

# Employee financial participation and tax obstacles in the EU

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by **Fabrice Pourceau, Project Manager, European Federation of Employee Share Ownership (EFES)**

## A recent evolution

In July 2002, the European Commission issued a communication on a framework for the promotion of employee financial participation<sup>1</sup>. Drafted in collaboration with the European Foundation for the Improvement of Living and Working Conditions and based on PEPPER (Promotion of Participation by Employed Persons in Profits and Enterprise Results) I and II reports.

The Economic and Social Committee adopted earlier this year a positive opinion on the communication whereas the European Parliament passed last June a resolution on the Menrad report on employee financial participation. The communication highlights in its provisions, a series of cross-border obstacles that impede the implementation of Europe-wide financial participation schemes.

**Restrictively, financial participation gives employees the opportunity to participate in profit and enterprise results. Variants of a broader definition include employee stock ownership possibly combined with direct or indirect participatory management.**

Financial participation has flourished mainly in the United States and the United Kingdom where profit sharing, gain sharing, savings plans, share based plans and employee stock ownership plans (ESOPs) have become relatively widespread on a voluntary basis with some government encouragement through the tax laws. In continental Europe, employee financial participation has been more influenced by ownership of capital, or profit-sharing. In part the growing of state owned companies has contributed to wider employee ownership.

In many cases ranging from enterprise transfer to the creation of additional savings and at a time when financing of retirement schemes come to the forefront, financial participation can prove to be a useful tool. In a report commissioned by DG Enterprise and published in May 2002, a third of all EU companies are estimated to have to change hands over the next 10 years (from 25-40%, depending on the Member States). This means an average of 610,000 small and medium-sized enterprises will change owner each year (potentially affecting 2.4 million jobs)<sup>2</sup>.

Besides, if properly implemented and associated with an emphasis on participatory management, financial participation schemes are generally deemed to have a positive effect on productivity, particularly through organisational innovation.

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<sup>1</sup> Communication from the Commission to the Council, the European Parliament, the Economic and Social Committee and the Committee of the Regions on a framework for the promotion of employee financial participation (COM(2002)364), 05.07.2002

<sup>2</sup> [http://europa.eu.int/comm/enterprise/entrepreneurship/support\\_measures/transfer\\_business/best\\_project.htm](http://europa.eu.int/comm/enterprise/entrepreneurship/support_measures/transfer_business/best_project.htm)

In a European and often global market where large companies operate in a competitive and multicultural environments, employee financial schemes become also increasingly defensive or offensive tools.

Defensive, because they help form blocking minorities intended to fend off hostile takeover bids while raising fresh money from loyal investors.

Offensive, because in this way, greatly diversified multinational companies or even start-up firms seek to create or strengthen their corporate identity.

It still remains that in the present European context, persistent discrepancies in national tax systems weigh heavily on the implementation of employee financial participation schemes. Indeed, given the lack of harmonized legislative frameworks, companies face a diversity of tax rules on personal incomes, equities, dividends and capital gains, which constrain them to resort to complex financial engineering solutions. As a result, the implementation costs and lack of legal transparency increase, rendering thereby such schemes less appealing to employees and employers alike.

As a consequence of Article 93 of the Treaty of Rome (consolidated version), fiscal policy is still a no-go area. Indirect taxes, turnover tax and excise duties are subject to unanimity voting while any nationally or Commission initiated move towards a greater convergence of direct taxation rules have so far appeared like wishful thinking.

### **Remaining fiscal diversity**

A glance at tax rules across Europe gives an appalling picture of the daunting tasks awaiting companies that would dare implementing cross-border participation schemes.

In the area of personal income tax and capital gains, a rapid stock-taking of the Member States' tax rules reveals mixed situations.

In the European union, three countries stand out as precursors of more friendly tax regimes to employee financial participation

- In Ireland, shares issued under approved profit-sharing schemes are exempt from tax income. Moreover subject to limitation, certain income derived from dividends out of profits which qualify for the 10% rate of corporation is not chargeable.
- In France, in the case of Company Savings Schemes, capital gains are tax exempt except for social levies.
- The UK government is committed to encouraging employee share ownership through targeted tax incentives. Employees who are given shares, or able to buy shares at a discounted price upon exercise of share options, are not required to pay income tax or national insurance on this valuable benefit, if one of several Inland Revenue approved employee Share Plans is used. Under a Share Incentive Plan (SIP), employees can now buy tax advantaged shares in their Company out of pre-tax income.

In the Nordic countries:

- Denmark applies a progressive tax on distributed dividends at source regardless of the holder. Additionally, the State levies a duty on share transfer, which affects buyers and sellers. A tax on employee bonds is payable by employers who pay out profits in the form of bonds to employees in their business. Employees are not required to include the value of such bonds nor the amount of the tax thereon in their taxable income.
- In Finland capital gain tax and dividend tax come under the scope of the tax on investment income, whereas in Sweden they obey the rules of personal income tax.

In Southern Europe:

- Italian and Portuguese tax law do not provide for any exemptions from capital gains tax or dividends tax.
- On a par with Italy and Portugal, Greece's fiscal system does not make allowances for employee financial participation.
- In Spain, certain transactions by cooperative societies with special status are exempted from tax on capital transfers.

In the Benelux countries; Belgium, the Netherlands and Luxemburg, no specific fiscal provisions deal with employee participation.

Germany and Austria :

- In Germany, double taxation of distributed profits (i.e. taxation of corporate profits and of income in the form of dividends received by a shareholder) is avoided because shareholders liable for income tax are taxed on only half of any profits distributed in the form of dividends. The same applies to capital gains from the sale of shares. A shareholder liable for income tax and having a significant holding in the equity of a company, or selling his shares within the one-year speculative period, pays only half the income tax. An equity holder liable for corporation tax pays no income tax on dividends.
- In Austria, dividends and capital gain tax are governed by capital yields tax and income tax. The allocation of free shares in companies limited by shares is exempt from income tax.

This kaleidoscopic view will certainly become even more blurred from the 1<sup>st</sup> of May 2004 with the accession in the European union of ten new member states.

## **What remedies?**

The Communication of July 2002 calls for the set-up of a group of experts responsible for identifying the main obstacles to the spread employee financial participation and the subsequent formulation of suitable remedies.

It is as of now possible to outline some of the issues that should be tackled by the experts group in order to improve the present situation.

### **Fiscal convergence through national coordination**

The diversity of the national tax regimes, the heterogeneity of financial participation schemes and more urgently, the need of appropriate legislative frameworks in the acceding countries call for some degrees of harmonization at European level.

Nevertheless, the use of EU's usual legal instruments for harmonization, among which a directive constitutes the most suitable one, would face many difficulties. Indeed the tenuous legal basis as well as the absence of political consensus on the subject, render the prospects of seeing the adoption of an ad hoc regime for employee ownership more than unlikely.

### **A more solid legal basis**

Employee financial participation falls under the ambit of Article 140 of the EC Treaty, which supports co-operation and co-ordination in the fields of employment, vocational training and collective bargaining between employers and employees.

This gives employee financial participation a rather fragile and awkward legal base. Indeed, Article 140 deals only with a few limited characteristics of employee financial participation and restricts its actual scope. It would therefore be necessary to broaden the legal basis to include Article 157, which encourages an environment favourable to initiative and to the development of undertakings and innovation throughout the Community.

### **A better sharing of competences**

Administratively speaking, any progress of employee financial participation is crippled by the dual management of Directorate General for Enterprise on the one hand, and Directorate General for Employment and Social Affairs on the other.

Besides their inherent conflicting philosophy and culture of dealing with job creation and more broadly, employment policy, the two directorates also often disagree on the objectives and priorities given to the promotion of employee financial participation. While the former favours a dynamic and proactive approach, the latter holds conservative or merely indifferent views on the overcoming of employee participation obstacles. It generally encourages limited and short-term actions of awareness-raising campaigns where comprehensive and long-term initiatives are needed. Moreover, they would rather strictly follow the lines of the national employment policies. Ironically, DG (EMPL)<sup>3</sup> has a near-monopoly on the funds destined to financing the support of employee financial participation actions.

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<sup>3</sup> Directorate General for Employment and Social Affairs

## **Overcoming political reticence**

The political prospects reflect a similarly differing and fragmented image. The Council of Ministers hosts a vast array of attitudes to employee financial participation that ranges from long-term familiarity or eagerness, to ignorance and apathy.

Those inclinations derive from specific national traditions and ideological influences. The French tradition dates back to 1966 when the first laws on profit-sharing schemes were voted. Britain and Ireland have followed a similar path. In spite of her advance in participatory management, Germany has no real legal employee financial participative framework. Some progress has been achieved in the Benelux countries, where the Belgian law on employee financial participation entered into force in January 2002. The Netherlands have also endowed herself with some sort of legal framework. Among the Nordic countries, Finland stands ahead of the legal innovation. Others, such as Denmark and Sweden are as a matter of course, very sceptical and would rather remain faithful to a non-committal stance. Finally, except for the Statutes regulating the Labour limited companies in Spain, the Southern European countries, in addition to Austria lie in total ignorance.

All in all, there is no deep-rooted resistance or all-out reluctance to employee financial participation. However significant a contribution employee financial participation could make to the Lisbon strategy for employment, it is nowhere near to come first on the Council's agenda.

Direct taxation is beyond the scope of the Treaty and constitutes thereby an exclusive competence of the national governments. Unless a repeat of the recent successful negotiations on the tax package on EU-wide financial transactions, other similar breakthroughs will be difficult to make on lower-stakes items.

As for the European Parliament and other bodies of the European union, the trend is much more encouraging. Employee financial participation has managed to gather a broad support across most of the political spectrum. The mainstream parties, PPE, PSE and ELDR have thus far not only favourably greeted all the initiatives on employee financial participation but also called for a more active involvement of the Commission.

However, in so far as fiscal policy still fall under the scope of the second pillar of the Treaty, it remains of the exclusive jurisdiction of the Council. Consequently, however loud and supportive, the voice of the MEPs is a far cry from being decisive.

Bearing all this in mind, the probability of the Commission drafting a specific directive to tackle the fiscal imbroglio encountered by the development of employee financial participation appears to be fairly low.

In that respect, we can only stand by the Commission and the European Parliament's strong emphasis on the non-feasibility and thereby non-desirability of a EU-made sui generis fiscal regime on employee financial participation schemes.

The Commission should instead pursue its efforts in favour of the promotion of employee financial participation by undertaking selective and focused actions. Thus, every single facet of employee financial participation would be tackled separately every time EU legislation is liable to have a bearing on it.

Special provisions should be introduced whenever it is possible and necessary. It should particularly be the case when fiscal packages or rules affecting European company law are in preparation.

Concurrently, genuine and proactive initiatives should be launched in order to further awareness of employee financial participation schemes at national level. Such actions should lead to a progressive coordination direct taxation policies.

On the rapid removal of tax obstacles will depend the preservation and creation of dozens of thousands of direct and indirect jobs.

Let alone, the potential rise in the demand of tailor-made business support services such as legal and financial advice that the development of employee financial participation schemes could generate.

### **The European Federation of Employee Share ownership (EFES)**

The EFES aims to be an open, democratic and participatory European organization, founded on shared values of dialogue and mutual respect.

The EFES seeks to make it easier for employees and their employer companies to establish sustainable employee ownership and participation, by promoting throughout Europe, developments in legislation and in financial and organisational structures.