements or organisation change that they may have concerns about. For example, if a major restructuring entails redundancies or a pay freeze, shares may be handed out to employees as a form of compensation.

Shares may also be awarded to an intermediary, such as a trust or nominee vehicle or a bank that holds the shares, either temporarily or permanently, on behalf of the employees. The extent to which the individual employees will benefit from this holding, for example from dividends and increases in the capital value of the shares, will vary according to the terms of the trust or the legal rights of the nominee and the employees.

In the typical profit sharing case, shares are usually subject to a holding period during which they are held in trust or special fund. The employee does not normally have the right to sell the shares during this period other than under certain specified conditions. In addition, some

[10] Under these plans, if employees purchase a minimum number of shares, they can also benefit from a proportion of any increase in value of a larger number of shares that are bought for employees by a fund that is established by the company and financed with bank loans. This plan multiplies the gain made by employees if the share price rises, while protecting them from the risk of the share price falling. At the same time, any potential loss to the company will have to repay the bank loan is covered through a hedging instrument.

employers attach "forfeiture" provisions to these shares with the result that an employee may forfeit or lose their entitlement to their shares if they leave the enterprise within a certain period of being awarded the shares.

Free share or share award plans are found throughout the EU and in enterprises of all sizes, including co-operatives and enterprises wholly owned by their employees. They began to appear in the UK in the 1950s when they were introduced by the major banks and are still widely used by UK companies (see footnote 7). Since the 1980s they have been very popular in Ireland. The Irish plans have largely followed the UK model, but in addition employees in Irish enterprises have also been awarded shares in return for major restrictions and pay freezes. Many of the first financial participation plans introduced by the Accession Countries were in the form of share awards in newly privatised businesses.

These plans have the advantage that there is no direct cost to the employee and therefore maximum participation can easily be achieved. The downside for the enterprise, however, is that they must bear the full cost of providing the shares. This may well explain why free share plans are less commonly used for cross-border plans.

2.2.3. Share options

Under a share option plan, the employee is granted options (or rights) to purchase shares at some point in the future. The purchase price of the shares (often referred to as the "exercise" price) will typically be the prevailing market price of the shares at the time of grant, although sometimes this price is reduced by a discount. Once the employee becomes entitled to exercise his or her options (i.e. when the option "vests") the options can be exercised by the employee paying the exercise price. The employee will then acquire the shares. Options will generally be exercised only if the market price at the time of exercise is higher than the exercise price. The recipient generally has the choice between an immediate resale of the shares, in order to profit from the current higher value, or the retention of the shares as an investment in the hope of further increases in value over time.

The share option plan is sometimes linked with a savings programme under which the employee saves regularly out of pay through payroll deductions to fund the purchase of the shares at the exercise price. The leading example of this type of plan is the UK's Save As You Earn Plan (SAYE)[11]. A similar SAYE plan is found in Ireland. The share option plan is

---

[11] Under the UK's *Save As You Earn* share option scheme, or *Sharesave* as it is sometimes known, a company can establish a plan whereby employees are given an option to buy, at a future exercise date, a certain number of shares, the price of which is fixed at the time the option is granted. The exercise price must be not less than 80% of the value of the underlying shares at the time of grant. Participating employees are required to save between £5 and £250 a month under *a Save As You Earn* contract with a bank or building society. These contracts last for 3 or 5 years. Employees with 5 year contracts may decide at the outset whether they wish to exercise their options after 5 years or to continue saving for another two years and earn an additional bonus.
The lumps sum arising from the *SAYE* contract can be used to buy the shares if the employee chooses to exercise his or her options at the end of the 3, 5 or 7 year period. If employees choose not to exercise their options, their cash savings are returned with their bonus. An employee in a *SAYE* scheme does not pay income tax or social security contributions on the bonus, on the benefit of being able to buy the shares at a favourable rate, or on any increase in the value of the shares between the dates the option was granted and exercised. Enterprises can also claim a corporate tax deduction for the expenses of administration and under a recent change a corporate tax deduction is available, equivalent to the gain

perhaps the easiest plan to export across borders. Many UK–based multinational enterprises use a version of their SAYE plan to establish share plans for their employees in their overseas subsidiaries.

While option plans are used by all sizes of enterprise, they are more frequently used by larger companies and by start-up companies in some sectors, for example the high-tech area and information technology sector.

2.3. Influences on the choice of a financial participation plan

While enterprises typically have considerable freedom as to which type of financial participation they adopt and will often seek to combine corporate and employee objectives, they are also influenced by the forms of financial participation that may be favourably treated in their Member State. Objectives can be broadly divided into attempts to improve the enterprise's performance, to increase its capital, to improve its governance and to supplement employees' savings and retirement pensions or help employees play a role as shareholder. Some plans will combine several objectives at once, as can be seen in the case studies described in the Appendices. The different tax and other incentives provided across the EU by Member States to encourage financial participation stem from a wide range of policy objectives.

2.3.1. Enterprise performance objectives

For example specific plans may be used in the following circumstances :

- Increasing productivity and improving company performance or profitability - all plans, with profit sharing having largely short-term effects and share ownership having more medium and long term impact
- Linking employee's financial interests directly with the company's share price – all share ownerships plans and in particular share options plans
- Providing greater wage flexibility and rewarding improvements in performance – cash-based profit sharing plans
- Recruiting and rewarding senior managers and executives - share options and free share or share award plans
- Helping small, cash-poor companies compete for talent and promoting entrepreneurial behaviour – share options
- Reducing opposition to major changes – "free" share or share award plans

2.3.2. Enterprise capital objectives

Again the following plans may help meet specified objectives:

---

made by the employee on the exercise of the option, which is given to the enterprise at the time the option is exercised.

- Encouraging employees to become direct owners of newly-issued shares – share purchase plans

- As part of an employee or management buy-out – all share ownership plans

- As part of a privatisation programme, raising new capital for the business – share purchase plans

- Preventing hostile takeover bids – all share plans.

2.3.3. Improving governance objectives

Corporate governance objective may be improved by:

- Financial participation can be used to promote good corporate governance, by making it possible for the employees to participate as shareholders, ready to promote socially responsible corporate behaviour or even to become board members of enterprises - all share plans.

2.3.4. Employee savings and retirement objectives

Employee savings and retirement objectives may be met by:

- Developing employee savings either in company shares or in a wider fund of investments (which may sometimes be regarded as a substitute for or supplement to pension schemes) – share-based profit sharing, the PEE and SAYE schemes

- Providing the opportunity to benefit from increases in share value with limited or reduced risk – SAYE and "leveraged" plans, PEE with diversified investments

- Giving employees the opportunity to own a stake in the business – either collectively or individually – free shares, share purchase and share awards, all create the possibility of greater identification with the enterprise.

All of these objectives, which are of a micro-economic nature, can be integrated into macroeconomic concerns. Because of the flexibility that it allows, although dependent in one way or another on the underlying performance of the enterprise, financial participation may create the conditions needed for increased competitiveness and promote rapid economic growth and employment.

The form of financial participation chosen will also be influenced by the prevailing socio-political, economic and cultural characteristics. For example, the attitude to collective ownership of enterprises by employees differs widely across the EU, as does the view on private individuals owning shares compared to other investments. A further influence will be the attitude of managers and trade unions to encouraging share ownership or profit sharing arrangements. Both management and unions vary in their attitude to financial participation from enthusiasm to opposition, both across enterprises and across Member States.

The size of the national market for equities and the general level of share ownership are also important factors. The extent to which there is an "equity culture" in a Member State or the infrastructure enabling employees easily to sell their shares will also be reflected in the types

of financial participation adopted. Generally speaking, where there is a developed equity market and widespread share ownership, employees will have a greater appetite for participating in share plans and governments will be keener to support these.

2.3.5. Current trends

The forms of financial participation found in the EU are constantly evolving. The various objectives envisaged can be combined, as can the types of financial participation.

Increased financial innovation in this field, such as the introduction of leveraged plans or the design of plans for senior executives with a view to reducing taxes or social security contributions payable by the enterprise, has resulted plans becoming more complex. This makes the cross-border expansion of such plans more difficult. Tax laws are also frequently changing or under review, for example in the Netherlands which has been considering major changes to the taxation of share options.

Other factors also intervene. The successive falls in the stock market from 2001 to 2003 have left many share options “under water” (where the exercise or strike price is greater than the current market value of the shares) and employees may well have purchased shares at prices much higher than currently prevailing in the market. Shareholder bodies have rejected attempts by companies to "reprice" their share options with a new lower exercise price. They have also demanded greater say over the introduction of all new plans. Wider disapproval generally with very large executive remuneration packages has resulted, in some cases, in a move away from granting share options and towards share awards that are subject to a holding period and/or performance conditions or a combination of share awards and options.

A proposed new international accounting standard will also reduce the attractions of options compared to share awards and share purchase plans by requiring enterprises to account for the cost of granting options and other share-based payments in their Profit and Loss accounts. In this climate, the type of financial participation and its cost to the enterprise is of growing interest to financial managers and company accountants and they have an increasing influence on the final choice of plan and indeed where there is a plan at all.

One effect of all these changes is the beginnings of a move away from financial participation through shares towards the increasing use of cash bonus plans and of cash rewards that are based on share-price performance, sometimes referred to as "share appreciation rights" or phantom share plans.[12]

Finally, there is a growing debate within the EU on the adequacy of future pension provision. Governments may wish to encourage personal savings to cover any possible gaps in pension provision, as well as measures to promote greater financial participation. Tax incentives to encourage both savings and financial participation may not however be possible given budgetary constraints.

---

[12] Under a phantom share plan, the employee will be awarded a number of phantom shares and will receive a cash sum based on any increase in the price of the “real” shares over a specified period. With a phantom share plan, there is no risk of loss to the employee if the share price falls. Similarly, under a phantom option plan, the employee will be granted a number of phantom options and will benefit from any increase in the market price over the phantom exercise price at the end of, or during, the prescribed period.

2.4. Conclusion

We have used these classifications in our report to analyse the different barriers to cross-border plans and our recommendations. However, as it can be seen, within these broad classifications there is considerable variety and overlap.

On the whole, it appears that financial participation in the EU is in a state of rapid change. In the four larger countries of the EU, more than 19% of the employees of the private sector are covered by profit sharing and by employee share plans i.e. probably more in total than in the United States13. But this level of interest is not found in all the Member States. The legislative, regulatory and taxation frameworks for financial participation, where they exist, are extremely varied. In such a context, the EU needs to clarify its position and to seek progress on two main fronts. The differences already found in the type of plans in the EU and the impact of individual Member State policy and legislation create obstacles to the spreading of the financial participation and to the achievement of the single market. These obstacles are the subject of the Chapter which follows. However, the question of better coordination or even of a certain harmonisation of national laws also needs to be discussed. We deal with this in Chapter 4.

3. ANALYSIS OF OBSTACLES TO CROSS-BORDER FINANCIAL PARTICIPATION PLANS

This chapter analyses the main barriers and practical problems currently perceived by enterprises (European and non–European) to extending their financial participation plans to their subsidiaries across the EU (Annex 5).

Recent research confirms an increasing trend for multinational enterprises to adopt global or group-level employee plans. However a number of obstacles, or perceived obstacles, may prevent them from, or hinder them in, offering similar or comparable benefits to their employees across the EU[14]. The intra-EU dimension of the application of financial participation plans has become particularly important within the context of the single European Market where there is an increasing movement of employees between group companies operating in different Member States.[15]

Comparisons of financial participation approaches in EU Member States reveal large differences in practice, policy and the spread of plans. This was believed to be due to the existence or absence of a specific legal framework and tax treatment, cultural and historical background, industrial relations and practice (see the two Commission Pepper Reports). This part of the report considers the extent to which these differences act as barriers to the implementation and development of cross-border financial participation plans, and to the mobility of workers, both internationally and between parts of the same enterprise.

---

13 "Employee Share Ownership and Profit Sharing in the European Union", Pendleton etc. op.cit.

14 European Commission, A company perspective on financial participation in the European Union, Objectives and Obstacles, Employment and Social Affairs, 2000 (Van Den Bulcke F.) see Commission's website as in footnote n°3. For survey results of 2003 see Annex 4 of the report.

15 Daltry,T., Mascre,F., Leffers, C., Employee share schemes in United Kingdom, France and Germany, European Taxation, October, 1993, p.1

An indication of the issues companies have to face when trying to implement a plan in different Member States, or even globally, can be found in the case studies included in the Appendices of this report. They describe the experience of two large multinational enterprises, Shell (Annex 8) and DaimlerChrysler (Annex 7), and a smaller company, with subsidiaries in different countries, Steria (Annex 6). These examples clearly demonstrate that the operation of a global or cross-border share plan, can be a complex task and may require considerable resources that may not be at the disposal of smaller or medium sized enterprises. The operation of share plans at a transnational level (we find that share ownership plans, rather than profit sharing plans, are more commonly operated across borders), may require a lot of energy, information gathering in many languages, and potentially considerable consultation costs which may be expended without a guarantee of legal certainty. In addition there are large disparities in tax treatment depending on the country and the type of plan.

As can be concluded from the results of two recent surveys (asking multinational companies to identify the main barriers to the extension of plans to other EU Member States or elsewhere) these transnational barriers can hinder the wider dissemination of financial participation plans in Europe.

According to the first survey16 sent to the top 500 European companies in 1999, most of the obstacles are related to the legal and tax frameworks; however these obstacles were considered to be less important in countries where financial participation is more common (such as France or the UK). Important variations were found in the role of the social and cultural barriers. All the companies involved in international share plans, which represent 40% to 50% of the respondents with plans, agreed with the statement that it was difficult to export their plans to other EU Member States. Nevertheless 70% of the respondents intended to export their plans to one or more EU Member States in the next three years.

A similar survey was sent to some 900 companies across the EU in 2003. It was commissioned by one of the members of the Working Party; the full details of this survey are included in Annex 4 to this report. Broadly the results confirm the findings of the first survey. Differences in legal, tax and social security frameworks, the complexity of social security requirements and of labour laws were reported as the main barriers encountered in extending share plans across the EU. Lack of tax incentives, legal restrictions, and cost and complexity are viewed as the main reasons for not extending a domestic share plan across the EU or only to certain Member States.

After an extensive overview of the possible barriers to the introduction and operation of cross-border plans (3.1), and an analysis of the main obstacles and problems per type of plan (3.2), this chapter concludes with the findings of the survey indicating the importance of these barriers from an employer's perspective (3.3).

3.1. Identification and classification of transnational obstacles

The barriers to cross-border plans are classified into six broad categories, based on the different situations prevailing in Member States in the following areas: the existing institutional framework, the securities laws and the relevant regimes, the labour or

[16] Van Den Bulcke, F., Obstacles for the Development of Financial Participation in the European Union, Brussels, 1999, published by the Commission in 2000 (Ibid)

employment laws, the financial market regulations, the social and cultural traditions, and the costs of the introduction and operation of plans.

3.1.1. The institutional framework: legal, tax and social security issues

The development of different forms of financial participation across the EU seems to be strongly influenced by national policies, in particular by the availability of an appropriate legal framework, tax incentives and other financial advantages[17]. In fact, different laws and often mandatory rules in many countries require specific forms of financial participation, forcing companies to tailor the design of an international plan accordingly[18].

Different types of plans across the EU are a first important obstacle for enterprises seeking to implement a uniform financial participation policy for their employees at a global or EU level. Due to the different regulations and tax rules, companies may have to consider alternative strategies for the extension of their plan across Europe and world-wide; this can be a costly and time consuming exercise for multinational companies seeking to apply a common compensation and benefits policy for all their employees. This is of course even more problematic for SMEs (small and medium sized enterprises) operating internationally.

3.1.1.1. Legal framework

There are, as it has been said, currently different approaches in government policy for financial participation across the EU; these different approaches have the following consequences:

- The existence of a specific legal framework or tax regime for different type of plans. For example, one or more types of profit sharing plan and/or share plan are facilitated in France, the UK, Ireland and Belgium. Frameworks apply, but to a lesser extent, in Germany, the Netherlands, Spain, Denmark, Greece, Austria and Finland. In other cases there is an absence of any specific regulations or tax rules, for example, in Luxemburg, Portugal and Sweden.[19] In countries with specific legislation or fiscal provisions, regulations can be supportive, as in France, the UK and Ireland,. Conversely they can be rather restrictive, complex or inflexible due to the number and nature of legislative requirements in exchange for tax relief, as in Belgium and Germany. When specific legislation is absent, the legality of certain plans and their fiscal treatment may be unclear (see taxation issues), creating uncertainty around the adoption of plans, for example in Italy, the Netherlands and Belgium[20].

- Differences in legislative requirements, in respect of:

---

[17] In some countries however, financial participation schemes have developed without specific tax incentives or when incentives have been reduced (Germany, Italy, the Netherlands, Canada): see “Employee participation in profit and ownership: A reviews of the issues and evidence” European Parliament, Working paper, Social Affairs Series, SOCI 109 EN, 01-2003

[18] Ibid., p.22-27

[19] See for example: Poutsma, E., “Recent trends in employee financial participation in the European Union”, European Foundation, Dublin, 2001, p.57-58. Observatoire de l’Epargne Européenne, "L’Epargne Salariale en Marche, Réglements et Pratiques de l’Epargne Salariale", Chambre de Commerce et d’Industrie de Paris, Octobre 2002.

[20] For specific country examples we refer to the analysis per type of plan.

- Employee involvement in the introduction of plans: Although the adoption of plans should always be voluntary- except the Participation legislation in France- and is mostly the result of management initiatives, for some plans an agreement with the employees or their representatives or even a collective agreement is required, including negotiations with representative trade unions or other representative bodies (e.g. profit sharing in Belgium and in France). In some cases where no formal approval or agreement with the Works Council or other body is required, consultation with, and providing information to, employees or their representatives is still necessary.

- The definition of companies or group (legal statute) is laid down in such a way that it may exclude certain organisations or hamper the implementation of international group-level plans (e.g. profit sharing in France).

- The plan coverage, i.e. the minimum percentage of staff covered. Often tax incentives are limited to broad based plans including all employees, (full time and part-time, as well as those on fixed term contracts, on a non-discriminatory basis -see labour law). These plans can be contrasted with selective or executive plans (see also employment legislation on non-discrimination on sex, age, type of contract etc).

- The limits (thresholds) and criteria for the calculation of the total amount of profits or share capital to be allocated to employees and the basis for the distribution of that amount among employees (e.g. equal amounts, maximum percentage of salary, hierarchy, etc).

- The eligibility criteria: e.g. minimum length of employment, distinction between active staff and retired employee (i.e. can retired employees still benefit from plans?), etc.

- The fixing of withholding or retention periods: variations in term, conditions for early disposal etc.

- The rules and vehicles for investment and administration of any funds, depending on the design of the plan and the way the funds are distributed to the employees (either directly or indirectly). Sometimes legislation only favours the collective holdings of funds (with or without individual ownership rights), through specific funds, trusts or other vehicles (e.g. fonds communs de placement d'entreprise (FCPE) in France and trusts in the UK and Ireland). Other related conditions may concern the type of securities (bearer shares or share certificates, new share issues or existing shares, restricted stock or stock appreciation rights), investment only in the employing company or a group company or diversified, control and return rights for employee shareholders etc.

In countries where specific legislation for the regulation and approval of plans by the tax uthorities offering income tax relief does not exist the situation is even more confusing for enterprises, because it is unclear which legislation and/or taxation rules apply to particular plans. Different interpretations and reliance on court decisions hamper a consistent financial participation policy for national as well as international enterprises.

Taking into account the above analysis, one can easily understand why the current disparate regulatory systems within Member States are seen as a barrier to the homogenous development of financial participation plans.

3.1.1.2. Taxation and social security issues

The divergence of tax treatment of the various types of financial participation plans across the EU, linked to general differences in taxation systems (combined also with the existence or absence of tax favoured plans), represent another very important barrier to the implementation and spread of plans.

These barriers are mainly related to the following issues[21]:

- Incidence and timing of taxation: there are a variety of points at which taxes may be charged which differ according to the type of plan. The most frequent differences concern:

– income taxation arising on grant, vesting or exercise for share option plans, and

– for "free" share awards or shares purchased at a discount, income tax at allocation, purchase or transfer of the shares or where there are sale restrictions or the share are "blocked", on those restrictions lifting and

– different taxation regimes for dividends and when shares are sold.

- Uncertainty and/or complexity of fiscal treatment: this is an issue especially when there are no specific regulations, concerning for example the recognition of trusts or other vehicles for the pooling, administration and/or investment of the funds allotted to employees employed in different jurisdictions. There are also differences in the tax treatment of specific plans (income or capital gains tax, withholding tax requirements etc.) and different tax rates or tax concessions.

- Differences in tax treatment and social security contributions for employers and/or employees: in some countries there is a specific tax regime for employers, employees, or both (e.g. in France and in the UK). For example there may be specific rules allowing employers tax relief in respect of a plan, covering the deductibility of administration and other costs, providing an exemption from social security charges on any discount on shares or in respect of options or free shares), etc. Employers also have to take into account differences in payroll withholding obligations for income tax and social security contributions.

- Double taxation or double exemption: different taxation systems across the EU may give rise to taxation in more than one jurisdiction on the same income or gain for employees who work in more than one Member State, or employees who reside in a Member State different from the Member State or States in which they work. Alternatively, the result of the way the different taxation systems interact may be that taxation arises nowhere. For example, an employee resident and working in Belgium may be granted a share options. He may have moved to France by the time that option is exercised. In these circumstances,

---

21 European Centre for Employee Ownership, Breaking the Barriers, Multinational Share Schemes Seminar, Brussels, April, 14, 1999; Van Den Bulcke, F., op.cit.

potentially he may suffer double taxation, i.e. on grant in Belgium and on exercise in France. Conversely if he was resident in France at grant and in Belgium at exercise, in certain circumstances, he may escape income tax entirely on that option. Distortions of this kind occur in the EU because of the different times at which income taxation is applied to share options in different Member States22 (e.g. on grant in Belgium, in the Netherlands the employee has the choice between taxation at vesting or on exercise, and in the majority of Member States, share options are taxed at exercise).

3.1.2. Securities Law

Each Member State has its own securities laws which can mean substantial differences in the obligations on enterprises to provide information to employees when offering shares in different Member States. Typically, if an offer of shares is made to the public (which an offer of shares to employees is generally considered to be) there is an obligation to provide some form of prospectus or other document. Some Member States allow a full or partial exemption from this obligation for employees share plans if certain conditions are met (e.g. the UK but not Finland). However, notwithstanding this, an enterprise currently offering share plans to its employees across the EU will have to consider and comply with the securities laws in each Member State in which the offer is made. This results in increased complications and administration costs. As we will see in Chapter 4, the recent adoption of the EU-Prospectus Directive will help alleviate this situation for companies listed in the EU, as it contains special provisions that relate directly to public offers of shares to employees.3.1.3. Labour Law and other employment related issues.

3.1.3. Labour Law and other employment related issues

3.1.3.1. Labour Law Issues

Irrespective of the existence of specific legal requirements for financial participation plans, in some Member States certain compulsory labour law provisions, designed to protect employees, may have an impact on financial participation plans, and can complicate or delay their introduction. Reference is made to:

- The necessity to consult with employee representatives, a trade union or Works Council during the development and implementation of plans.
- The obligation to negotiate plans at company level with the employees, their representatives, or employee organisations.
- The obligation on companies to include arrangements in the plan concerning the provision of information to employees of details of the plan and the management of the funds allocated to the employees (e.g. under the French Labour Code).
- The definition of pay in social and labour law, i.e. the effect of classifying financial participation as part of ordinary pay with subsequent consequences for social security charges and allowances.

---

[22] Daltry, T., Mascre, F., Leffers, C., op.cit., p. 326-327

- The impact of plans on pension rights, which leads to uncertainty and additional costs in some Member States because they may have an impact on the pension liabilities of the company and the permitted pension contribution level.

- The relationship of the plan to the employee's employment contract (e.g. what rights are given on the termination of employment). Different employment law requirements may confer rights in some Member States in the event of unfair or unlawful dismissal (e.g. in Denmark, Greece, France and Ireland), or in the event of redundancy (e.g. in the Netherlands).

- Differences in employment legislation on non-discrimination among employees based on criteria such as sex, race, age, contract and terms of employment. For example, when only full-time employees with a minimum term of employment in the company may participate in a financial participation plan, the exclusion of part-time employees may indirectly be interpreted as a discrimination against female workers, because women still represent the majority of part-time employees.

3.1.3.2. Other employment related issues

- The existence of "acquired rights": in some Member States where regular participation in the plan can be seen to constitute future entitlement to participate, i.e. the creation of "acquired rights", this is the concept that providing a benefit to employees once or more often constitutes a promise that the benefit will be provided again in the future with the result that the promise amounts to a contractually binding entitlement on the part of the employee (e.g. in Belgium, Luxemburg, and the Netherlands).

- Employee data privacy (data protection): the need to obtain written consent from employees for the transfer of their personal data (remuneration and taxation information) outside the local jurisdiction (particularly for countries outside the EU, which are not "safe harbours"). This is not an obstacle within the EU, because of the EU Data Protection Directive of 1995[23]. In accordance with this Directive and national law on data protection employees have a right to control the use of their personal data. Problems may however arise when the management of plans takes place outside the EU.

- Language and translations: in some Member States there is a requirement to translate the prospectus (if one needs to be provided), the plan rules and other documentation into the national language (e.g. in France and Belgium). Furthermore the national language may vary depending on the region of the Member State in which the company operates or the employees are based (e.g. in Belgium), and this increases costs and administration accordingly.

- Where plans necessitate the withholding of employees' money or the making of direct deductions from wages, complications arise when legal provisions do not allow deductions to be made from wages for the purposes of the plan (e.g. Belgium), or when institutions that could collect this money are not authorised to do so.

---

[23] Directive 95/46/EC of the European Parliament and the Council of 24 October 1995, OJ L281, 23.11.95. European Commission, Enterprise Directorate-General, Taxation of employee stock options in the EU and some other selected questions, Final report of the Expert Group on Taxation of Employee Stock Options, March 2003

3.1.4. Barriers related to stock exchange and corporate governance rules

- Stock exchange disclosure rules and the levels of compliance required vary between the different Member States, e.g. requirements in relation to the publication of a prospectus or in relation to an appropriate report or notification (such as an annual filing) etc. However the extent to which this is a barrier is questionable. Typically such requirements are applied by the stock exchange where the primary listing of the company is found and as such these requirements must be complied with even if the plan is not extended outside the borders of the home country. However the variations between the requirements of different Member States can mean that it may be easier for companies listed in some countries to introduce plans in the first instance than those listed in others.

- Different, sometimes more onerous, requirements for foreign companies issuing shares in certain Member States than for companies domiciled in that Member State (e.g. in Belgium).

- Different requirements regarding shareholder and regulatory approval, depending on whether the company is listed or unlisted and whether the shares are newly issued or market purchase (e.g. in Spain).

- Different requirements within the Member States as to whether shareholder approval is required to implement share plans, depending, for example, on whether the shares are in a company registered in that Member State, or in a foreign parent/subsidiary (e.g. in Belgium).

- Different requirements as to the necessity for shareholder approval depending on whether the company issues new shares, grants share options, or provides warrants (e.g. in Denmark and Sweden).

- The entitlement of the employees' legal representatives to receive the same information about the share plans as do the company's shareholders (e.g. in Spain).

3.1.5. Social and cultural barriers

<u>Differences in industrial relations practice</u> and climate and trade union attitudes have an impact on the introduction and the success of plans across the EU. Several of the labour law provisions described earlier result from different industrial relations' systems, in particular collective bargaining traditions and industrial democracy in its various forms and models of employee representation and participation, such as:

- Prior consultation with the workforce or their representatives on a formal basis (e.g. as in continental Europe with the role of Works Councils) or in a more informal way (e.g. as in the UK).

- The need for a written individual agreement (e.g. for share options in Belgium), or a collective agreement covering all the participants, to be negotiated with the trade unions or employee representatives (e.g. as with certain plans in Belgium and France).

In addition to their possible official involvement in the development of plans, trade unions can be in favour of or against plans, and consequently may influence employee participation rates in a positive or negative way.

Cultural differences across the EU affect the willingness of employees to invest in their employer, and are linked to savings patterns and risk aversion. The impact of this can be seen more in relation to the take-up rates of plans in certain Member States rather than acting as a barrier to the introduction of cross-border plans. In some countries they are affected by government savings policies, which do not always encourage share participation in the employing company or group, or when tax benefits cannot be accumulated with incentives for other forms of savings (housing, life insurances, pensions savings e.g. in Germany, Netherlands, Belgium).

3.1.6. Administration and operation costs

Companies wishing to extend their plans across the EU must be committed to spending sufficient time (e.g. involving various internal departments such the Human Resources Department, tax, legal, company secretarial etc, providing information to and communicating with employees, etc) and resources (cost of legal and tax advice, and expenses in relation to the administration of the plan etc). The time and resources required will depend on the nature of the plan and implementation strategy chosen. Commitment of sufficient time and resources may be more of an obstacle for SMEs than for large multinational organisations.

3.1.7. Conclusion

The lack of a consistent approach for financial participation plans across the EU means that a multinational company wishing to reward the employees of its European subsidiaries in a uniform way has to consider the requirements of each Member State individually, rather than treating the EU as a homogenous whole.

Companies will have to weigh the potentially high administration costs and time and resources required against the benefits employees will receive in countries where implementation may not be straightforward. In some cases implementation in subsidiaries or plants with low numbers of employees may therefore not be feasible. This may explain why international companies often chose not to extend their plans to certain countries.

3.2. Obstacles per type of plan

The following text presents in detail, plan by plan, the respective obstacles as they were listed in paragraph 3.1. The reader who does not wish to go further into these points can refer directly to paragraph 3.2.3.

3.2.1. Profit sharing and gain sharing

The analysis of the barriers for cross-border profit sharing plans is complicated by the different type of plans that exist in practice and by the fact that they are treated differently by Member States, in particular depending on whether:

The following text presents in detail, plan by plan and the respective obstacles as they were listed in paragraph 3.1. The reader who does not wish to go further in these points can refer directly to paragraph 3.2.3.

- the bonus is paid directly to the employee as earned **(cash plans**), or is deferred until some later date (**deferred plans**); and

- the bonus is paid in cash or in shares (**share based profit sharing**).

Some plans involve a combination of some of the above leaving the choice to the employee.

3.2.1.1. Obstacles relating to the legal framework and tax and social security issues

Multinational companies with plants and subsidiaries in different Member States, planning a profit sharing plan for the whole group, or wishing to extend their local plan across the EU, will need to know:

- whether there is supportive legislation and/or special taxation provisions and if so, for what type of plans, i.e. for cash profit sharing, whether deferred or not, or for share based profit sharing, or for both;

- to what extent do the legal requirements and conditions differ across Member States and if they are more complex, inflexible or restrictive than in the home country; and

- if there are any tax advantages or if the profit share is simply considered as normal pay with consequential tax and social security implications.

Mostly it is only share-based profit sharing plans that offer substantial tax advantages, following the example of the USA, but the situation differs across the EU. Some Member States offer tax relief for cash as well as deferred plans (e.g. France and Belgium), others only for (share based) deferred plans (e.g. the UK and Ireland).

3.2.1.1.1. Differences in the legal framework

In order to qualify for tax concessions generally plans must fulfil a number of conditions, which may include some or all of the following:

- the need to cover all employees;

- other specified eligibility criteria;

- the requirement for the introduction to be by (collective) agreement with employees or their representatives (eg as in France and Belgium);

- criteria and limits for the calculation of the total profit sharing amount (e.g. a pre-determined formula, maximum % of profits, maximum % of wages etc);

- a specified basis of allocation to individual employees;

- specific rules governing the administration and investment of the funds in case of deferred plans (e.g. through trusts in Ireland and in the UK, FCPEs in France); and

- rules relating to holding /blocking periods.

In some Member States regulations are minimal, leaving much freedom in relation to the design and the implementation of the plan to enterprises (e.g. in the UK except where tax favoured status is sought), but other Member States are more restrictive. For example, in

Greece, the many administrative regulations may explain the low incidence of cash profit sharing, notwithstanding the favourable tax treatment.

Examples of difficulties for international profit sharing plans that may arise from these differences in legislation or in conditions for tax approved status (qualified plans) include:

- The introduction of profit sharing plans

- Compulsory or voluntary: the obligation for French companies with more than 50 employees to operate a deferred and strictly regulated profit sharing plan ("*participation"*), which is an exception in the EU.

- The introduction of plans by management decision (on a discretionary basis, e.g. as in the UK), by agreement with the employees or their representatives *(*e.g. *"intéressement*" in France), the need to consult through the Works Council (e.g. under the Netherlands labour law), or to negotiate with the trade unions (e.g. a separate collective agreement in Belgium). Different information and consultation procedures may complicate or slow down the introduction of profit sharing plans in certain Member States, which is certainly the case when plans must be negotiated with the trade unions on an enterprise or sector level, and for each plant separately (e.g. as in Belgium).

- Obstacles related to group level plans

The main questions to consider in this context are:

- How do national regulations apply to profit sharing plans covering the whole group?

- Does national legislation also apply to foreign subsidiaries?

In addition difficulties may result from the lack of, or the differences in, the definitions used by different Member States for "group" and "group profits".

International profit sharing plans can either be based on the performance of the entire group (e.g. some group performance measure such as consolidated profits etc), or on the performance of the local plant or subsidiary. Problems can arise when national legislation only envisages one of these alternatives. In addition, subsidiaries in those countries where the definition of the group and therefore the calculation of profits is unclear under national legislation (e.g. as for co-ordination centres under the Belgian legislation of 2001 and the French profit-sharing legislation), meet with issues when trying to implement plans. Finally the adoption of plans can be hindered where plans can only be implemented at the company level, such as in Austria, where it is envisaged that the profit share should be based on subsidiary or divisional performance

- Investment and administration of deferred plans

In some EU Member States- deferred profit sharing is historically viewed as an instrument to promote savings (e.g. *épargne salariale* in France, asset formation laws in Germany and wage savings plan in the Netherlands). In others it is viewed as an instrument to allocate shares (eg approved profit-sharing plans in the UK and in Ireland and the Belgian profit sharing legislation of 2001). Therefore these plans can also be classified as asset accumulation and

savings plans, or even share plans and as such may subject to the same difficulties (see section 3.2.2).

Different requirements for the investment of funds and different holding periods complicate the implementation and extension of deferred (share based) profit sharing plans across the EU. As an example one could consider FCPEs in France and trusts in the UK and in Ireland. These structures are designed for local employees and are bases on the legal framework in those Member States, but they are difficult to "export" to, or establish in, some other Member States (e.g. in Denmark and in Spain) (see the case study on *Steria*, in Annex 7).

3.2.1.1.2 Taxation and social security

Different taxation and social security regimes may exist for employers, employees or both. Also the tax benefits can be substantial, limited or non-existent. As already mentioned the tax treatment can differ for cash and deferred or share based plans. The following considers the position where there is supporting legislation and where there is none:

- Cash plans

- No supporting taxation: profit share payments are likely to be treated as normal pay and taxed as such when received. Normally it would follow that such payments would be tax deductible for the company and that social security liabilities would arise for both the employer and employee. This is the situation in most Member States; however, France, with the 1959 legislation for "*intéressement*", Belgium, with 2001 legislation, Greece and Portugal all take a different approach (see also labour law)[24].

- Supportive taxation regime: in those countries offering tax relief for employees, employers' contributions to the plan may not be tax deductible for the company (e.g. as in Belgium). However typically tax concessions are generally more substantial for deferred plans (e.g. in Belgium and France) than for cash plans.

The social security treatment given to employers and employees can also differ (e.g. in Belgium exemption for employers and a low rate for employees and in France exemption for both employer and employee).

- Deferred and share based plans

- No supporting taxation: except where there is a complete exemption (e.g. under the French, "*intéressement*" regime of 1959 if the bonus is deferred, or "*participation*" regime of 1967), the problems relate mostly to the timing of taxation, for example where there is a holding period and when the bonuses or shares and the dividends arising thereon are allocated to blocked individual accounts or invested collectively (through pooling of funds or ESOP-type arrangements). The situation in relation to social security is often even unclear.

- Supportive taxation regimes: which may mean different tax incentives and tax points for employers and employees. Examples of this include:

[24] See Pepper II report, 1996; Poutsma, E., op.cit.

– taxation at payment (attribution) or at the end of the freezing period, subject to special regimes for earlier disposal of the funds (e.g. as in the UK);

– taxation differences based on the system applied, i.e. individual attribution of shares or investment through saving vehicles (e.g. the link between profit sharing and company savings plans (PEE) in France);

– differences in the amount of tax relief.

3.2.1.2. Labour law and labour relations

In some Member States (cash) profit sharing is considered part of the employment relationship, and incorporated into the employment contract. This has an impact on the tax treatment of the payments and the rights of employees (e.g. protection, information rights, etc). The fact that profit share bonuses can be characterised differently by Member States can cause problems, for example:

- issues arising out of whether or not the payments are considered to be normal pay or wages: under social or labour legislation, profit sharing bonuses are generally considered to be basic remuneration, and therefore are subject to the same social security treatment as pay and other employee benefits. However they are sometimes covered by specific exemptions under a government support programme (e.g. as in Belgium and in France). An exception to this rule is Portugal, where profit sharing is not considered to be remuneration, and consequently is not subject to social security charges, but it is not tax deductible for the employer.

- consultation with and providing information to employees: prior consultation with employee representatives or trade unions, possibly through a Works Council, is compulsory in some Member States, requiring either consent (e.g. as under Dutch Labour law) or advice. Under French labour law, profit sharing agreements and the investment of the bonuses, require extensive information to be provided to participants in the plan. Foreign companies view this as an obstacle to the international operation of their plans[25] especially, for example, UK companies that have no legal obligation to negotiate or to reach a formal consensus on the implementation and the design of a plan.

- relationship to wage policy and collective bargaining: the concept of "acquired rights" (i.e. that a contractual entitlement is created to a particular benefit) may prevent companies from introducing some flexibility in the compensation of employees though a profit sharing plan, especially when profit sharing is viewed as part of the employment contract. In addition an obligation under rules relating to profit sharing to negotiate a plan at the company level may interfere with wage negotiations. Trade unions may either be in favour of or against profit sharing agreements, depending on their attitude to profit sharing, particularly in the context of wage moderation policies.

3.2.1.3. Summary and conclusion

Multinational companies wishing to operate a profit sharing plan in different Member States or wishing to export a plan that is tax qualified or approved in their home country to their

[25] See: Van Den Bulcke, F., op.cit.p.40-41

subsidiaries elsewhere in the EU, have to take into account the differences in taxation and social security regimes, in legal and administrative requirements, and the social, cultural and institutional barriers in the host countries. Exporting deferred plans is particularly difficult, especially for plans where specific mechanisms for investment and administration of employee funds are needed and when plans are designed to be acceptable to a specific Member State.

In practice these problems will not only prevent companies offering their employees similar incentives, but also reduce the efficiency and flexibility of an international compensation and HR strategy (e.g. as in Greece, where a favorable taxation treatment for cash profit sharing is offset by the complex administrative requirements that need to be met to qualify for this treatment and in Belgium where a mandatory separate collective agreement is required for each plant within the group). Generally, at the present time, the transnational dimension of profit sharing plans is very limited. They are most easily applied at national level. More than any other type of financial participation, profit sharing is often based on divisional or subsidiary results. Therefore many companies are happy to introduce tailored profit sharing plans for each such unit and do not seek to have uniformity across the EU for this part of employee compensation. It appears however that certain European - based groups would prefer to Europeanise such plans to stimulate a common feeling and motivation among their staff, as part of a remuneration strategy focusing on short-term company goals.

3.2.2. Share plans

This section analyses the main obstacles to introducing and operating cross-border share plans, based on the classification set out in section 2.1. Some of these barriers are common to all types of share plan, whereas others apply to specific plans only.

Although chapter 2 categorises the main types of share plan, in practice it is not always possible to make a clear distinction between plans. Companies often offer combinations of plans or hybrid plans that may be best suited to their strategy or that have been adapted to fit the legislative framework and government support available in a specific country. This is particularly the case for asset formation plans which may be financed from a number of different sources, e.g. the employee, the company and potentially the government where tax relief are provided. These plans may combine elements of share purchase, free shares and share savings approaches (e.g. the *PEE* in France, the *SIP* in the UK and saving schemes in Germany and the Netherlands), or share options and share savings, (e.g. the *SAYE* scheme in the UK). Also the combination of share plans with profit sharing complicates any attempt to set out simple classifications. Notwithstanding these issues, this chapter considers the obstacles based on the broad classification set out in chapter 2

3.2.2.1. Share purchase plans/share savings plans

3.2.2.1.1. Obstacles relating to legal issues

-Financial and company law, securities legislation

Under share purchase plans employees receive the right to subscribe for newly issued shares reserved exclusively or partially for them, or to acquire shares in the company that have been purchased on the market. In the EU capital increases and acquisitions of own shares by a company are regulated by national company law but in accordance with the second Council Directive on Company Law (of 13 December 1976/ 77/91/EEC). Essentially this Directive

provides that the shareholders in general meeting should take the final decision in relation to any increases in share capital and on certain other related issues. However the same Directive allows some derogation designed to encourage the participation of employees in the capital of undertakings. Important exceptions from the basic rules are that:

- the board of directors may proceed with a purchase of issued shares without the prior authorisation of the company in general meeting if the shares are to be acquired for distribution to the company's employees;

- a company may offer financial assistance in respect of the acquisition of its own shares if the transactions are effected with a view to the acquisition of shares by, or for, the company's employees, or the employees of an associate company; and

- a minimum payment of 25% (of the nominal value of the share price) is not required.

Not all Member States have adapted their regulations or introduced specific exemptions to encourage share offers to employees. Therefore in some cases share offers to employees can still be subject to the same regulations and control as a public offering. Furthermore, if there are specific provisions covering employee financial participation in a Member State, these provisions may not always apply to foreign companies or shares registered outside the relevant Member State. In addition, a number of difficulties for cross-border share purchase plans are related to the impact of financial rules, company law and securities legislation in different Member States. And finally, whilst it may not necessarily be an issue specific to cross-border plans, the legal requirements may be more onerous in some Member Sates than in others making the introduction of plans by companies based in those Member States more difficult in the first instance.

Examples of potential difficulties are:

- differences in shareholder and regulatory approvals required by Member States;

- different requirements as to whether shareholder approval is required to implement a share plan, (e.g. as in Germany, and Spain) and differences depending on whether the shares are in a company registered in that Member State or in a foreign/parent or subsidiary (e.g. as in Belgium);

- different, and potentially more onerous, requirements for foreign companies issuing shares in certain Member States than for companies domiciled in that Member State (e.g. as in Belgium)

- different requirements regarding shareholder and regulatory approval within a Member State, depending on whether the company is listed or unlisted and whether the shares are newly issued or market purchased (e.g. as in the UK)

- different requirements on the level of compliance required with stock exchange disclosure rules in the relevant Member State, be this the publication of a prospectus, an appropriate report or notification etc (e.g. see Austria, Belgium, Italy and the Netherlands);

- legal duties to inform a federal reserve board or a central bank;

- legal requirements as regards the documentation of such plans;

- limits for a company concerning the purchase of its own shares (e.g. maximum of less than 10% of share capital);

- prohibitions on a company from giving financial assistance (e.g. by advancing funds, granting loans or giving credit etc) to third parties (including employees) for the acquisition of its own shares (eg as in France, Portugal and Austria);

- problems related to share plans involving an element of savings, i.e. legal prohibition on the employer preventing it from making direct deductions from salary or wages (e.g. as under Belgian labour law), or concerning the authorisation of institutions to hold employees' money (e.g. the recognition of the concept of a trust or a FCPE in certain jurisdictions, see the Steria case study-in Annex 6);

- legal restrictions on certain foreign shares kept in local (individual or central) deposits. In some Member States (e.g. in Germany and Italy) it is difficult to expand the formula of collective holding of shares through company investment funds. This obliges the parent company to allocate shares directly to employees, i.e. direct share ownership instead of indirect share ownership. (AFEP-AGREP, Annex 8); in other Member States employees covered by a share plan are not treated as the owners of shares, which means that the shares cannot be paid into individual accounts (e.g. in Spain, see the Shell case study);

- where it is not possible, as it is the case in certain Member States, for employees to buy shares that are part of a fund (e.g. a *FCPE*.), and instead they have to buy shares directly, employees are unable to participate in "leveraged" share plans, and to benefit from tax advantages enjoyed by these plans under the law in some Member States[26].

– Differences in legal requirements for qualified plans, such as:

- different rules across the EU on the purchase price employees must pay to acquire shares, e.g. it could be a fixed price, an average price or the market price or value and some of these definitions could result in the price paid being less that the prevailing market value;

- different holding or blocking periods (e.g., sale restrictions ranging from 1-10 years), and related provisions for early withdrawal in specific circumstances; different investment provisions (especially for share savings plans), based on the tax and social security regime in place (see below).;

- different eligibility criteria for share purchase/savings plans: some Member States require a minimum length of service before employees can participate in a plan. This varies across the EU. In addition in some Member States retired employees may also receive share offers (directly or indirectly through funds).

- different thresholds, i.e. ceilings on the maximum amounts employees may subscribe for shares or maximum numbers or values of shares that may be acquired or purchased, can mean that employees working for subsidiaries of the same enterprise across different Member States have varying participations levels. This could be viewed as unfair.

---

[26] Bouin, D., The international employee shareholders' plan at Suez, Transfer, Vol. 8, nr. 1, 2002, p. 109-114; LuxCo is an example of fund which may offer an alternative solution for a FCPE outside France, in the context of the group share plan operated by Suez.

- corporate governance rules: different Member States have different requirements concerning the representation of employee shareholders and this may complicate the administration of cross-border plans.

- Securities regulations

For cross-border share plans, the need to respect different securities regulations and procedures in each Member State may oblige companies to make separate filings in several countries. This may require translation into the local language, and in some Member States, more than one local language. All of this can delay the implementation and increase the costs of group share plans.

3.2.2.1.2. Taxation and social security issues

Companies considering implementing cross-border share purchase/savings plans or the extension of their home country plan to their subsidiaries across EU, will need to know the possible income tax, social security and capital gains tax consequences of this. The main problems are differences in tax and social security rates, the different relief and concessions available, different taxation points, uncertainty of taxation and social security treatment, the risk of double taxation and differences in withholding requirements and employer reporting.

-Differences in tax rates and social security charges and different relief and concessions available in respect of:

- the discount on shares - whether or not there is taxation at the time of purchase if the employee is offered the shares at a discount to the then market value, or if there is taxation on any discount to the price of the shares if the shares are offered by a bank under a leveraged plan;

- interest on loans by the employer for the acquisition of the shares – if no interest is payable or interest at a favourable rate is applied, whether or not a tax liability arises or if it is tax relieved or exempt;

- dividends (and/or their reinvestment) – the tax position whilst the shares remain subject to the plan and potentially any impacts on dividends that are payable (on the same terms as apply to other shareholders) after the end of the holding or blocking period;

- capital gains taxation when employees sell their shares – whether it applies at all as in some Member States and if it does any relief or exemptions;

- rulings - whether or not the company can obtain a ruling when there is no specific taxation regime, or the regime is unclear or open to interpretation, for all or some of the benefits employees may receive under the plan;

- employer contributions - in certain Member States the costs incurred by a company in the acquisition of shares for a plan are tax deductible, or the tax deduction may be linked to the amount on which the employee pays tax. There may be a ceiling on the amount of the relief, it may differ depending on the source of the shares, i.e. whether the shares are purchased on the market, are shares held in treasury or are new issue shares, and in some

cases it may be necessary for the employee to retain the shares for a certain period (e.g. as in Belgium and in France for funds received from "*participation*" or "*intéressement*) [27];

- wider savings policies - in some EU Member States, lower-paid employees are offered tax advantages (e.g. tax free amounts, government subsidies, no taxation on any discount offered on the shares or on employer's contributions up to a limit etc) on share acquisitions in the employing group, provided certain conditions are met. In practice, the regulations for qualified plans may be so complex (and the fact that they generally differ significantly between the Member States adds to this complexity) that enterprises may prefer not to take advantage of government supported plans (see the case studies on DaimlerChrysler and Shell);

- payroll deductions - when the company is allowed to make regular payroll deductions to fund share purchase/savings plans, these deductions may be from gross (pre-tax) or net (after tax) income, depending on the legal and tax framework in the Member State and the terms of the plan.

- *Differences in the timing of taxation:*

- shares may be taxable on the initial allocation/acquisition or on any sale restrictions falling away if the shares are blocked or not until the shares are sold, depending on the rules applied by the Member State to the particular plan, e.g. even within Member States different rules and different relief may apply to different plans.

-*Uncertainty on the taxation and social security position, for example:*

- in some Member States there is uncertainty as to whether or not the benefits to employees are subject to social charges (e.g. as in Belgium) or are treated as normal pay (e.g. as in Germany);

- it may not be clear under the laws of certain Member States how leveraged plans, which use a fund for the administration and investment of the employee shares, should be treated.

-*Double taxation*:

- problems arise in relation to the allocation of taxation rights between Member States for internationally mobile employees or employees who work in more than one Member State (see the Shell case study).

- *Differences in withholding requirements and employer reporting:*

- the same benefits provided to employees by an enterprise operating across a number of Member States may give rise to a myriad of reporting and withholding requirements.

In conclusion because of the differences in legal and tax rules across the EU for these type of plans, companies have to face "a variety of tax and social levies on sums regarded in some cases as a simple return on capital investment, in others as a simple fringe benefit, at tax rates

[27] Observatoire de l'Epargne Européenne, op.cit. p.4-7

varying from 0 to more than 50%, sometimes including and sometimes excluding exemption thresholds"[28].

3.2.2.1.3. Employment law

There are different requirements, rules and practices concerning:

- prior approval of plans - consultation with or the provision of information to representatives of the Works Council, trade unions or other employee representatives about the introduction of plans is required by some Member States in varying degrees although the position is not always clear;

- discrimination - in some Member States certain plans must be offered to all employees on a non-discriminatory basis;

- transfer of personal data – although the transfer of personal data is covered by an EU Directive, there are differences in the way in which Member Sates have implemented this Directive;

- acquired rights - in some Member States regular participation in a share plan could be construed as creating a future entitlement to participate. (see also share options);

- payroll deductions - in some Member States it is not possible for a company to make regular payroll deductions to be used for the acquisition of shares (e.g. as is prevented under Belgian social law);

- the definition of pay, including all payments in kind – this may differ between Member States(see taxation issues).

3.2.2.1.4. Administrative and operational costs

It is clear that the operation and administration of cross-border share purchase/share savings plans is complex. This stems from the diversity in the legal, taxation and regulatory rules of the different Member States. For such cross-border plans, depending on how the plan is structured, there may be the additional costs arising out of transnational bank transfers to facilitate the acquisition of shares and/or the payment of dividends. Companies need to weigh their administration costs, both in terms of cash costs and internal management/administration time, against the benefits achieved (by the employer and employee). The benefits may vary from Member State to Member State.

3.2.2.2. Free shares (share awards)

As discussed in chapter 2 free shares, i.e. a gift from the employer or other group company may be awarded to employees on a one off or on a continuous basis. One off award is often made to mark a special event, e.g. a merger or a first listing. One of the features of the UK *SIP* is that it can be used as a vehicle for awarding free shares in a tax efficient manner plan on an ongoing basis. However free shares are typically offered with, or as part of, other financial participation plans, such as profit sharing (e.g. share-based profit sharing in

---

[28] Bouin, D., op. cit.p.112

Belgium, France and Ireland) or share purchase/savings plans (e.g. as the "free matching shares" offered when an employee buys shares under a UK *SIP*). Depending on national regulations, the shares can be allocated directly to employees or through specific vehicles (such as a fund or employee benefit trust).

As mentioned previously, there is considerable overlap in the issues relevant to the different types of financial participation. As such many of the issues relevant to free shares have been highlighted in the context of the plans discussed above. Therefore, in this section, we only mention the difficulties specifically relevant to free shares, which are mainly related to legal, tax and social security issues

3.2.2.2.1. Legal requirements

Free share plans are typically plans aimed at all employees rather than being of a discretionary nature. Hence many of the eligibility criteria, particularly for free share plans that enjoy government support say in the form of tax relief, are often set out in the national law. These requirements therefore can differ between Member States. For example there may be:

- different eligibility criteria - it may be necessary for the plan to cover all employees, but generally a minimum length of service before an employee becomes eligible to participate is acceptable;

- different limits on the maximum award that can be made and the basis for calculating this maximum - there may be an overall limit based on value or the maximum and individual can receive could vary based on different criteria, i.e. it could be performance-related, or based on length of service or salary etc;

- different holding periods and provisions for early withdrawal – not surprisingly, as such conditions will be based on national law and practice, there are variations between the approaches taken by Member States.

3.2.2.2.2 Taxation and social security

-*The tax position of the employee*

The tax position of employees participating in free share plans varies from Member State to Member State. In particular some Member States provide specific tax relief and benefits to employees receiving free shares provided the plan under which they receive the shares complies with the conditions imposed by national law. The following problems arise with free share plans in common with other types of share-based financial participation: different tax and social security points, potentially unquantifiable future social security liabilities, different valuation methods for the shares and potential double taxation.

-*The tax position for the employer*

Again, similar issues arise for employers operating free share plans as do for other types for share awards. For example, issues around the deductibility of the costs incurred in introducing and administering a free share plan must be considered. In addition employers need to establish if tax relief will be available for the costs of providing the shares, whether they be purchased on the market, taken from treasury or new issue shares. In some Member States the

market value of any free or matching shares allocated to employees may be used as a basis for a tax deduction (e.g., as provided for under the UK's *SIP*).

3.2.2.3. Share option plans

Since the 1990's, following the trend in the US, European companies have increasingly used share options as part of the remuneration packages of management and selected categories of employees, i.e. executive or selective share option plans. Increasingly companies are now extending their plans to broader categories of employees or to all employees, i.e. broad based plans or all employee share option plans.

As we discussed in relation to other types of share plans, companies extending their plans internationally have to face different regulations and tax rules, as well as different economic-political, financial and socio-cultural environments. This may make cross-border plans more or less attractive and successful in different EU Member States.

The most common obstacles for employee share acquisition through awards of share options are related to:

3.2.2.3.1. Institutional and legal issues

Share option plans in the EU are hindered by a relatively complicated legal environment and diverse regulations[29]. Some of the legal and administrative barriers to cross-border share option plans are common to share purchase plans, as discussed earlier, for example, those arising out of securities regulations and employment legislation. Other barriers however, such as certain taxation issues, are specific to share options. The analysis below focuses on the specific issues for share option plans.

- Regulatory requirements

In general, the legal framework for share option plans require the plan to comply with a number of regulations particularly if it is the intention that the plan should qualify for a favourable tax treatment or incentives. There are specific tax rules for share option plans in 10 of the 15 Member States. In these Member States, companies must comply with these rules if they want to qualify for a more favourable or a specific taxation treatment. In some of the Member States, there is legislation for certain defined plans (e.g. in France, Ireland and the UK). For example, in the UK there are a number of tax-favoured plans (known as approved plans in the UK).Tax favoured status is available in the UK for discretionary share option plans as well as for certain all employee or broad based plans. . Whereas in Ireland, only all employee plans can benefit from a tax favoured status.

Differences in regulations among Member States are mostly related to

– the calculation of the exercise or purchase price of the shares to be acquired under the options;

– the different approaches to the above for listed and for unlisted companies;

[29] European Commission, Directorate General Enterprise, op.cit.p.10

– the type of shares that are/may be used;

– whether or not options may be offered at a discount.

In addition, for taxation benefits to be available in some Member States, the plan must cover all employees on a non-discriminatory basis and this can also act as a barrier to cross-border plans (e.g. as in Ireland and in Spain).

Regulations vary between Member States. Some are strict and others are more flexible. In Member States where tax favoured plans exist, the general philosophy is often similar. In particular, broad based plans are promoted, but there may be restrictions on the benefits that high- income earners can receive (although an exception to this would be the *EMI* scheme and the approved selective share option plans in the UK).

Most difficulties therefore occur with the expansion of a tax-approved plan from one Member State to those Member States where no specific tax and related legal provisions exist (e.g. in Germany, Luxembourg, Portugal, Finland and Sweden).

-The introduction of plans

As with other share plans, the introduction of a share option plan usually needs to be approved by shareholders (e.g. in Belgium, France, Greece, Ireland and Spain). However again the regulations surrounding this may differ across the EU. In some countries, whether or not shareholder approval is required depends on the type of shares to be used to satisfy the options (e.g. warrants, newly issued or existing shares), or the requirement is restricted to plans involving a capital increase (e.g. as in Germany, Portugal, the Netherlands), or the conditions are different for listed and unlisted companies (e.g. as in the UK). For example, in France the introduction of a plan has to be decided in an extraordinary general meeting, whereas in Germany shareholders usually have to decide on the major points of a share option plan. In Italy shareholder approval is required to approve the plan and to choose the method of providing the shares.

These requirements are often requirements of an enterprise's home Member State and must be met when a share option plan is first introduced, regardless of whether or not it is to be expanded outside that Member State's borders. Therefore they do not always create barriers to the cross-border expansion of share option plans. However this initial requirement can be more onerous in some Member States than in others.

3.2.2.3.2. Taxation and social security issues

Differences in national systems for share option plans are to a large extent a result of taxation, as described below, and are related to the type and the timing of taxation

3.2.2.3.2.1. Tax position of the employee

-The timing of taxation

The taxable benefit for an employee of participation in a share option plan may be calculated on one or more different events[30]:

– when the option is granted;

– when the option vests;

– when the option is exercised;

– when the restrictions on the sale of the shares acquired on option exercise fall away;

– when the shares acquired under an option are sold.

- Type of taxation

Closely linked to the question of what benefits should be taxed and when tax will be due, is the question of what type of tax will the employee have to pay, i.e. income tax or capital gains tax or both[31]?

This is further complicated by the use of different calculation and valuation methods.

The fact that share options are normally awarded as part of an employment package points towards their being subject to tax and social security as income in the same manner as the other elements of employee remuneration. But there is the question of when the profits an employee receives cease to be employment income and become capital gain. The OECD has also been considering this issue and the revised public discussion draft document on cross-border income tax issues arising from employee stock options comments on this point. That paper suggests that all profits up to the date of exercise should be employment related income and any subsequent profits should be treated as earned in that individual's capacity as a shareholder/investor. It goes on the say that this should not restrict a State in its decision on when to levy tax (e.g. on grant, exercise etc) or whether that benefit should be treated as employment income or capital gain. Another argument sometimes put forward is to consider the actual holding and subsequent exercise of the option as a pure investment decision, which would support its taxation as a capital gain[32]. Most tax systems consider that the profit earned up to the date of exercise is employment related income with any subsequent gain realised on the sale of the shares being considered capital gain.

How Member States apply taxation to the employment related profits employees receive from share options varies across the EU. The approach taken may be influenced by the benefits different Member State perceive they receive from incentivising employees through employee share option plans and national policies on taxation. The most common approaches are as follows:

- Taxation at the grant of the option or purchase rights: with the exception of Belgium (and the Netherlands in the case of "unconditional options"), EU Member States generally do not impose an income tax liability on the grant of options. However there may be

[30] OECD, Cross-border income Tax issues arising from employee stock-option plans, A public discussion draft, Paris, 2002, p.7
[31] European Commission, DG Enterprise, op. cit.p.28
[32] OECD, op.cit.p. 19

exceptions if, for example the option is transferable or tradable or is granted at a discount to the market value of the underlying shares. If there is a liability to taxation on grant, a value for the option may need to be established. Sometimes the basis of calculating the value is set out in the national law of the Member State (e.g. as in Belgium and the Netherlands) and in others the option will need to be valued based on option valuation principles. In many cases this gives rise to a lack of certainly.

- Taxation at vesting of the option: vesting takes place when an employee is in the position to exercise the option and acquire the shares. In practice, this occurs when any conditions have been met (e.g. certain success indicators are reached, a continuous employment requirement has been satisfied, etc). For example, in the Netherlands employees are taxable when the options become "unconditional", subject to an election to be taxed on exercise. The valuation problems highlighted above that arise if taxation is imposed on the grant of an option, are also relevant here.

- Taxation at the exercise of the option: share options may be subject to income tax at exercise on the difference between the “market value” of the shares on the exercise date and the exercise price. Member States may use different definitions of “market value” for this purpose.

- Taxation at the vesting of the shares, i.e. when any restrictions imposed on the shares acquired on the exercise of the option fall away: shares obtained by exercising the option may be subject to further restrictions before the employee is free to sell them. Normally one would expect this gain, as it is a post acquisition gain, to be treated as capital and not as employment income. However some countries may also treat this increase in value (or part of it) as employment related income.

- Taxation at the sale of the shares: employees may be subject to capital gains tax if the shares increase in value. Subject to national laws, this is typically computed based on the difference between the value realised on selling the shares and the value of the shares at exercise, where taxation takes place at exercise. In other cases, the capital gain may be calculated on a different basis, e.g. from grant, vesting of the option or vesting of the shares[33].

In the EU, income taxation at exercise is the most widespread, but in some countries employees are allowed to chose between taxation at grant and taxation at exercise, or between taxation at vesting and taxation at exercise (e.g. as in the Netherlands).

In certain Member States, tax exemptions and/or relief may be available to participants in tax approved or official share option plans, if they are designed to meet the rules governing such plans. In practice this does not prevent companies from also operating non-approved or non-qualified selective plans, which remain popular mainly because of their flexibility (e.g. the ability to include performance criteria).

In addition to the differences in tax rates and the timings of tax between the Member States, there are also differences in how and when social security charges are calculated and applied.

- Taxation of discounts

---

[33] European Commission, DG Enterprise, Ibid.

In some Member States, when options are granted to employees at a discount (ie the exercise price of the option is less than the prevailing market value of the underlying shares), the value of the discount may be charged to income tax at that point. For this type of share option plan, issues arising out of the different timings in the application of taxation between Member States can be particularly important[34].

-Social security contributions

Social security contributions may be due on any taxable income recognised by an employee in relation to a share option at the same time as the income tax charge arises. Alternatively social security may be levied on a different basis or not apply at all.

3.2.2.3.2.2 Tax position of the employer

The tax implications for an employer under a share option plan may differ between countries because of differing approaches on:

- the deductibility of administration and other costs of setting up and operating a plan: typically tax relief is available for such expenses;

- the deductibility of the costs of granting the share options: the deductibility may depend on the way in which the shares are sourced, e.g. through the purchase of existing shares, or by issuing new shares, or by using shares held in treasury. In most Member States a deductible expense is only available when the company actually incurs a cash cost in acquiring the shares to be used for the plan, although there are exceptions to this rule (e.g. in the UK, the company is generally able to deduct an amount equal to the amount on which the employee is taxable). In Belgium, a deduction based on the benefits received by the employee is not possible, regardless of the way the shares have been obtained. In the Netherlands the deductible amount is independent of the actual cost and is equal to the amount taxable on the employee for income tax purposes[35]..When costs of the shares are recharged to the employing company, usually by the ultimately parent company of the group, the rules on deductibility are complex and vary between Member States.

- the social security obligations on the employer: different Member States impose different obligations in relation to social security. On the basis that the benefits from share options are generally treated as employment income, employer's social security obligations are also due in the majority of Member States. However in some Member States no social security contributions are payable at all or are only payable in certain circumstances or to a limited extent (e.g. in Denmark, Ireland and Portugal). In practice employer social security obligations can cause liquidity and valuation problems that can complicate the employer's planning and budgeting for these costs[36].

- the withholding obligations in respect of taxable benefits received by employees: in most cases the employer is required to withhold any income tax and social security tax due when the employee is subject to income tax. There are exceptions, for example in France, income tax is not withheld from the employee and he or she must pay his or her own tax

---

34 European Commission, DG Enterprise, op.cit.p.34

35 Ibid. p.35

36 European Commission, DG Enterprise, op.cit. p.35-36

over to the authorities. The obligation to withhold can cause problems for the employee particularly where the tax is at a point when the employee is not authorized to sell shares to meet this cost, e.g. as in Belgium where tax is at grant, or where the tax is on exercise and employees are precluded from selling the shares for a period of time. Some employers offer arrangements to help their employees deal with this cash flow issue.

The treatment of cross-border cases: double taxation and non-taxation

The differences in how national taxation systems tax benefits received under employee share option plans are a clear source of difficulty in cross-border situations. For example, complications arise if an employees changes residence during the life of an option or is temporarily assigned to another Member State.

Because of the increasing mobility of employees, and the growth of share options in the EU in recent years, cross-border taxation problems, are viewed as a barrier to the free movement of labour in the Internal Market.

Cross-border taxation problems for internationally mobile employees arise in relation to:

- the fact that the benefits received by employees are not taxed in a uniform way, i.e. certain benefits may be treated as income by some Member States but as capital by others;

- when the employee has worked in more than one Member States the sourcing of the benefits between the Member States, i.e. to which employment and to what extend does the benefit relate;

- the different base on which income tax is charged (e.g. value at grant, value at vesting, gain at exercise, gain on selling the shares, etc);

- the different times at which different Member States apply tax (e.g. on grant, vesting, exercise, sale etc).

The different rules applied by Member States mean that there is a risk of double taxation or even no taxation, particularly when employees move between countries that tax benefits at different times, as explained earlier (see 3.2.2.3.).Although, in theory, the same problems can exist for other forms of remuneration, they are exasperated in the case of share options as employees don't always realise the benefits at the time the services are rendered, e.g. most Member States apply income tax on exercise[37], (see also the *Shell* case study, Annex 5).

Recent studies by the OECD (2002) and DG Enterprise (2003) maintain that the system of double taxation treaties between countries does not fully solve the income tax problems for share options in cross-border situations.

Cross-border problems for employers are mainly related to the deductibility of costs, in particular when the costs are recharged to local group companies. In addition there can be withholding and reporting obligations that vary between Member States and may depend on the structure of the plan.

[37] OECD, op.cit.p.8

3.2.2.3.3. Barriers related to financial, company law and securities legislation

As described in section 3.1.1, share option plans, in common with other employee share plans, are subject to a number of different rules and requirements that govern financial markets, in particular they must comply with national company law, stock exchange regulations and securities law. Despite the growing impact of EU legislation on these important aspects of EU financial markets, there are still major differences between the requirements of Member States.

Companies can source the shares needed to cover share option exercises through a purchasing of shares or though a fresh issue of shares. Both methods of proving the shares are subject to the common rules on capital increases and acquisition of own shares laid down in the second Council Directive on Company Law (of 13 December 1976, 77/91/EEC), unless Member States made special provisions for the adoption or application of employee share plans, as described above. (see 3.2.2.1.1.).

- *Securities legislation* (see 3.1 and 3.2)

For a more detailed list of barriers related to financial, stock exchange and corporate governance rules, which apply to share plans (including share option plans) please, refer to 3.2.2.1.1.

3.2.2.3.4. Labour law and other employment related issues

Although the obstacles related to differences in labour law, labour conditions and industrial relations practices between Member States are generally less problematic than the differences in tax and securities law, there are some specific employment issues that companies should be aware of when introducing a share option plan in different countries, especially in those Member States where broad based plans are relatively uncommon[38] as follows:

- the necessity in some Member States to inform or consult the Works Council, trade union or other employee representatives: potentially there is such an obligation in Austria, Germany, Belgium and France. In Ireland and in Italy, it is desirable. It is advisable in Luxemburg, and finally it is recommended in the Netherlands, Portugal, Sweden and Spain. Although this is generally considered good practice, and in most countries not binding (except in the Netherlands[39]), these procedures may slow down or prevent the introduction of a plan (e.g. if they become wrapped up with other trade union claims on pay and labour conditions);

- non-discrimination requirements between employees on criteria such as gender, race, age and religion: this is common or will be common for all Member States as a result of EU Directives. Other non-discrimination rules apply to share (option) plans, for example based on the type and terms of the employment contract, e.g. open-ended or fixed term contracts and the comparative opportunities offered to full-time and part-time employees. In general, discrimination is only possible based on objective criteria, for example based on a minimum period of employment or company performance measures etc;

[38] European Commission, D.G. Enterprise, op.cit.p. 47

[39] In the Netherlands the Works Council may have a right of prior approval regarding the decision to implement a plan.

- plan entitlement claims: can options become acquired rights for employees, particularly when the plan is offered over several years? Employees may claim that the plan benefits have become part of their employment contract, and that they are entitled to receive the options on an ongoing basis (e.g. as in the Netherlands);

- other employer obligations: can employees claim that plan benefits should be included in the basis for calculating other entitlements, such as severance payments, or redundancy payments (e.g. as in the Netherlands). In other Member States employees may be able to include option benefits when calculating compensation for unfair or unlawful dismissal (e.g. as in Greece) and under Danish employment law, an employee may be entitled to a proportion of the option value, even if the option is unvested and even if the dismissal was not unlawful or unfair;

- the form of acceptance a participant may have to sign: this may be governed by law, e.g. in the UK an employee must given written (and not electronic) permission if deductions are to be made from salary or wages to fund his or her contributions to the plan.

Some problems may be avoided, or the risks reduced, if the employees' rights are specifically set out in the plan documentation and the employees confirm their agreement and understanding in writing to these terms when the award is made (e.g. as in Belgium). For cross-border plans this can cause additional administrative and be time consuming. However it is important to note that even the employees' agreeing in writing to the terms of the plan cannot protect the employer in some instances, e.g. in the UK against claims for unfair dismissal).

-Employee data protection: see 3.1.3.2.

- Language and translation: see 3.1.3.2

3.2.3. Summary and Conclusions

Recent research indicates that of the different financial participation plans, share options (although mostly restricted to senior management and executives) are the most prevalent type of cross-border plan operated across the EU by international groups. This is in contrast to profit-sharing plans that are generally operated on a local basis[40]. The fact that the share option plan is the easiest to export does not mean that employees in different Member States can benefit from these plans to the same extent.

The previous analysis clearly shows how taxation issues are an important obstacle to the broader use of share option plans by companies throughout the EU. Although most Member States tax share options at exercise, not all do, e.g. Belgium. Taxation at grant, especially in a volatile stock market, may act as a barrier to the wider dissemination of share option plans, as has been seen recently in the case of Belgium.

Similarly, the taxation at the allocation of shares that are then subject to a holding or blocking period, and not when the shares are transferred to the employee, may be viewed as a barrier to employee participation in other types of share plans, such as share purchase/savings plans.

---

[40] Van Den Bulcke F., op.cit. 1990, European Commission, 2000, op.cit.

Besides important differences in taxation and social security regimes, the operation of group-wide share plans across the EU is hindered by the different rules and requirements governing these plans in the different Member States. The disparate legal and administrative environment for all types of financial participation plans, especially share plans, without doubt influences the decision of companies whether or not to introduce group-level plans, or to exclude certain countries. This is confirmed by the results of the survey, commissioned by the members of the Working Party in 2003, which we have summarised below.

Although in recent years most attention has been focused on the obstacles to cross-border share plans, the application of common principles to profit-sharing plans by Member States would be welcomed by those multinational enterprises wishing to expand their profit-sharing plans to subsidiaries or business units in the EU preferably under the same conditions as those applying in the home country[41].

Finally, to simplify the reading of this chapter, the table in Annex 5 summarises the main obstacles per type of plan, indicating the barriers and difficulties that are common for different plans and others that are more specifically linked to certain plans.

3.3. The main barriers: the view of employers

The members of the Working Party carried out a survey that was sent to over 900 companies in Europe, practically all based in the EU[42]. The purpose of this survey was to ascertain:

- The barriers companies most often encountered in extending their financial participation plans across the EU.
- The main reasons why they had not extended a domestic plan across the EU, or only to certain parts of the EU.

The full details of the survey questionnaire and the responses received are in Annex 4. We concentrate here on the type of plans adopted and extended by the participants, and the most frequently encountered obstacles for the exportation of these plans across the EU.

Information on current plans

In the context of this report, the participants were questioned about the type of plans they operated and the exportation of their domestic plans to other EU Member States.

Table 1 in appendix 4, indicates that for those replying to the survey (44 companies), share option plans were the most widely used plan and the most common type of share option plan noted was the selective or discretionary plan. The next most common types of plan mentioned were share purchase and savings plans. (Selective) share options were also the most exported type of plan (table 2), followed by broad based share purchase plans. The exportation of other

[41] An international application of profit sharing does not necessarily mean the participation in the consolidated profits of the group. In order to maximise the economic (productivity) and motivational effects, companies will prefer to link the plan to the profits or performance of the local subsidiary or business unit.

[42] 65% (570) of the total sample were companies based in the UK. The response rate was about 5% (44 companies).

types of broad based share plans (free shares and share savings) and to a lesser extent profit sharing plans appears to be less common.

By asking companies to indicate to what extent their plans were available to employees in the other international jurisdictions in which they operated (to all, most, some, or none), the survey provides interesting information on the difficulties enterprises encountered or perceived that may have acted as a barrier to their extending plans to their subsidiaries and affiliated plants across the EU (see table 3).

Looking at the all employee plans, it appears that respondents considered share option plans to be the easiest plan to operate internationally, as 60% of the plans were offered in all or most of the undertakings in other countries where the enterprise operated. For share purchase plans the results are rather mixed, as more than half of the plans (53%) are not exported at all, or only to a few countries. This is even truer for savings plans (69%) and free share plans (64%). In contrast, 41% of the broad based profit sharing plans are operated in all jurisdictions, but 35% are not applied outside the home country (see table 3).

Obstacles for the exportation of plans

In terms of barriers encountered by companies, based on the survey results, these can be categorised in order of importance as:

- Differences in legal frameworks supporting financial participation;
- Lack of tax or social security incentives;
- Overly complicated securities requirements;
- Differences in regulations and restrictions in labour law;
- Little tradition of share ownership by employees.

Barriers that prevent companies from extending their plans in the first instance were listed as (again in order of importance):

- Lack of tax incentives;
- Legal restrictions;
- Cost and complexity.

3.4. Conclusion

The responses to the survey questionnaire with respect to the main barriers show a clear picture that supports the analysis in the report and the view of the Working Party. The examples given by companies of the most frequently encountered obstacles in practice underline and illustrate our analysis of the main barriers per type of plan. However it does suggest the need for some differentiation in the degree of importance attached to the different barriers, i.e. some is considerably more important than others. For example, this seems to be the case for labour law and social issues, and issues arising out of employee protection and consultation are mentioned. However with a number of other legal issues, it is not so much

the existence of these requirements in the Member States that creates the obstacles to employees' financial participation, but the lack of a more coherent and consistent framework across the EU.

A more uniform approach by Member States to the main types of financial participation plans, and the removal of a number of barriers, which we explored in this chapter, would mean a further step in the realisation of a unified internal market. This will be the subject of the next chapter.

4. STEPS THAT WOULD HELP TO ELIMINATE THE BARRIERS AND PROMOTE FINANCIAL PARTICIPATION

4.1. Community policy on financial participation

As explained in Chapter 1, Community policy goes back to 1992 when the Council adopted a Recommendation that invited Member States to acknowledge the benefits of the wider use of financial participation.

More recently, at the Lisbon Summit in March 2000, the leaders of the EU set an objective of becoming "the most competitive and dynamic knowledge-based economy in the world, capable of sustained economic growth with more and better jobs and greater social cohesion"[43].

The Lisbon Summit was shortly followed by the inclusion of financial participation in the Social Policy Agenda of the Commission in June 2000 and by the adoption of the Commission's Communication in 2002. Both texts acknowledge that financial participation can make an important contribution to meeting the Lisbon objectives. Many studies have indicated that, if implemented in the right way, financial participation can improve the productivity, competitiveness, and profitability of enterprises and at the same time it can encourage employees to become involved, improve the quality of their work, and contribute to greater social cohesion. If financial participation, in its various forms, can achieve these aims and is favourable to both employers and employees, it needs to be clearly and vigorously promoted throughout the EU in order to make it possible to meet the ambitious aims set by the European Council at Lisbon.

As we have seen, since the early Pepper initiatives, cross-border financial participation has grown because of the tendency of enterprises to "Europeanize" themselves by acquiring, creating and developing subsidiaries in other Member States. Consequently, the cross-border aspects of financial participation affect an increasing number of enterprises and employees[44]. It is probable that more than 10% of the employees working in one Member State are employees of subsidiaries of enterprises that are based in other Member States. Because of this, financial participation cannot be seen just in a solely national context, as reforms made in one Member State indirectly affect employees working for enterprises based in other States.

---

[43] Lisbon European Council, in http://europa.eu.int/comm/lisbon_strategy/index_en.html

[44] For example, in one survey undertaken in 2000, 6,728 subsidiary companies of French enterprises established in the fifteen countries of the EU employed 1.8 million people, "The spread of French companies in Europe", the Bleus Notes of Bercy, N° 241.16 of 30 November 2002.

But as we documented in Chapter 2 a great many differences exist between the types of plans that are found in Member States and Chapter 3 shows how these differences can create considerable barriers to the development of cross-border plans. Moreover, some Member States have no mechanisms whatsoever to promote financial participation. The multiplicity of barriers has an impact on both the development and functioning of the Single Market, leading to inequalities of treatment and reducing the mobility of enterprises at a time when they face an increasing need to implement a common management and apply the same or similar motivational programmes across the EU in order to compensate for an increasing diversity and heterogeneity at the social, managerial and cultural level. But if enterprises in the EU come up against, on their own territory, many and costly obstacles, or even increasing complexity, they will in addition have to face a competitive disadvantage in relation to their American counterparts, who operate in a more unified economic area, where these obstacles and their associated costs do not exist to anything like the same extent.

We therefore believe it is essential that the Member States and the Commission act to remove these barriers. This Chapter therefore considers what steps could be taken to remove some of the barriers that prevent the spread of financial participation across the EU.

4.2. The impact of barriers on different cross-border plans

Most enterprises that want to put in place cross-border financial participation will want to put in place arrangements that will deliver the same or similar benefits to their employees across all the different Members States in which they operate. For some, it is important to use the same type of plan throughout. The *Shell* case study is a good example of a single global plan. The type of plan chosen largely determines the extent to which this is possible. As we saw in earlier Chapters, putting in place a global share option plan is considerably easier than a global profit sharing plan. For some enterprises however, a more flexible approach is desirable and a basic plan is adapted in each Member State to suit particular legal requirements or to obtain local tax incentives. Such a plan can also be used to reward performance at local as well as the top corporate level. The *DaimlerChrysler* plan would be an example here.

In broad terms, the barriers that we have identified in relation to cross-border plans will have a greater impact on those enterprises that want to have a global plan and are less flexible in the type of plan they wish to put in place. Sometimes an enterprise will put in place a plan in its home country and across other Member States at the same time. Very often however, the plan develops in the home country and is extended abroad later and it is not practicable to start again in the home country with a brand new plan. But as management of the enterprise across the EU becomes more homogeneous and as the Single Market develops, there may well be stronger demands for a global plan.

4.3. Recommendations

Our recommendations focus on two main areas. They look at ways in which the Member States could remove existing barriers and avoid the creation of new ones through greater understanding and co-operation, as well as considering how some of the current barriers could be alleviated.

In brief they cover:

- Improving the general approach to financial participation.

- Resolving current problems arising from differences in securities and taxation laws.

4.3.1. Recommendations on improving the general approach

This can be done by:

- developing a better dialogue among the Member States and the social partners,
- promoting information sources and spreading knowledge and best practice, and
- fostering greater co-ordination through mutual recognition and the development of a model plan.

4.3.1.1. Developing a better dialogue within the Member States

As part of its Communication on Financial Participation, the Commission will promote the organisation of national conferences bringing together all the key stakeholders in the field of financial participation with the aim of transferring information and experience across Europe. It will also undertake a benchmarking exercise of national policies and practices.

While the proposed conferences and the benchmarking study should be helpful in providing a more structured exchange of information, we think that the Commission should do more to develop the awareness of Member States as to how policies on financial participation are developing generally and in particular how they are developing in other Member States.

We therefore recommend **that the Commission should establish a consultative "Committee on Financial Participation"** for the life of the next Commission, beginning in November 2004.

Such a Committee should be made up of representatives from all the Members States and from European level social partners, including SMEs. The representatives from the Member States should be high-level officials competent in the field of financial participation or, if more appropriate, independent experts nominated by Member State governments. Member State representatives would also be required to consult their social partners.

However, as such a Committee would be inevitably a large group, we recommend that a smaller Steering Group should assist it. This Group would be made up of nominations from the main Committee and would include Commission officials. It would also invite other experts and practitioners to participate on an occasional basis.

The role of the Committee on Financial Participation would primarily be to disseminate information, but it would also have an important role to play in providing non-binding advice and guidance to the Commission on areas of Community policy that have implications for financial participation[45].

[45] An example would be the EU Prospectus Directive which will have a significant impact on employee share plans, as it will remove the need to obtain approval for, or exemption from, issuing a prospectus to employees in every Member State in which the offer to employees is made.

The activities of the Committee should be focused on greater awareness and knowledge of how financial participation is developing across the EU Member States. In particular the Committee should be instrumental in promoting:

- Detailed information. The Committee should discuss what is happening in each Member State in this field.

- Research. The Committee should commission original research and studies (for example into the impact of financial participation on economic performance) and disseminate the results of research generally in this field.

- Good practice. The Committee should pool expertise (for example on what is effective in terms of greater productivity or employee involvement) and inform the members of good ideas.

- Benchmarking. The Committee should undertake a benchmarking programme of all 25 Member States, evaluate the results and consider what further actions are needed.

The Committee should determine the number and type of meetings, but we would recommend that:

- The Committee should prepare a report for the Parliament, Council of Ministers, the Economic and Social Committee, the Committee of the Regions and the social partners at least for each mandate and more often if necessary.

- The Committee should convene a forum at which it meets once a year to present its work and the work of the Steering Group and discuss views on current topics.

Creating this opportunity for much greater dialogue among the Member States should help to remove some of the most important barriers that affect both profit sharing and employee share plans and this will facilitate the development of financial participation across the EU. Moreover, it will encourage Member States to consult each other more when they are considering reforms, so that they prevent the creation of additional or new barriers.

4.3.1.2. Improving dialogue with the social partners

We have noted, with some disappointment, that despite the well-documented benefits that financial participation may bring to both enterprises and employees, it features rarely, if at all, in the future plans of the social partners.

In some Member States the progress of financial participation has taken place in close co-operation with the social partners and has relied heavily on their support. Lack of interest as well as support from the social partners can itself act as a barrier to the development of financial participation.

Both employer and employee-based organisations have an important role to play in encouraging Member States to remove the barriers to financial participation and to introduce incentives. Employer organisations have a role in disseminating information to their membership about the different types of financial participation plans and how they work. Trade unions and other employee representative bodies have an equally important role in

educating employees about plans and encouraging their members to have a positive attitude towards financial participation.

We therefore recommend that **the social partners should develop a greater awareness of financial participation and its benefits by including this in their plans and work programmes from 2004 onwards and should incorporate ways in which they can disseminate information and greater understanding to their membership.**

Moreover, a study of financial participation by the European Parliament46 emphasises that both profit sharing and employee share ownership "have more impact on productivity when employees are well informed of the internal business of the company, if there is a good communication with the management and if employees take part in the governance of the company and in decisions".

Given the existence of European Works Councils within the larger enterprises in Europe, it would be appropriate that the question of implementing a financial participation plan at the enterprise level is regularly put on the agenda, for example every five years. The enterprise and employee representatives on the Works Council would not be obliged to implement a plan, but at least the question would have been raised.

4.3.1.3. Improving knowledge and awareness among the Member States

A fundamental problem for cross-border financial participation is how a plan is going to be treated in a Member State. In the absence of clear rules for that particular type of financial participation plan, the general rules applying in that Member State to offers of shares to the public or to savings instruments, whatever the case may be, would probably apply, with or without any modifications. As we have seen in Chapter 3, this in itself can create considerable barriers to exporting a plan. In addition there is likely to be no clear understanding as to the tax status applying to the outcomes of particular plans, whether the result would be taxed as employment income (like wages or salary) or as investment income or as a capital gain.

While it is always possible to obtain professional advice from lawyers or accountants on how a particular plan might be viewed, there is often no way that an enterprise can obtain general high-level information from Member States directly and free of charge. We therefore recommend that, in order to address this gap, **the Commission should help to provide such advice and guidance from the Member States by establishing a website**.

The main purpose of such a website would be to explain how the basic types of financial participation, as set out in this Report, are treated in each Member State. This would cover compliance with their laws governing the issue of shares, financial instruments, taxation and social security contributions, that will apply as regards both the enterprise and employees that could participate. The website should also contain details of the relevant government departments and officials with responsibility for these areas and their contact addresses. This should cover the legal, regulatory and taxation aspects and therefore more than one government department or agency would need to be included. There should also be links to Member States' own websites and to external sites that provide helpful information.

---

[46] "Employee participation in Profit and Share Ownership: a Review of the issues and evidence", by Virginie Perotin and Andrew Robinson. European Parliament, Directorate General for Research, Working Paper, Social Affairs series SOCI 109, EN.

In addition, we recommend that this should also include examples from enterprises that have put in place some form of financial participation and, where available, information on the number and type of financial participation plans in place in each Member State. The website would also be a vehicle for publishing the work of the Committee on Financial Participation and associated research, surveys and other useful papers.

This website should be located within the Directorate of Employment and Social Affairs website and we recommend that **the Commission should set aside funds for a period of three years to develop and host this site**. It would be essential that information is kept up to date.

4.3.2. Recommendations on removing existing barriers

4.3.2.1. Tackling the current differences in securities laws

Rules governing the issuing of shares to the public, which includes employees, affect every share-based financial participation plan offered to employees in the EU. The need to issue a prospectus to employees, what it must contain and whether there are any exemptions for offers to employees, vary considerably across the EU and are seen as a major barrier to cross-border financial participation. This is because complicated requirements may lead to considerable extra expense and can delay implementation, and may even result in a plan not being offered in a particular Member State.

As part of the creation of the Single Market within the EU, the EU Prospectus Directive will bring in a common approach to public offers of shares and in particular to the requirements of publishing a prospectus. This will have major implications for all financial participation plans, whether or not they go across borders.

Because of the additional cost and time involved, enterprises would generally favour a complete exemption across the EU from the requirement to issue a full prospectus to their employees when introducing a share-based financial participation plan. The majority consensus of Member States however was that some measure of investor protection was desirable, especially when employees are being asked to contribute to the cost of acquiring shares. The final Directive does however include a number of exemptions and exceptions that may be used for financial participation plans as well as a specific exception for shares provided to employees.

There is a general exemption from the Directive where the shares are part of an offer, or offers, where the total consideration is less than € 2.5 million in any 12-month period.

In this case the offer will be dealt with under the domestic law of each Member State in which the offer is made. We would recommend **that Member States should consider carefully the potential barriers to promoting cross-border financial participation when drawing up the national legislation necessary to implement this Directive**. Ideally we would like to see Member States introduce either a clear exemption for employee share plans in these circumstances or a shortened document of the form outlined below.

There are also two general exceptions where the offer is one that falls within the Directive but there will be no obligation to produce a prospectus. These will apply where the offer is addressed to less than 100 persons per Member State or where the offer has a total consideration of less than €100,000 over any 12-month period. These exceptions will be

helpful to smaller companies and to those offering discretionary plans to limited numbers of executives, but will not help larger companies with all employee plans.

The specific exception from the obligation to publish a prospectus for employee financial participation plans is available when shares in the enterprise are already listed on a stock exchange in the EU and provided that a shortened form of prospectus document is made available to the employees "containing information on the number and nature of the securities and the reasons for and details of the offer"[47].

This should be helpful in reducing the burden on enterprises wishing to put in place all employee plans. However there are two remaining issues to be resolved.

Firstly, there is no requirement within the Directive for the Commission to adopt any implementing measures in relation to the shortened form of prospectus. Without any further guidance from the Commission, Member States will be free to interpret this as they wish. Our concern is that this may re-introduce some differences of view and approach and will not remove the complications that currently exist. We therefore recommend that, with the assistance of the proposed Committee on Financial Participation, **the Commission should prepare guidelines on this document, which could be adopted by the competent authorities in each Member State**. The Expert Group has already considered a number of criteria that the Committee could include in its discussions[48].

Secondly, enterprises whose shares are not listed on an exchange within the EU, such as private companies or large multinationals with shares listed outside the EU, will be required under the Directive to produce a full prospectus whenever they offer shares to their employees based in the EU unless they fit within any of the other exemptions or exceptions. For some plans, this could be as often as every month. This will be a major barrier to many enterprises and will seriously hinder the development of financial participation generally by these types of enterprises, depriving many employees in the EU of this opportunity. We therefore recommend that, when drawing up the national legislation necessary to implement

---

[47] This exemption is found in Article 4.1(e) in relation to an offer of shares to the public and in Article 4.2(f) in relation to shares admitted to trading on a regulated market in the EU.

[48] The criteria are as follows:
In relation to large enterprises or in the case of an all employee plan, employees should each receive a concise summary of the plan, including an explanation from the enterprise on the motivation for offering shares to them. Subject to any existing rules on language, it would be best practice for this to be provided to employees in their local language or languages. This should be available to employees either electronically or in paper form as appropriate.
Alternatively, where the number of employees employed in a particular Member State is small, documents could be provided in another language if employees or their representatives agreed to this, again subject to any existing rules on language provision.
There should be an exemption from the requirement to translate documents in the case of SMEs and in respect of discretionary plans.
Employees should have access to the “fundamental documents” including financial reports either themselves or through their appointed representatives – including trade unions, employee representatives, or trustees where shares are held in a trust for the benefit of employees.
As provided for in the Directive, documents can be made available through a website or company Internet. Any employee or any of their representatives that has difficulty in accessing electronic documents should be able to obtain paper copies on request.
Any exemption from a full prospectus or shortened document would not affect the employee’s rights once he becomes beneficially entitled as a shareholder to receive subsequent documentation and reports in whatever format is normally available to shareholders.

this Directive, **the Member States should allow such enterprises wishing to use a shortened form of prospectus, equivalent to that applying to enterprises that qualify under the Directive for this exception, to do so**.

4.3.2.2. Agreeing on common rules or procedures for internationally mobile employees

Differences in tax and social security contributions between Member States are undoubtedly a key barrier to the spread of financial participation in the EU. In addition to the lack of certainty surrounding the tax status of financial participation plans in certain Member States, the same participation in a plan across different Member States can be subject to a different type of tax (e.g. income tax or capital gains tax) or the incidence of taxation varies (e.g. on grant, vesting, exercise or sale).

A good example is the different approach taken to the taxation of options across the EU. While Belgium taxes the employee when a grant of share options is made and the Netherlands taxes an employee when the option vests subject to an election to be taxed on exercise, the other Member States will normally only tax the employee when (and if) the options are exercised and will do so at the time of exercise on the gain made on that event. Further complications arise with regard to the type of tax and the taxing point when the plans are "tax favoured", "tax qualified" or "tax approved".

Problems arise when an employee moves from one part of the enterprise to another across an EU border while participating in a share option plan. For example, having been granted an option while resident in one Member State, the employee is resident in another Member State when the option is exercised, and may even be resident in a third Member State when the shares are sold. Double taxation on the same amount – or even no taxation may occur – if Member States apply different rules to either the timing of the tax charge or to its treatment as employment income, investment income or capital gains. Resolving these issues is costly and takes considerable time. Employees also only rarely receive the full benefits they are entitled to under double tax treaties in relation to, for example, reduced withholding rates on dividend income.

We therefore welcome the work that is being done in this area by the Organisation for Economic Co-operation and Development (OECD). The OECD's Committee on Fiscal Affairs is working on a protocol to the OECD Model Treaty that should provide a basis for an internationally accepted way of allocating taxing rights between jurisdictions. Once agreed, Member States may consider adopting this revision when revising their bilateral treaties with other Member States in the EU.

This is however likely to take many years to become an effective answer. We recommend therefore that the **Member States should consider the introduction of an EU-wide Convention** that would agree on a consistent approach to share options as regards the allocation of taxing rights and social security charges when employees move across borders. This approach could equally apply to other types of financial participation, but as the concept of a share option is simple and generally interpreted the same way by all Member States, which is not always the case for other types of financial participation, the desired result is most likely to be achieved in the first instance with options. This is why we have advocated it here, rather than because the Working Party considers that share options should be particularly privileged in any way. This would be similar to the first stages of the EU

Arbitration Convention, an agreement between Member States that provides a practical solution to transfer pricing disputes between Member States.

4.3.2.3. Developing mutual recognition of plans and savings funds

As we have seen, where there is a legal framework operating in a Member State that supports a specific type of financial participation plan, exporting that plan in its original form to employees in other Member States is often very difficult, if not impossible. One possibility is that some adjustments can be made that result in a version of the plan that can be offered to employees in another Member State. But even if legally possible, producing variations of a plan can be costly in terms of professional advice and is time-consuming.

A major barrier arises from the fact that the specific legal framework of a financial participation plan is often intricately linked with the provision of a particular tax status or specific relief from tax or social security contributions for the enterprise or the employees. Hence, even where there may already be a legal framework or recognised savings funds to hold employee contributions in a Member State that would support the introduction of a similar plan to that found in the enterprise's home Member State, it will usually be very difficult to access the same tax or social security benefits. This hinders the development of cross-border plans as it makes plans less efficient. It creates inconsistencies and reduces the cross-border mobility of key employees.

One solution would be the **development of a mutual recognition procedure by Member States for financial participation**. This could take two forms.

The easier application of mutual recognition would allow a mobile employee who moved to another Member State while participating in a plan, the possibility of retaining the tax and social security treatment and benefits that he or she would have been entitled to under the laws of the first Member State if he or she had remained there for the duration of the plan.

A more ambitious form of mutual recognition could be for Member States to recognise a plan drawn up under the laws of another Member State as equivalent to a plan drawn up under its own laws and provide equivalent benefits. This would go beyond considering issues simply for internationally mobile employees and would enable an enterprise wishing to offer the benefits of a plan drawn up under the laws of its home Member State to all of its employees in another Member State to do so. For example, the UK could treat a French PEE as fulfilling all the conditions for tax relief that apply to a UK Share Incentive Plan. At present these plans are very similar, aside from primarily a difference in the length of the required holding or blocking period that affects when the shares can be released to the employees and their subsequent tax treatment. Under a mutual recognition procedure, a French PEE could be used for all the UK employees of a French-parented enterprise and these employees would then be entitled to the same local tax and social security benefits as though they were participating in a UK Share Incentive Plan.

Mutual recognition could also assist the cross-border development of plans with savings elements. For example, where the employees of a French enterprise make contributions under the French law to an FCP (a Fonds Commun de Placement) a major difficulty arises in expanding this type of plan into another Member State because such a fund falls outside the

undertakings for collective investment in transferable securities found in the UCITS Directive[49].

The UCITS Directive ensures freedom of movement of undertakings for collective investment in transferable securities but only if the fund is open to the public and follows strict diversification rules. But many of the FCPs are restricted to employees' contributions and the capital is invested only in the shares of the enterprise. In this case, employees outside France are not always able to hold their contributions in a FCP and another savings vehicle must be used.

A possible solution would be to introduce **a separate Directive that would ensure the mutual recognition of funds** that derogate from this principle of diversification, defining carefully the potential beneficiaries (employees, former employees, pensioners). This Directive could also possibly harmonise the rules covering discounts and establish free choice rules between several different investment products for beneficiaries.

Mutual recognition, whether or not it is voluntary, as in the first two examples, or legally binding as in last example, is nonetheless a major step and would require considerable co-operation between the Member States. However it has already happened to some extent in the case of pensions and we think there are some areas where it could work now in respect of financial participation. We look to those Member States with the most experience of financial participation to take a lead and to use their best efforts to remove barriers through mutual recognition procedures. We think this approach could initially work in those cases where the plans, or the vehicles they use, are fundamentally similar but there are relatively minor differences, such as different maximum discount rates applying to the purchase of shares or the exercise price of an option or the maximum length of periods over which shares are held in a trust or blocked. Moreover, in a more general way, a mutual recognition procedure could lead over time to a growing harmonisation of Member States' laws.

4.3.2.4. Building an EU model plan for financial participation

As an alternative, or supplement, to a system of mutual recognition that is based on plans drawn up by the Member States, an EU model plan would place at the disposal of enterprises a Community-wide instrument that would remove barriers and also promote cross-border financial participation. **We recommend that such an instrument be drawn up by a group of experts appointed by the proposed Committee on Financial Participation**.

As a first step, such a plan could incorporate some or all the principles set out by the Commission in its Communication[50] and all relevant Community-level law:

- Participation should be voluntary for both the enterprise and employees
- Access should normally be open to all employees

---

[49] Council Directive 85/611/EEC of 20 December 1985 on the co-ordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) *Official Journal L 375, 31/12/1985*

[50] "*On a Framework for the promotion of Employee Financial Participation*" Communication from the Commission to the Council, the European Parliament, the Economic and Social Committee and the Committee of the Regions" COM (2002) 364 Final 5 July 2002

- It should be set up and managed in a clear and transparent way
- It should use a pre-determined formula that should be linked to an enterprise's performance or results.
- It should be applied regularly basis rather than on a one-off basis
- It should avoid unreasonable investment risks for the employees
- It should not be used as a substitute for wages or salary
- It should comply with the Information and Consultation Directive, requiring enterprises to consult with their employees before a plan was introduced but would not require prior negotiation or agreement with employees or their representatives
- It should comply with EU labour law and should not treat the opportunity of belonging to the plan as an "acquired right" or as an item to be included in compensation for dismissal or as part of a basis for pension provision
- It should contain rules based on EU legal and regulatory requirements, such as the Prospectus Directive and UCITS Directive.

The model would initially be adaptable in each Member State to cover national tax and social security laws, in a similar way to the European Company Statute.

As a first step towards greater co-ordination, the model could however incorporate a set of taxation and social security principles. These would determine whether income arising in a Member State was to be treated as employment or investment income or as capital gain and when the incidence of taxation arose. Member States would remain free to decide whether or not to offer enterprises that adopted the model plan, or their employees, any specific tax or social security benefits.

As a further step however, a Member State could decide to award the model plan "most favoured nation" status. This would mean that an enterprise adopting the model plan, and the employees participating in this, could not be treated any less favourably than that Member State treats its own nationals using an equivalent plan drawn up under its own tax and social security rules.

For example, a French enterprise with a subsidiary in Spain could set up a model plan for its French and Spanish employees. The French employees would receive the same tax and social security benefits as though they were participating in an equivalent French plan, such as a PEE, and the Spanish employees would receive the equivalent benefits available to a Spanish employee participating in a plan drawn up under Spanish law.

This may of course mean that, if there are currently no national laws providing tax or social security benefits, no similar benefits will be available to those enterprises or employees participating in the model plan. **In this situation we would recommend that each Member State provides specific tax and social security benefits for the model plan**. In a later step, minimum levels of taxation and social security contributions could be established at Community level.

We see a model plan as eventually providing a blueprint for the main types of financial participation (profit and gain sharing, share purchase, share award and share options), although we recognise that it may be easier to start with one or two types of plan.

Share option plans would be an obvious category, not because we favour the development of share option plans over other forms of financial participation, but because enterprises have remarked that this is a particular problem for them in practice and because the Working Party feels that this would be one of the easiest areas in which to establish common principles. It is also an area where the majority of Member States have already moved to a common taxation position.

An Expert Group working with DG (Enterprise) focusing on SMEs has considered in detail how such a position might be established[51]. We would endorse their conclusions as forming the basis for a discussion within the EU of common taxation principles that could be adopted by Member States in relation to a model plan for share options.

Eventually, we would like to see the Member States move to a position of much greater co-ordination and harmonisation of tax and social security rules in this area and provide common benefits for all participants in a EU model plan. This would at present have to be agreed unanimously by the Member States.

The existence of a model plan would remove many of the existing barriers and enable multinational enterprises to spread financial participation to their employees across the EU. It would provide certainty of treatment for both the enterprise and employees. It would significantly reduce the costs of putting in place a cross-border plan that would be particularly helpful for SMEs wishing to do this. It would, however, also create a minimum framework for financial participation plans in the Member States that currently have no or few provisions for financial participation, in particular among the Accession Countries.

We recommend that the model plan should be available to any enterprise, even if its activity is currently restricted to only one Member State, rather than reserving it for companies operating in several Member States. This would prevent enterprises having to adapt their plans if they subsequently expanded across the EU. We feel that this initiative would be particularly useful for Member States where financial participation is still

---

[51] "The Taxation Of Stock Options In the EU" sets out the following criteria for a set of common taxation principles:
Employee share options should constitute employment income for the purposes of taxation and social security charges.
Options should only be taxed at grant if they are tradable and if their value can be clearly ascertained (e.g. because they are traded on a stock exchange)
Where employee share options are not freely tradable, they should, as a general rule, be taxed on exercise. In this case the taxable benefit should equal the value of the acquired shares at exercise less the exercise price and other costs necessary to exercise the options, in particular any price that might have been paid for the option.
Any increase in the value of the shares after exercise should be considered as a capital gain and should be treated accordingly.
If restrictions apply to the sale of the shares, taxation should not take place at exercise but only when the restrictions are lifted (i.e. at the "vesting" of the shares). The tax base should be calculated as the difference between the value of the shares at vesting and the expenses necessary to exercise the options (see above).

developing but would also have benefits for any Member State that was thinking of introducing new incentives or changing their existing laws.

4.4. Conclusion

Even with greater understanding and dialogue, sharing of information and increased co-ordination, large differences will continue to exist between the regimes applying to financial participation across the EU. The recommendations outlined above will in stages alleviate the barriers and provide opportunities to align the benefits from financial participation across the EU. They can however only go part way in removing all the fundamental differences that arise from very different policy considerations in Member States.

ANNEX 1
Experts

a. M. Jean Baptiste de Foucauld (President) French Economist : Mr de Foucauld is working since 1969 in various posts in the French administration. As General Inspector of Finances, he drafted with Jean-Pierre Balligand, a Member of Parliament, a report for the Prime Minister called "L'épargne salariale au coeur du contrat social", January 2000. He was in 1982 Rapporteur of the French Commission for the protection and development of savings, and from 1982-1984 Technical counsellor for monetary and financial issues of the office of Jacques Delors, Minister of Economy and Finances. From 1988 to 1995, he worked at the French "Commissariat Général du Plan", as "commissaire-adjoint" and "commissaire". From 1996 he is Administrator of the "Caisse nationale d'assurance vieillesse" and from 2000 member of the "Conseil d'orientation des retraites". Président of the NG'O "Solidarités nouvelles face au chômage", he is the author of several books concerning employment and social policy. Mr. de Foucauld was also rapporteur of the High-level Group chaired by Mrs. Pintasilgo in 1996 and related to "social and civic rights in Europe"

b. Mr. Paul Sweeney, Irish Economist. He worked from 1977 to 1980 in the public Administration, Revenue Commissioners, Inspector of Taxes and Accounts. From 1980 – 1999 SIPTU, Ireland's largest Trade Union, Senior Research Economist. From 2000 until now he is a self employed business and financial advisor, mainly to unions on corporate re-structuring, change management and advising on employee share schemes. Mr. Sweeney has served as a director of Ireland's largest company for 5 years and is on the board of a telecoms company where he represented the employees' 20 per cent stake. He has sat on a number of Irish government advisory committees, including the Competition and Mergers Review Group, the Company Law Review Group. He has written several books, including "The Celtic Tiger: Ireland's Continuing Economic Miracle." He is a Council Member of the Statistical and Social Inquiry Society of Ireland. Mr. Sweeney has been proposed by ETUC

c. Mr Arnold J. Ouweneel, Dutch Lawer. He worked from 1975-1986 with the Ministry of Finance, Head of Wage Tax department and as from 1987-1998 he is a tax consultant. Since 1998, he is manager of the "Personal Tax " Unit in the company Shell International plc, Den Haag in the Netherlands. He is responsible for the application of relevant schemes in his company. He is also a member of the experts' group on "stock options" organised by Directorate General "Enterprise" of the Commission. Mr Ouweneel has been proposed by UNICE

d. Dr. Christa Neuhaus, German Lawyer. From 1990 to 1993 she was legal practitioner and until 1994 she was appointed Judge at the Landgericht Stuttgart. Since 1998 she is a senior executive manager at the Department of Social and Labour Law and Labour Relations at "DaimlerChrysler AG", Stuttgart and is responsible for the application of employees' financial participation schemes in this company, not only in Germany, but also in subsidiaries in other European and non-European countries. Mrs Neuhaus has been proposed by "European Round Table" of Industrialists (ERT).

e. Mrs Diane Hay, British Economist. As from 2000 up to now, Mrs. Hay is the Chief Executive of ProShare, which is the leading not-for-profit organisation in UK that promotes employee share ownership. From 1977 to 2000 she worked in the British Administration, in the Inland Revenue, the UK direct tax authority. Until 1993 she was Assistant Director in the International Division, and later the person responsible of the Local Services in London and

finally from 1997 a Deputy Director in charge of the "Share Schemes Unit ". In her latter position she had the responsibility for all the policy, technical and operational aspects of employee share schemes and other forms of financial participation. She worked on the design of the two new share schemes in UK, the Share Incentive Plan and the Enterprise Management Incentives. She ran the first series of Revenue/ProShare Roadshows (financial education plans) in UK. ProShare is a consultative body close to the UK Government and offers also financial education to individuals and to the social partners.

f. Prof. Francine Van den Bulcke, Belgian Economist. From 1965-1972 she was Assistant for Microeconomics and Labour Economics in the University of Gent. She is nowadays a professor in economics at the Catholic University of Brussels, Belgium (KUB, Flemish) where she founded the Research Institute for Financial Participation in 1989. Since many years she has been active in the field as a researcher, she published a book (1990) and several articles and studies on employee profit sharing and worked for international organizations as the ILO. She contributed for the drafting of the Commission's report PEPPER I (1990 Promotion of Employees Participation in profits and enterprise results) and PEPER II (1996), and she was responsible for the study "An employer's perspective on financial participation in the European Union, Objectives and Obstacles" (2000) financed by the Commission.

g. Mrs Carol Dempsey, Irish Economist. Since 1988 up to now Mrs Dempsey is a Partner in the firm Pricewaterhouse & Coopers, Human Resource Consulting practice, in London. She is specialised in share plans and employee incentives. Mrs Dempsey advises on both tax efficient domestic plans and plans for companies operating globally or with internationally mobile employees. Her experience covers areas relevant to company law, tax and accounting issues and securities. Mrs Dempsey was responsible for the study on national legislations on "stock options" run by the Commission, Directorate General "Enterprise".

h.The group has also been assisted in its work **by Dr. Petra Höss-Löw German Lawyer** executive manager at the Department of Social and Labour Law and Labour Relations at "DaimlerChrysler AG".

ANNEX 2
Terms of reference

The political context

Employee financial participation had for a number of years a long and successful tradition in a small number of Member States. However, new countries have now embarked on initiatives, which aim at promoting a more favourable environment for the introduction of financial participation schemes.

Recently, new legislation and new initiatives are adopted in a number of countries, including **Belgium**, **Ireland**, **Finland**, **Austria** and the **Netherlands**. Further measures are also introduced in **France** and the **UK**. In **Italy** employee financial participation has been included in a recent White Paper on labour market reforms. In **Germany and Spain** there have also been renewed appeals to the social partners to take up financial participation as an issue in collective bargaining. And in countries such as **Finland or Ireland** steps are already made in the direction of extending financial participation to the public and non-profit sector.

The positive experiences with financial participation schemes in many countries have certainly contributed to putting this issue on the political agenda throughout the EU. In particular the experience of the US shows the important impact financial participation can have in terms of economic growth, fostering industrial change and making sure that all workers participate in this growing prosperity.

The Problem

Now-a-days a growing number of enterprises have started to realise the potential of employee financial participation schemes, which in Europe both with the relevant national policies are characterised by a huge diversity. These differences imply obstacles to the use and development of employee financial participation at a transnational level for those undertakings, which, having secondary establishments in countries other than the State of their main establishment, wish to extend plans across frontiers.

Differences in tax systems, in social security contributions, in the general legal framework and cultural differences make it very often impossible for enterprises to develop and apply a common financial participation scheme across Europe. This implies that employees in different countries will in fact not be treated equally even though they participate in what should be the same financial participation scheme.

Moreover, existing differences can act as a barrier to the free movement of workers and in some cases also to the free movement of capital, especially where they give rise to problems of double taxation.

a. Differences in taxation are the first main problem, which can imply substantial administrative costs for enterprises wishing to introduce financial participation schemes in different countries.

b. Differences in the treatment of income from financial participation with regard to social security contributions can add to the complexities involved in introducing such schemes.

Thus, the level of social security contributions may deter firms from extending financial participation schemes to certain countries.

c. Legal differences between Member States in the case of share-ownership plans, differences in securities laws and in particular in relation to prospectus requirements can be problematic. A fundamental problem may be the general lack of mutual recognition. Specific problems may arise also in relation to employment law, concerning for instance eligibility criteria or the termination of contracts, including severance pay or the portability of shares or stock options. Differences in data protection laws can also complicate the actual administration of financial participation schemes.

d. Enterprises may further encounter problems because of cultural differences, different attitudes towards financial participation, different national traditions or differences in industrial relations systems. The introduction of financial participation schemes at an international level is also hampered by a general lack of information about existing financial participation schemes or policies. Overcoming this lack of information may be prohibitively costly especially for smaller enterprises and may deter them from even contemplating the introduction of such schemes. In addition, this lack of information can also limit the potential for national authorities being willing to recognise existing financial participation schemes in other countries and making it possible for employees in the home country to participate to them.

The mandate

The task for the High Level Group will be to propose recommendations addressed to European policy makers and social partners aimed at alleviating these obstacles.

The driving force of the mandate for the high level group will be to find solutions, which would make it easier for enterprises to introduce financial participation schemes at European level, for the benefit of both the workers and the enterprises concerned.

The High Level Group will first draw down a list of the various categories of obstacles, and will examine several possible ways out. It has to be beard in mind that there is no intention to propose legislation concerning the various fields where the obstacles exist, nor a full-scale harmonisation of existing rules on financial participation schemes. The group may of course assess the negative effects these obstacles may have as to the free movement of capital and workers or to the freedom of establishment.

Proposed approach

Without prejudice of the High Level Group's autonomy to establish its methodology, the group shall possibly build its expertise and knowledge about obstacles faced by companies, trade unions, works councils, by conducting interviews, launching questionnaires, surveys, etc or by obtaining additional knowledge through existing studies.

Reporting and final output.

The group will deliver its final report before summer holidays 2003. By the end of spring 2003 the group will deliver an interim report.

ANNEX 3
List of hearings

Ms. E. Stringfellow, an expert representing the European Union of Craft Industry and SMEs (UEAPME) who has been invited to give an overview of the obstacles faced by SMEs in applying transnational schemes

Mr. W.Menrad, member of the European Parliament and reporter of the opinion of the Committee of social affairs and employment of the EP on the Commission's Communication.

D. Vaughan–Whitehead: Senior wage advisor for the ILO on Central and Eastern Europe. Expert on financial participation and detached for the ILO to the European Commission for the social impact of EU–enlargement.

N.B. Only hearings which were held during the meetings of the Group are mentioned here, and not the meetings the members of the group may have individually with outside experts.

ANNEX 4
Survey

Transnational Obstacles to the Financial Participation of Employees.
This survey shows the analysed results from 44 participants

1. Does your company operate any of the following Plans?

In the following table:

- the percentage of participants that responded to this question is shown, and
- of these, those that said 'yes' to 'All employee' or 'Other than all employee' are shown.

	Share Option Plan	Share Purchase Plan	Free Share Plan	Savings Plan	Cash Payment Plan	Profit Share Plan
% responding out of total sample	*98*	*80*	*70*	*70*	*70*	*75*
All Employee – yes	19 (59%)	21 (64%)	9 (30%)	16 (55%)	4 (15%)	10 (33%)
Other than all employee – yes	32 (97%)	7 (35%)	4 (18%)	7 (32%)	9 (35%)	6 (24%)

– Other …

3 respondents stated 'Deferred Share Plan'; 5 respondents stated 'Long Term Incentive Plan'; 1 respondent stated ' Phantom Option Plan'

2. If your Company has chosen not to operate Plans, what do you think are the two primary reasons for this?

12 companies responded to this question. The reasons these respondents gave are as follows:

Remuneration Strategy

- Not included in professional advice for remuneration strategy to date
- Some plans more in tune with our internal HR strategy than others

Time/cost of administration and operation of plans

- Because of the time and expense needed to administer additional plans
- Size, complexity and cost

• Limited participation of employees in the majority of the plans is because of reasons of cost and affordability of the company

Regulatory/corporate governance Issues

• Impact of available shares and dilution limits

Complexity

• Business complexity

Market Conditions

• Difficult trading conditions

• In cases where such plans do not represent common practise in the market (based on our comparator peer group) there is no need to operate them

Certain Plans target certain categories of employee

• Cash payment plan (bonus) versus profit sharing distinguishes employees from senior management

• Share option plan just for executives, restricted share plan for senior manager upwards. Lower level incentives if missed out

• Option plan aimed at senior management, sharesave aimed at all employees

• Because of the limited benefit they offer to lower paid employees

3. Does your company extend any of its Plans internationally?

In the following table:

• the percentage of participants that responded to the question is shown, and

• of these, those that said 'yes' to 'All employee' or 'Other than all employee' are shown.

	Share Option Plan	Share Purchase Plan	Free Share Plan	Savings Plan	Cash Payment Plan	Profit Share Plan
% responding out of total sample	*100*	*68*	*57*	*57*	*55*	*59*
All Employee – yes	15 (56%)	15 (54%)	8 (36%)	6 (26%)	4 (20%)	9 (38%)

Other than all Employee – yes	34 (97%)	8 (53%)	4 (24%)	4 (22%)	7 (37%)	4 (24%)

– Other …

4 respondents stated 'Long Term Incentive Plan'

2 respondents stated 'Deferred Share Plan'

1 respondent stated 'Phantom Option Plan'

4. In broad terms, please indicate if your Company's Plans are available to employees in all, most, some or none of the international jurisdictions in which you operate?

All Employee						
	Share Option Plan %	Share Purchase Plan %	Free Share Plan %	Savings Plan %	Cash Payment Plan %	Profit Share Plan %
All	25	30	12	18	17	41
Most	35	17	24	13	0	12
Some	15	30	17	38	8	12
None	25	23	47	31	75	35
Other than All Employee						
	Share Option Plan %	Share Purchase Plan %	Free Share Plan %	Savings Plan %	Cash Payment Plan %	Profit Share Plan %
All	52	21	7	8	31	25
Most	24	7	14	0	13	0
Some	24	29	36	50	25	17
None	0	43	43	42	31	58
% responding out of total sample	*98*	*66*	*50*	*45*	*45*	*50*

– Other ...

3 respondents stated ‘Deferred Share Plan’

3 respondents stated ‘Long Term Incentive Plan’

1 respondent stated ‘Phantom Share Option and Plan’

1 stated ‘Leverage Plan’

5. If your Company has chosen not to extend its plans internationally, what do you think are the two primary reasons for this?

15 Companies responded to this question. The reasons these respondents gave are:

Remuneration Strategy

• Use only local markets for remuneration

Time/cost of implementation of plans

• Costs relating to introduction/implementation

• Size, cost

• Cost effectiveness

Tax efficiency and legal restrictions

• We do not extend All Employee Plans where it is not legally or financially viable however we will use phantoms, if possible to be fair to all employees

• Savings Plans are tax facilitated; therefore available in the Netherlands and Germany

• Legal/tax restrictions

• Local tax disincentives

• Tax and regulatory requirements in different jurisdictions

• Taxation issues. Legal frameworks

• We have extended our plans internationally as and when required; however we are concerned about extending them further due to the lack of knowledge we have regarding securities requirements, legislative restrictions and withholding tax requirements

• Tax situations in some countries is so high that there is no point in setting up a plan like stock options

• Legal Aspect: In France, by law, you have to offer a share plan to employees. In other countries such conditions do not exist

• The main reasons are related to tax and legislation in specific countries that are not encouraging the operation of certain plans

Complexity

• Because of the comparative difficulty of issuing securities to overseas employees

• Complexity/cost of solving legal requirements

• Plan complexity

Foreign market conditions

• Because of the relatively less benign environment overseas to UK share plans

Of the above responses, 8 (53%) companies have tax issues and 4 (27%) have complexity issues.

6. The following have been identified as transnational obstacles to the financial participation of employees. In your experience, please rank them in order where 1 is the obstacle that you encountered most often and 5 is the obstacle you have encountered least often.

95% of participants responded to this question

The obstacles mentioned were:

Disparity in other legal systems and lack of recognition of different financial participation arrangements between companies leading to inconsistency and complexity

Little or no tax or social security incentives available to the employees or company

Securities requirements are too complicated

Labour law is too restrictive

The company is based in a country where there is little or no tradition of share ownership/participation in profits by employees

Most often encountered ………………Least often encountered

A 48%…………19%…………21%…………..7%…………...5%

B 34%…………27%…………20%…………..4%…………...15%

C 12%…………32%…………24%…………20%…………..12%

D 2%…………...10%…………17%…………..39%…………32%

E 2%…………...7%…………...15%…………..27%…………..49%

7. In respect of the statements above, and thinking about the two most frequently encountered obstacles primarily in respect of EU member states, please give an example of each that you have encountered in practise.

(80% of participants gave examples for this question although not all companies provided details of 2 obstacles)

Barrier A. Disparity in other legal systems and lack of recognition of different financial participation arrangements between countries leading to inconsistency and complexity

Disparity between legal systems

• We have investigated a savings plan across Europe but the set up costs are prohibitive

• In Germany the process of analysing how to get round the legalities of share options means you end up complying with traditional remuneration methods

• Option plan costs of legal/fixed detention is a barrier to extending options internationally

• In certain countries you are not allowed to hold foreign shares therefore a share purchase plan could just be operated

• The differences between member state rules

• Need to operate stock appreciation right type arrangements in country where options are not allowed

Lack of recognition

• Recognition of French collective structure (FCPE, SICAU AS), securities held in collective structure not recognised as direct shares. Financial arrangements providing guarantee and up side on a share not recognised as a package

Barrier B. Little or no tax or social security incentives available to the employees or company

Timing of taxation

• Tax on grant versus tax on exercise

• General issue is the tax/social security regime instigated against share option plans being a useful incentive, eg taxed as income rather than capital gains or taxed at grant rather than exercise

• Up front taxation on discounted shares issued to employees. Taxation on company financial contribution

• Those where taxation takes place at the time of granting stock options while execution is possible at maturity date only equals problem of individual

• Tax on grant not exercise – Holland and Denmark

• Compared to Dutch tax system on stock options (choice to be taxed on becoming exercisable) the rest of Europe (where taxed on exercise) is far more restrictive

• 3 year vesting period in UK

• The fact that in some countries (eg Switzerland and Czech rep) it is not possible to tax the granting of stock options at the time of the grant, doesn't encourage their operation *check survey*

• Certain countries – Belgium, Switzerland, Norway (historically but not now) tax participants on grant date instead of exercise – we use share/cash or phantom options instead

• Taxation rules in Belgium – executive share options taxed 15% on value of options at point of grant irrespective of whether options exercised

• Tax on grant of options in Belgium and other countries

• Belgium – ease on grant selection of tax rates

• Immediate taxation in Belgium

• In Belgium there is a tax liability on grant

Belgium - issues relating to the set up of share option plans due to tax on grant.

Tax efficiency

• Different rules ie no discount or lower discount

• Shares purchased from net pay – tax paid at time of purchase

• Luxembourg – no tax incentives for our sharesave plan. We try to globalise our sharesave but there are significant inconsistencies between all aspects of transnational objects. Luxembourg has a stock option plan with tax incentives but this has not been explained as it would not be consistent with 'global' approach

• Difference in SAYE – up to 20% discount to market value in UK; up to 15 % in USA

• The tax efficiencies of the profit sharing plans are quite different between, for example, UK and France on one hand and Spain, Italy on the other

• We would like to introduce an all employee savings plan or stock purchase plans in Sweden but there are no tax or social security incentives to do this

• France; limits on discounts 5% on sharesave when 20% allowable in UK

• Taxation of share programs (payment in kind) in Belgium

• All employee share plans – no recognition of 'approved' UK plans in other jurisdictions (or vice versa) so not tax favourable – but amounts are relatively small and similar principles in many countries

• Tax incentives for sharesave are almost non-existent outside UK

Social security issues

• Share Appreciation right plan/phantom plan still gives rise to high employee social liabilities – employees would potentially gain more from salary

• National Insurance in UK and lack of tax relief elsewhere

Tax rates

• Very high tax/social charge in France make 'unapproved' awards unattractive and costly

• The interest rate on the savings in Denmark in 2002 for the sharesave plans was 0%

General

• No extension to EU states – very limited operations there. Obstacles we need to remove; different structures to plans to obtain tax advantages or enable them to operate

• Qualification of share option plan. Tax ruling in some countries

• Germanys' very long holding requirements (now relaxed)

• Belgium stock options taxation system

• The only country in Europe, where it is possible to waive gross income for other remuneration elements such as stock options is the Netherlands. Other countries are inflexible in their tax system

• Double jeopardy on savings plans other than SAYE

• Valore normale tax determination in Italy

Barrier C. Securities requirements are too complicated

• In Belgium a prospectus is required for offers to 50 or more employees

• Belgium – Listing requirements and provision of information too complicated and costly to justify grant to 7 employees

• Belgium – prospectus requirements

• Italy and Poland. Limitations on number of people eligible to avoid filling requirements that would deem plan not capable of implementation/expensive/time consuming

• Security requirements; in Slovak republic participants need a foreign exchange permit to open a bank account in Germany and to sell foreign shares. He has to transfer his profit after exercising/selling back to Slovak republic within 30 days

• Italy's listing requirements

Barrier D. Labour Law is too restrictive

• The works council co-determination creates a shared misery culture

• Suspicion generated by work councils, effectively the traditional resistance to change and a 'not invented' here stance

• Data Protection problems

• France is very restrictive from labour law perspective in general. Profit sharing by French Legal standards is obtrusive and state dictated. This should be left for companies to decide upon at their will

• In Czech and Slovak Republics recharge of any costs creates legal risk (triangular relationship). Labour law; data protection problems e.g. in Slovak Rep and Hungary makes it difficult to get personal data for admin in Germany. In Spain employee will retain the rights to exercise his options in case of termination of employment without cause

Barrier E. The company is based in a country where there is a little or no tradition of share ownership/participation in profits by employees

• We have problems outside the EU

• Stock options and stock purchase plan in the Nordic countries

• The take up rate in Germany for the 2002 launch of the sharesave scheme was 1%. We believe this low rate was primarily due to a lack of share owning culture in the country

8. In your own experience, primarily in respect of EU member states are there any obstacles to financial participation of employees that you have encountered but are not identified above?

Foreign exchange controls

• Foreign exchange on savings

• Foreign exchange and control restrictions. Inability to hold savings in an account under control (or joint control) of a company

General

• Understanding the concept of shareholder value

• Only active in candidate countries (Estonia, Bulgaria and Poland). No obstacles have arisen to date

• Because of the current economical climate there may be no interest to implement such plans

• Generally, employees themselves will need to decide if they can afford to save (via international sharesave). Exchange rate issues may limit number of shares they can buy. Need to set the minimum savings for employees based on their currency/situation. Eg Poland participants start at 30PNZ equivalent to £2/3 rather than the usual £5 minimum in UK/other countries

3 (21%) participants mention foreign exchange issues as an obstacle they have encountered

9. Primarily in respect of EU member states, what changes would you like to see to facilitate the implementation of transnational plans and participation or your employees in them?

Remuneration Strategy

• Company should decide on remuneration types and levels other than minimum wages, working hours etc. Furthermore Dutch tax system/principles are example to others.

Tax/Legal/Regulatory

• Tax law harmonisation. Legal status of trusts – would help if they were recognised. Ease of admin – make plans easier to roll out

• Common rules on taxation and labour law. Postponement of taxation until exercise or sale

• Simplified tax rules and listing requirements

• Common approach to taxation of equity plans

• Standardisation of tax treatment and introduction of tax breaks where shares are retained

• Taxation social security incentives

• Consistent tax regulations concerning incentives

• Some harmonisation of tax treatment would be welcome – not necessarily the rates but amount of tax. We would welcome some relaxation for the treatment of all employee plans

• Consistency in approaches ie tax treatment allocation method

• Relaxation in institutional controls on option flows subject to strict performance conditions that would interfere with our capacity to issue shares

• Common legislative requirements

• Harmonisation at time of taxation granting. US execution of stock options

• Cross border equalisation of tax incentives (maybe by acceptance of UK base)

• A common all employee plan with common tax breaks. Reciprocal tax arrangements for non all employee plans. Exemption to securities requirements for employee options and purchase plans

• Harmonisation of tax treatment

• Harmonisation of taxation, security requirement in the EU

• Harmonisation or at least compatibility between EU taxation systems. Progress has been made on pension transferability but not much on company's plan

• Reduction of security issues/harmonisation. Create emphasis on benefits of any shares via government support (as in UK)

• Offer more favourable tax benefits for participation in sharesave schemes

• Standardisation of tax or social security incentives (e.g. approved plan in UK, qualified plan in France), no similar possibilities in other countries. Standardisation of securities requirements (different exemptions from publishing a prospectus, number of participants or max price for number of offered shares differ between the countries). Standardisation of foreign exchange requirements, difficulties to open a bank account abroad or limitations of cash transfer abroad

• Consistency in taxation and other legislative environment could facilitate the implementation of transnational plans

Recognition of specific arrangements

• EU recognition of collective structure (FCPE, SICAU). EU recognition of fiscal plans in shares or units could benefit for incentive taxation

• Rules requiring UK operations/participation should be replaced with rules allowing EU operations/participation e.g. Enterprise incentive scheme

General

• Commitment to remove barriers that restrict real profit sharing with employees

• Some harmonisation

• We would appreciate that the FCPE vehicle (France) would be susceptible to an agreement in all EU companies

20 (71%) participants reported that they would like to see harmonisation and standardisation on taxation and legislation.

ANNEX 5
Obstacles per type of financial participation plan

Obstacles	Profit Sharing		Share purchase / Share savings	Free shares	Share options
	Cash	Deferred			
Institutional and legal framework : -legal requirements -collective holding of funds (1)	x x	xx x x	Xx x x	xx x x	xx x
Taxation and social security (2)	x	xx	xx	xx	xx
Securities law			xx	x	xx
Stock exchange and corporate governance rules			xx	x	xx
Labor law and Related issues (3)	x	x	x xx	x x	x xx
Social and cultural barriers (4)	x	x	x		
Administration and operation costs		x	xx	x	x

8. Different requirements for deferred (share based) profit-sharing plans and share plans involving the collective holding of funds: different rules and vehicles for investment and administration of the funds according to national jurisdictions.

9. Specific difficulties and differences concerning: the incidence and timing of taxation, uncertainty and/or complexity of fiscal treatment, the tax and social security treatment for employees and employers, double taxation or double exoneration.

10. Labor law provisions affecting financial participating plans (e.g.: information and consultation procedures, definition of pay, link with employment contract, non-discrimination …). Examples of other employment related issues: the existence of acquired rights, employee data protection, language and translations.

11. Social issues: impact of differences in industrial relations practices (role of works councils, collective bargaining, trade union attitudes…); cultural barriers: such as employee attitudes regarding share ownership, saving patterns.

ANNEX 6
Brief history of a European saving plan

1. BACKGROUND

Over the years, Steria has acquired considerable experience of European saving plans, the first of which was launched 18 years ago. The introduction of the first plan in 1984 was designed to revive, and open up to as many people as possible, the employee share ownership that had been introduced when the enterprise was created in 1969. For thirty years employees owned the majority of Steria shares and controlled the enterprise. Today, employees still own more than 30% of the capital of the enterprise. In addition, employees control 100% of SODERI, the general partner of Steria Group, which has been a partnership limited by shares since 1996.

At the end of 2001, Steria signed an agreement with BULL for the acquisition of most of its European data processing service activities outside of France. This acquisition virtually doubled the size of the group, whose turnover rose from €530 million in 2001 to €1 000 million in 2002.

In line with our business culture and in order to help to integrate this new staff, Steria decided to launch a **G**roup **E**mployees **S**hareholding **P**lan (**GESP**), the aim of which is to allow all staff to take part in this employee share ownership and the related bodies, if they so wish. This decision was announced throughout the Group at the beginning of 2002.

2. PREPARATION

Preliminary contacts made in 2001 with enterprises that had opened up their employee share ownership internationally showed us that the operation would be far more complex than the French plan that we were used to. We launched an invitation to tender among several consultancies with an international network, and we selected Clifford Chance. It should be noted that no consultancy committed itself to a lump sum, even though they all stated their experience.

On 24 January 2002 a meeting was held to launch this operation, which would be conducted as a project. At that time we still thought that this operation could be conducted as a *Fond Commun de Placement* (FCP – collective investment fund), which was our preferred solution for reasons of uniformity, management costs and voting rights. On this last point, our experience had shown us that any solution other than the representation of employee share ownership at the General Assembly by the supervisory board of the FCP would result in low representation of employees. Our initial planning foresaw the launch of the subscription at the beginning of May.

From 24 January 2002 onwards we held weekly working meetings attended by the persons concerned at Steria, Crédit Lyonnais, our administrator, and Clifford Chance. At the meeting on 8 February, Clifford Chance warned us that the FCP could not be used everywhere, especially in Scandinavia.

Throughout the operation we suffered from so many unforeseeable difficulties concerning the feasibility of one point or another that we, and Crédit Lyonnais, were forced to adjust procedures, documents and planning.

On 25 February the feasibility studies for each country were submitted to us, except for the one on Denmark and Norway, which had to be supplemented. On 8 March, we learned that the Spanish stock exchange authorities (CNMV) would require a prospectus to authorise the FCP, which might take six months to be approved. Consequently, we decided to use individual share accounts in Spain.

On 28 March, the choice of the instrument to be used in each country was finally made:

– a FCP in Germany, Belgium, France, Luxembourg, Sweden, Switzerland and the UK;

– individual share accounts in Spain, Denmark and Norway.

On the following day, 29 March, the management, under the authorisation granted by the General Assembly, decided to make a new equity issue earmarked for employees and, on the basis of the 20 previous prices on the stock exchange, set the subscription price, after discount, at €29. Given the extent to which the work had progressed, it was agreed to open the subscription period on 27 May and to close it on 17 June, with the individual files to be sent out on 21 May.

In the weeks before the equity issue, local correspondents were appointed in each subsidiary and country: some of them were to be administrative relay points, whereas the others were to relay information under the authority of local personnel managers. On 18 April a meeting of all these correspondents was held in Roissy in order to prepare the launch and subscription operations. The content of the file that each employee would receive was specified at this meeting:

– a shareholder's guide presenting the operation;

– a subscription order;

– a tax sheet;

– an explanation of the practical arrangements.

It should be noted that this file was different for each country, being adjusted to its specific characteristics: FCP or share accounts, exchange rules (several countries did not form part of the Euro zone), taxation rules on all the aspects concerned: discount, capital gains, dividends, etc. It was published in the local language (which meant that there were two different files in Belgium and in Switzerland), with the three Scandinavian countries accepting English for certain documents.

3. STOCK EXCHANGE EPILOGUE

While all this work was being carried out, the financial markets started to fall on 15 March, with the area of new technologies being particularly hard hit. This fall, which amounted to 25% between 14 March and 13 May, suddenly accelerated from 13 May onwards (amounting to 40% between 12 and 30 May). Consequently, from 10 April onwards, the quotation for the day fell below the average for the 20 previous days and, from 16 May onwards, dropped below €29, which was the discounted subscription price set by management.

Those involved in the project and the management of the Group unanimously agreed that the operation had become too unpredictable and risked being a failure. Moreover, all the external administrators on the board of directors of Steria group took the view that any equity issue in this situation would be misunderstood by the market. Consequently, on 16 May, the decision was taken to stop the whole process just before the files were sent out.

4. CONCLUSION

When seeking to draw the lessons from this experience, it is necessary to disregard completely the very unusual conditions that led to the decision to abandon the whole project because they are not related to the internationalisation of the saving plan. On the other hand, the difficulties caused by the considerable disparity between the legislation in the various countries must be underlined.

These difficulties concern, first of all, the stock exchange regulations. We had to put together three files:

– one for the COB (*Commission des opérations de bourse*),

– one for the CNMV (Spain),

– one for the Belgian Banking and Financial Commission,

– each of them in the language of the country concerned.

In addition to the costs of drafting and translation, there is an investigation period of about one month, which complicates planning. If the certification by the COB could be recognised by the other authorities, this would really simplify the procedure.

t is clear that the differences in taxation are a major obstacle to simplicity. These disparities concern all the relevant aspects:

– the contributions by the enterprise (*abondement*),

– the discount,

– the interest in the event of advance against subscription,

– revenue (dividends),

– gains.

In certain countries, it is possible to obtain certain facilities by prior agreement (ruling), but this takes time.

Finally, it must be borne in mind that the costs of consultancy, drafting the tax sheets, negotiating rulings, etc. do not depend on the number of employees concerned. What we consider acceptable in the case of the UK, for example, where we have 1 500 staff, is out of the question for Luxembourg (25 members of staff and perhaps 10 subscribers). All this is expensive, especially in terms of consultancy fees. We paid Clifford Chance €336 445 inclusive of tax for this operation even though we accepted some risks. Moreover, the system

is cumbersome to manage: application to Paris, forwarding to local correspondents, reply sent to the Paris office, which then forwards it to us.

ANNEX 7
Employee Shares in the DaimlerChrysler Group

The DaimlerChrysler Group has a long tradition of issuing employee shares. Were wealth formation as well as old age provision paramount in the beginning of the share program additional aspects have emerged like strengthening of employee motivation and integration, especially in regard to internationalization of staff. Today, employee shares are seen as an important aspect of value-oriented management and the global HR strategy.Since 1973, the employees of the German Since 1973, the employees of the German affiliate companies have been able to acquire employee shares at very favorable prices. From 1973 to 1995, employees could take up 1 Daimler-Benz share per year, with a nominal value of 50 DM, at a preferential price. In 1996, the nominal value of the share was changed from 50 DM to 5 DM. Between 1996 and 1998, employees were able to purchase either 5, 10, 15, 20, 25 or 30 shares per year in October. The first 10 shares were blocked for 6 years, while the rest of the shares purchased were locked in until the end of the following year. The allowance was 150 DM if 5 shares were purchased, or 300 DM for 10 shares. The price at which shares were sold to the employees was based on the company's share price on the date when the Board of Management of Daimler-Benz passed its resolution on the promotion concerned, which had to occur at least nine months before the surrender date of the shares.

(i) legal framework in Germany

These rules arise from § 19a EStG, Germany's Income Tax Act. According to this legislation, a maximum of € 154 (300 DM) per year is tax-exempt if an employee receives an equity stake free of charge or at a discounted price in the context of a current employment relationship. If the employee receives shares from his employer, and these shares are officially allowed to be traded on the German stock exchange on the date of the decision to transfer them, then the price of these shares is fixed at the lowest price at which they are traded on the official stock market on that date, provided that, on the date of transfer, no more than nine months have elapsed since the date of the decision to transfer the shares. In the event that, on the date of the transfer, more than nine months have elapsed since the decision was made to transfer the shares, then the date of the actual transfer applies instead of the date of the decision to transfer the shares.

Since the share price on the date of the Board of Management resolution in 1997 and 1998 was lower than the share price on the date of transfer, the Board of Management of DaimlerChrysler AG passed a resolution in 1999, more than nine months before the transfer of the shares to the employees, to the effect that the employees would henceforth be issued employee shares on an annual basis. As a result, from 1999 onwards, it was no longer the day of the Board of Management resolution that was authoritative in calculating the monetary value of the shares, but rather the share price on the actual date of the transfer of share ownership. This enabled the employees of DaimlerChrysler to acquire shares in DaimlerChrysler at a purchase price that was closer to market values than was the case in previous years.

(ii) plan design in Germany

In addition, the Board of Management of DaimlerChrysler AG had resolved to offer their employees an option to purchase a total of 5, 10, 15, 20, 25 or 30 shares three times a year (in March, June and October, in 1999 and, from 2000 onwards). The employer allowance is € 77

for the purchase of 5 shares and € 154 for 10 shares. In addition, employees who purchase 15 shares obtain a completely free bonus share. These privileges are only offered once a year. From 2001 onwards, the employees were entitled to purchase 30 shares in each promotion, in other words a total of 90 shares per year. The first 10 shares were blocked for 6 years, up to and including 2001, while all other shares were locked in until the end of the year following the purchase year. On 01.01.2002, § 19a EStG was modified. The freeze period of six years formerly stipulated in the EStG was eliminated, even for shares purchased in previous years, without the enactment of any substitute provision. Since then, all DaimlerChrysler employee shares, even those purchased before 2002, are only blocked until the end of the following year.

In March, June and October of every year, employees have a period of two weeks in which to order shares. Ownership of the shares is then transferred to them at the start of the following month, and the purchase price is deducted from the employee's salary statement for that month.

The selling price for the 5 to 10 shares offered with a discount is calculated according to DaimlerChrysler's closing Xetra share price on the last working day prior to the start of the respective promotion, minus the tax exemption privilege of € 77 for the acquisition of 5 shares in the context of the legal provisions of § 19a EStG, and the tax exemption privilege of € 154 for the acquisition of 10 shares in the context of the legal provisions of § 19a EStG. For the additional shares offered, the purchase price is likewise based on DaimlerChrysler's closing Xetra share price on the last working day prior to the ordering period.

In the event that the DaimlerChrysler share price on the date when the shares are transferred is lower than the price on the date when the offer price is fixed, then the named purchase prices are reduced respectively by the difference between the closing Xetra share price on the last day of trading prior to the start of the respective promotion and the lowest recorded share price in official German trading on the day on which the shares are transferred according to the legal tax provisions. In the event that the DaimlerChrysler share price on the day on which the shares are transferred is higher than on the last day of trading prior to the start of the promotion, the determination of the purchase price is based respectively on the share price on the last day of trading prior to the start of the respective promotion.

Until 1998, the shares were purchased in the context of a capital increase for the employee share promotions authorized at the shareholders' meeting. Since 1999, the shares are purchased on the open market.

Shares acquired by the employees are centrally deposited in a bank. In the context of this central custodianship, however, every employee shareholder has an individual custody account with a personal custody account number. The costs of depositing and custodianship are borne by the company. If the employees sell any of their shares, they must pay the associated costs. The employees are allowed to transfer their shares out of this central custodianship and redeposit them in any bank they choose; however, they must pay all the costs associated with such a transfer.

Up to and including 1994, the employees could put the employee shares they had purchased into capital-forming investments pursuant to the 5th Formation of Wealth Law, and receive an employee savings bonus on them, subject to specific requirements. Since 1995, wealth-forming investments have no longer been allowed. DaimlerChrysler AG decided to stop

investing its employees' shares in wealth-forming investments because, as an employer, it would have been forced by the implementing order of the 5th Formation of Wealth Law of 20.12.1994 to pay the employee savings bonus on investments of employee shares it had issued. According to this regulation, DaimlerChrysler AG would have to make payments on the expiration of the freeze periods (6 years, according to the 5th Formation of Wealth Law) for the fixing of the shares, even for employees who had already retired and for whom no current data was now available. This is a costly task associated with extensive obligations to produce supporting documentation and certificates, which has no comprehensible relationship to the actual size of the employee savings bonus.

Transnational developments since the year 2000 in Europe

In 2000, the Board of Management resolved to expand the reference model for employee shares worldwide on a gradual basis to foreign companies in order to strengthen employee integration and relationships in the face of the progressive globalization of the group. At the same time, this would also promote the interests of employees in the development of the company, even across national borders. Therefore, since 2002 the topic of employee share ownership has been an official component of the Global HR Strategy.

The German employee share ownership model is traditionally linked – as already described – closely to the tax law framework, i.e. § 19a EStG in particular. For this reason, it did not seem to be strategically correct to expand the German model in an entirely unmodified form to companies abroad, which naturally operate in a different fiscal and statutory environment, subject to the laws in force locally. Anyway, the German model, particularly with regard to the extent of the payments made to the employees, should set key goals so as to ensure neutrality of treatment.

For this reason, a somewhat localized approach arose in the gradual expansion of the program, insofar as an individual reference model was developed for each country, a model adapted to the local fiscal and statutory environment, and furthermore to enable the employees to take advantage of tax privileges existing locally. The national reference models, which are adapted to the respective region's legal and HR policy conditions, are thus diversified. For example, in the United Kingdom, a special fund model with a monthly supply of shares, is offered. In France and Switzerland, employees may purchase shares three times a year via the company's Intranet and call center, whereas in all other countries, shares may only be acquired once a year, and the transactions are executed conventionally on paper. In a pioneering step in 2000, foreign companies in Austria, France, Spain, Portugal and Switzerland were included. They were followed by the United Kingdom, Italy and the Netherlands in 2001.

Since 2002, a further expansion also covering foreign countries outside Europe has also been carried out. In many states, e.g. even in the majority of the EU pre-accession countries, no tax advantages exist for participation in employee share ownership programs. Moreover, experience has shown that every expansion into foreign territory must overcome a very wide range of legal and administrative hurdles. Examples include the differently organized regulations in different countries with regard to the fiscal treatment of the sums spent by the employee and, where applicable, subsidized by the employer, for the share purchase transaction, as well as the question of whether subsidies or rebates offered by the employer have an impact on the size of social security contributions. From a legal standpoint, attention must be also be paid to the statutory freeze periods, which may be set at different durations

from country to country. Apart from these fundamental legal issues, the existing regulations of the stock exchange supervisory authorities have an influence. For example, mention should be made in this regard of the CONSOB rules in force in Italy. In Germany, in relation to the identification requirements associated with the money laundering legislation, the opening of custody accounts has proven itself a very elaborate affair. In Spain, for example, the need arose to submit the above-mentioned Board of Management resolution in notarized form before the employees could be offered shares. In the environment beyond Europe, restrictive stock exchange regulations make share transfers very difficult or in some cases impossible.

From a practical viewpoint, these legal and bureaucratic necessities lead to high administrative expenditure in the implementation of the various employee share ownership programs. Before they are introduced, complex consultation and testing procedures must be performed. When they are deployed, all of the national peculiarities must be considered, which translates, in practice, into correspondingly higher costs for software recoding, if – as is often the case – the share ordering process is administered electronically. In addition, in the event that regular international transfers of shares and dividends are necessary, and also in the case of the execution of sales orders, unreasonably high banking fees are incurred. Experience has shown this to be the case even within the European Union. It is to be assumed from this that, in the final analysis, these high administrative costs and expenses can contribute to the decision not to implement a possible employee share ownership model, particularly in small and medium-sized companies.

The participation rates in European foreign companies varied in the year 2002: In Germany 24 % of the entitled employees (i.e. 45.330 employees) ordered an average of 24 shares. In Italy, the participation rate in 2002 was very low compared to the previous year, a mere 5.6 % of those eligible, purchasing an average of 23 shares each. In the Netherlands, 21 % of those eligible participated, purchasing an average of 37 shares – an average of 10 shares more than the previous year. In the United Kingdom, employees are entitled to receive shares within the frame of a trust model on a monthly basis, offered without any subsidy but with tax advantages. 10 % of the entitled employees ordered shares with each employee purchasing an average of 40.

In France, 15 % of the eligible employees within the L´actionnariat des Salariees purchased an average of 16 shares. In Austria 30 % participated with an average of 38 shares purchased. In Spain the participation rate amounted to 10 % in Spain and 21 % in Portugal. In Switzerland 12 % of the employees ordered an average of 21 shares each.

In many states, for example the majority of the EU pre-accession countries, no appreciable tax advantages exist for participating in an employee share ownership program. This, coupled with the high administrative costs related to the localized approach to the expansion of the existing program, mean that, in its further expansion, DaimlerChrysler is now also pinning its hopes on testing out possibilities for centrally applied and administrated schemes, especially in regard to countries outside Europe.

Additional forms of financial participation within DaimlerChrysler

Today, stock options are a normal part of management remuneration for international corporations. Unlike short-term earnings on performance-based variable pay, which focus on the past, stock options depend on the future and on the long-term success. During the duration of the plan managers are supposed to have a stake in the growth in value of the Corporation.

DaimlerChrysler offers its managers a total compensation package, which, as well as the annual base salary, includes a short-term bonus scheme based on earnings in the year. In the course of the long-term stock option plan – the first worldwide Daimler-Benz Stock Option Plan was set up in the year 1996 - managers can have a stake in the growth in value of the corporation. Short-term variable pay is based on the internal measures of individual performance and company success. The long-term equity based compensation depends on an external measure – the stock price. Variable pay always involves chances and risks. Equity-based compensation provides the chance that the price will soar way above the exercise price during the 10-year term. The risks relate to the possibility that, if market prices fall, the option cannot be exercised following the retention period or that, over a long period, the stock price never reaches the exercise price.

Based on the shareholders approval at the DaimlerChrysler AG Annual General Meeting dated April19, 2000, the Management Board decided to introduce a further stock option plan in 2003 for managers of the corporation and group companies. Like in the precedent year the plan will take the form of a so-called Premium Priced Stock Option Plan. If the performance goal is reached or exceeded, plan participants will fully benefit from the increase in the stock price. The stock must rise by at least 20 % in relation to the reference price before it is worthwhile to exercise the options.

Finally and besides the stock option plan for executives DaimlerChrysler AG in Germany has been providing since 2000 a third type of financial participation in the form of profit sharing for non executive employees depending on a voluntary three year term agreement with the central works council. The basis of the calculation for the entitled employees is the aggregate amount of the consolidated testated and published operating profit of the relevant business unit. In comparison to the employee share program there are no legally granted tax privileges for this type of financial participation that is therefore seen as one component of regular and short-term employee compensation.

Apart from the forms of financial participation that are explicitly highlighted here there may exist other forms of employee financial participation being deployed on a decentralized basis by group companies or subsidiaries that are not reflected in this monography.

ANNEX 8
Royal Dutch/Shell Group's Global Employee Share Purchase Plan

In 2001 the Royal Dutch/Shell Group introduced a Global Employee Share Purchase Plan. The Plan offers eligible employees the opportunity to buy shares in one of the Group's parent companies, the NL based company *Royal Dutch* (NL) or the UK based company *Shell Transport and Trading* , through a contribution that is deducted through the payroll. In principle all full-time and part-time staff having a permanent contract with a participating company is eligible to participate in the plan.

At the time of the introduction of the Plan the Group had approximately 96,000 permanent employees working in more than 135 countries around the world.

From end 2001 until 2003 the Plan was rolled out over 85 countries, including a number of European countries.

Characteristics of the Plan

The Plan has a simple and rigid structure, designed to be operated in many different jurisdictions.

The plan has a savings cycle of twelve months, divided in four savings periods of three months. Once per year the employees are invited to participate. The maximum contribution is € 399 per month (2003). Contributions are withheld from the employees' net salary and paid into a non-interest bearing Plan-account, held by the Plan Administrator.

Shares are bought after the end of each savings period, during the 14 days following publication of quarterly results. The shares are held by a nominee for the beneficial ownership of the employee.

Net dividends received are reinvested in shares.

At the end of each savings cycle the employee can:

- continue to participate in the plan;
- change the amount of his monthly contributions
- withdraw from the plan and sell the shares or have them transferred to a private account.

The employee who keeps the shares in the plan until at least three months after the end of the annual savings cycle is rewarded with an additional number of shares, the 'matched shares', equivalent to 15% of the shares bought during the savings cycle.

The proceeds from a sale of shares are distributed to the employee through payroll.

The plan is not a tax favoured plan. Contributions are made from the net income. Any income tax due on the value of the matched shares is withheld from the salary.

Until now the Plan was not yet introduced in a.o. France and Germany.

The Plan was not intended to replace existing tax favoured share schemes. In the UK only expats from other countries are eligible to participate, since they are excluded from the existing share save schemes.

Transnational obstacles

Prior to rolling out the Plan in the various countries legal and tax advice had to be sought in order to make sure that implementation of the Plan could be realized within the boundaries set by the legislation of each country. It appeared that, even within the EU, the legal requirements are varying very much from country to country. Often it appeared to be uncertain whether or not specific legal rules apply to the Plan, and how these rules must be interpreted.

The plan was designed to play the role of a global plan, and therefore is simple and rigid. Some countries have a tax regime that contains certain facilities for share save schemes, with varying criteria with respect to the holding period, where the shares must be held, etc. Amendments on a country basis, in order to meet these different criteria for a tax favourable treatment, would have made the Plan too complicated. As a consequence the plan is in many countries less attractive than it could have been if it had been adapted to the local tax regime.

Below some examples of obstacles are mentioned. All data were gathered in 2001.

Country specific examples

Belgium

Language is a key issue in Belgian employment law but is also relevant for Belgian securities laws

The Dutch language must be used in all documents and communications prescribed by law and relating to labour relations in companies, the business of which is located in the Flemish region, as well as in all documents addressed to the employees of such companies. Failure to use the Dutch language renders the document void and may entail fines and criminal sanctions. The same applies to using the French language in the French-speaking region.

The prospectus (including any annexes to it) must be drawn up in at least one official Belgian language (Dutch, French or German). In practice the Belgian Banking and Finance Commission requires the prospectus to be drawn up in both Dutch and French, but allows annexes to be in English.

Belgian law requires that a prospectus is issued. A special regime facilitates the implementation of employees share plans. Under certain conditions an offer under an employee share plan would qualify for a partial or total exemption (at the discretion of the Belgian Banking and Finance Commission, BFC), but at least a short form prospectus is required. The content of any videos, seminars or presentations must be submitted to the BFC.

Deductions cannot be made from salary in Belgium.

Austria

In Austria *taxation* was an issue.

Up to ATS 20,000 per year (2001) and per employee is tax free, if participation is granted to all employees or a specially specified group of employees and the shares are held by the employee for five years in an Austrian or an EU bank depot. The plan does not qualify for the tax incentive, since the shares are not held directly by employee, but by a nominee on behalf of the employee.

The local Shell company has a withholding obligation for any tax payable under the Plan. Tax rates vary with the length of the period the shares were held. A tracking system had to be put in place.

Spain

The acquisition of shares in an non-Spanish company by Spanish residents must be communicated to the General Director of Foreign Investments of the Ministry of Economy. The local employing company may do this on behalf of its employees, indicating the name, ID, and number of shares acquired by each employee. The communication must be made once a year. A copy of the extracts of the securities accounts abroad must be attached.

Receiving and transmitting orders on behalf of investors is considered to be an investment service under Spanish law and is therefore subject to certain restrictions as to who can render such service. The Plan Administrator needs to have a Spanish license to the extent that its activities are deemed to be carried out in Spain

Finland

In principle a prospectus is required. An exemption could be obtained from this requirement. Originally this exemption had a duration of twelve months, but later the authorities made it indefinite.

Italy

The carrying out of a service of 'amministrazione fiduciaria' (i.e. holding on a fiduciary basis) is restricted to certain Italian companies who have obtained a specific authorization. It is incertain if a foreign entity is allowed to offer these services in Italy on a cross-border basis.

The employee has to give his written consent to the disclosure of his personal data to third parties.

A risk exists that continuing rights will be created, even though it is agreed that benefits resulting from the Plan are discretionary and non-recurrent.

Czech Republic

Each individual resident who transfers funds outside the Czech Republic is obliged to send a notification to the Exchange control authorities.

Strict data protection requirements are in place with the suggestion that transfer of data outside the EU would need to be approved by the Czech Data Protection Office.

General obstacles with respect to taxation

Allocation of taxation on matched shares

The staff of Royal Dutch/Shell Group is traditionally very mobile. In many countries the matched shares are taxable as income from employment. Under the legislation and tax treaties of most countries it is uncertain if the matched shares, earned during a savings cycle of 12 months, are taxable in the country where the employee is working on the moment these shares are granted, or must be allocated on a prorated basis to the countries of employment during the savings cycle.

Withholding of dividend tax

25% dividend tax must be withheld from any dividend distributed on the Royal Dutch shares. Under the tax treaties between the Netherlands and most countries the individual shareholder is entitled to a reduction of dividend tax to 15%. No procedures are in place that allows the company or the Plan Administrator to arrange a tax refund collectively for all employees in a specific country. For an individual the admin burden of a request for a refund of Dutch tax generally is too high.