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Management Compensation and Profit Sharing. an overview of Slovenia and Selected European countries

Abstract

The article deals with questions of management compensation in Slovenia and describes Euro- pean and Slovenian legislation and experience in the field of profit sharing. As part of their total compensation for work, members of the board are entitled to a salary, a profit share, reimbursement of expenses, insurance premiums, commissions, and other additional payments. However, the law in Slovenia prescribes the principle of proportionality of compensation to the actual tasks of board members and to the company's financial state.

According to the Report of the Commission of the EC on promoting the participation by employed persons in profits and enterprise results, active campaigns to promote employees' participation can be found in France, the UK, Finland, the Netherlands and Ireland. Countries like Germany and Italy refer in this respect to the responsibility of the social partners. In Ireland a specific national program was launched. The Draft Law on Profit Sharing of Employees (LPSE) of Slovenia 1regulates the forms of profit sharing where a company or the employees (workers and managers) are entitled to tax deductions or other benefits under special laws.

Some Comparisons of Management Compensation between Germany, Austria and Slovenia

The Supervisory Board must according to Par. 87/1 gAG2 insure that the remuneration of any member of the Management Board (salary, profit participation, reimbursement of expenses, insurance premiums, commissions and additional benefits of any kind) bears a reasonable relationship to the duties of such member and the condition of the company (the same applies analogously to pensions, payments to surviving dependants and similar payments).

Par. 87 gAG regulates the situation where after determination of remuneration the condition of the company deteriorates to such a substantial extent that continuation of payment of that remuneration would constitute hardship for the company. In such a case, the Supervisory Board is authorized to make a reasonable reduction of the remuneration determined in the contract of employment without affecting other terms of the contract. However, the member of management may, pursuant to the same provision of the AG, terminate his contract of employment.

Similarly, under Slovenian law (art. 253/1 LLC3) in determining the aggregate remuneration of individual Management Board members (salary, share in profits, cost refunds, insurance premiums, commission, other additional receipts) the Supervisory Board ensures that the total remuneration receipts are in proportion with:

· the tasks they perform; and

· the company's financial position.

If after the remuneration has been determined the company's business slackens, threatening to damage the company and its economic position, under the LLC the Supervisory Board may reduce the remuneration. That reduction does not affect other terms of the employment contract; however a member of the Management Board has the right to cancel his contract at the end of the subsequent quarter and after giving two-months' notice. There is no important difference on this issue. However, the German law regulates the case when the court, on the motion of the Supervisory Board, is authorized to make a reduction, whereas in Slovenian law this is not available. Namely, in the case of the appointment of Management Board members by the court, which at the same time fixes the remuneration and the amount of expenses (par.85/3 AG), such reduction is ordered by the court on the Supervisory Board's motion.

The Management Board members may pursuant to the LCC (paragraph 252) be granted the right to participate in profits as a share in the company's annual profit only if so provided in the Articles of Association.

Under Par. 86/1 of the German AG, members of the Management Board may be granted for their services the right to participate in profit, as a share in the company's annual profit, but such a share may not be computed otherwise than as laid down by the law. This means that Management Board members' share of the profit must be computed on the basis of the annual net profit, reduced by any loss carried forward from the previous year and by any amounts which are to be transferred from annual net profit to profit reserves pursuant to the law or the Articles (Par. 86/2 AG). According to the LCC (paragraph 252), the Articles of Association may provide that Management Board members be entitled to a share of the company's profits. The amount of the share is as a rule determined as a percentage of the company's annual profits.

There is no further regulation of this right in the LCC, as in paragraph 86 of the German AG, where it is stipulated that such a share shall be computed on the basis of the annual net profit, reduced by any loss carried from the previous year and by amounts which are to be transferred from annual net profit to profit reserves.

It is explicitly stated in the German AG that any stipulation to the contrary shall be null and void.

There is no regulation in the LCC for the case where bankruptcy proceedings or composition proceedings are instituted over or against by the company and the company has given notice of termination of the contract of employment (Paragraph 87/3 German AG)1.

The compensation of a director in Germany may consist of a salary, profit-sharing arrangements, repayment of expenses incurred by him in relation to the company's affairs and life assurance, as well as commissions and other performance-related payments.

In addition, loans to directors of an AG may only be made with the approval of the Supervisory Board. A Supervisory Board resolution is required for a specific loan facility or similar transaction and may not be given in advance for a period exceeding three months. The interest and conditions of reimbursement of the loan must be fixed. If the loan is paid to a director without the approval of the Supervisory Board, it must be repaid immediately, unless the Supervisory Board gives subsequent ratification, in which case the grant of the loan will retrospectively be deemed to have been approved by the Supervisory Board from the outset. If the company is a bank, additional and complex rules are imposed by the provisions of the Banking Act.4 Under Austrian law, the total remuneration of Management Board members must be in reasonable proportion to the tasks of the individual member and the position of the company (paragraph 78/1 a AG and paragraph 87/1 g AG). Similar to German law, participation in profit may only be in one part of the annual surplus (paragraph 77 a AG). The Management Board in addition is entitled to participate in profit only when the shareholders are paid out5. The reduction of remuneration subsequent to determination due to the detoriation of a company's condition has since the AG 1965 not been prescribed in Austrian law. There is a possibility to acquire treasury shares for the purpose of offering them to Management Board members though which the stock option plans of the American type are followed.

Compensation of management in slovenia

Current system of salaries

The current labor legislation6 in Slovenia leaves the area of salaries almost unregulated. In contrast to the previous system, for employers (but not for management) salaries are regulated through collective agreements. Article 7 of the General Collective Agreement for the Commercial Sector (hereafter SKPG)7 sets out the classification of jobs in a manner where jobs are divided into nine tariff classes depending on the required expert education specified in the act on systemization of jobs8.

This classification applies only to those employed persons who are subject to the collective agreement, therefore it does not apply to managers and high-level experts who are not included in a collective agreement.

Typical jobs for individual tariff classes may be classified into pay levels in collective agreements for individual branches. The basis for classification into individual pay levels is the requirement for additional skills, longer work experience, higher responsibility, work-related stress and difficult working conditions.

An employee's salary is composed of:

· the base salary;

· bonuses;

· an amount based on work efficiency; and

· an amount based on operating results.

In the employment contract the employee and the employer define the amount of the employee's basic salary in Tolars9 and additionally in a manner allowing the calculation of the corresponding German mark amount.

An employee's base salary for full working hours, pre-defined work results and normal working conditions, with which the employee was acquainted prior to taking on employment or prior to his allocation to a position, may not be lower than the salary defined in the tariffs annex. Pre-defined (100%) work results are work results measured according to pre-defined criteria, either on an individual or group basis. A norm (or quota) or other similar instrument for measuring work results is appropriate if at least 90% of the employees working pursuant to these criteria meet it. If an employee fails to attain the pre-defined work results for reasons beyond the employee's influence, he is entitled to 100% of the base salary.

Normal working conditions are the conditions in which such work is generally performed. These conditions are a component of the difficulty level of the job and are integrated into the base salary.

The starting salary for an individual tariff class, as defined in the tariff annex of the collective agreement, is the lowest base salary to which an employee is entitled for working full working hours and for pre-defined work results and normal working conditions. In branch-specific collective agreements, starting salaries for typical jobs may also be defined alongside starting salaries for tariff classes. A starting salary for typical jobs takes into consideration the difficulty components of typical jobs and is based on agreed methods for their assessment.

Compensation of board members, pursuant to the Law on Commercial Companies (hereafter the LCC)10 Profit sharing is a special form of compensation for members of the board. The law expressly states that a profit share must be defined for their work. Article 228 of the LLR regulates the use and division of profits, Article 68 regulates the distribution of profits, while Article 59, item 3, of the LCC regulates the statement of profits in the income statement.

A statement of profit sharing is a prescribed component of the annual report (point 3, 56.2. LLR) According to Article 593 of the LCC (transitional and final provisions), profits for 1993 cannot be distributed for profit sharing until the process of ownership transformation is completed. The entitlement of board members to profit shares must be prescribed in the company's Articles, meaning that only the founders of the joint-stock company can do so, or, if the Articles are amended accordingly, the shareholders' assembly. There are no limitations as to the level of the profit share of board members, however these are usually small percentages since this reduces the profits intended for distribution to owners or shareholders.11

The Articles can therefore prescribe that members of the board are guaranteed a share of the profits for their work, the level of participation in profits usually defined as a percentage of annual profits of the company. As part of their total compensation for work, members of the board are entitled to a salary, a profit share, reimbursement of expenses, insurance premiums, commissions, and other additional payments.

Examples of board members' compensation are listed in the LCC. The provision therefore cannot be interpreted in a way where members of the board are entitled to all types of the compensation listed. In principle, it is up to the contracting parties (member of the board and the joint-stock company, represented in this case by the Supervisory Board) to determine the types and scope of receivables. However, the law applies the principle of proportionality of compensation to the tasks of the board members and to the company's financial state. This proportionality is only a principle until the occurrence of circumstances signifying a deterioration of the company's economic position.

The type and level of compensation of the board member are determined by the Supervisory Board or, if the joint-stock company has no Supervisory Board, the assembly (261.3 LCC). The Supervisory Board determines the type and level of compensation for individual board members by way of a resolution, or it can also adopt an act which generally sets out the rules for compensating members of the board (rules). The rights and obligations of board members of the company are defined by contract (Article 259 LCC). The chairman of the Supervisory Board represents the company (Article 275 LCC) when closing contracts with members of the board. If, after the compensation has been defined, the company's operations worsen so that the economic position of the company is jeopardized or if damage is actually caused, the Supervisory Board may reduce compensation (253.2 LCC).

These are legally defined changed circumstances that justify one contracting party (the company) to amend the contract and the other contracting party to withdraw from the contract. These circumstances must occur after the compensation has been defined. The deterioration of the company's operations must be such that it jeopardizes its economic position or that it could cause damage.

The resolution on the reduction of compensation is adopted by the Supervisory Board. The law offers no possibility for the Supervisory Board to change other provisions of the contract despite the occurrence of the circumstances described above. A deterioration in the company's operations only allows the Supervisory Board to reduce compensation.

A reduction of compensation although for reasons of objective deterioration in the state or operations of the company is a legally prescribed justification of withdrawal from the contract, regardless of any other provisions regulating such withdrawal in the contract between the board member and the joint-stock company. Regardless of the period of notice, the one stipulated by law prevails (the end of the following quarter with a two-month period of notice). If the compensation of an individual board member is not in accordance with the abovementioned provisions, the company may be fined at least 3 million Tolars and the responsible person at least 150,000 Tolars for committing a commercial offence.

Agreement on Minimum Contents of Individual Contracts for Managers

The general collective agreement for commercial activities and collective agreements for commercial activities are respectively fully and partially inapplicable to management workers and workers with special authorizations and responsibilities (managers). According to the Agreement on Minimum Contents of Individual Contracts of Employment for Managers and Workers with Special Authorizations (Official Gazette of the Republic of Slovenia, No. 64-3117/97) which constitutes the basis for contracts of employment for managers, the individual contract of employment must define:

· the position for which the contract is concluded;

· the salary and benefits;

· duration of the contract; and

· other components of employment contracts.

Individual contracts of employment may also define the right of managers to the same scope of the following entitlements from the collective agreements as defined in the general and collective agreements for commercial activities:

· sickness benefits for up to 30 days;

· solidarity assistance in the event of the death of the person closing the contract;

· reimbursement of the costs of food;

· reimbursement of costs for transport to work if not entitled to a company vehicle also for private purposes;

· reimbursement of the costs of business trips;

· supplement for field work; and

· supplement for separated living.

The above listed entitlements in order to be actionable must be expressly agreed in the individual contract of employment either by stating them or by referring to individual articles of the collective agreement applying to the employer. A more detailed content of contracts of employment is defined by the criteria for individual contracts of employment for managers.

Criteria for individual contracts of employment for managers

The criteria for individual contracts of employment for managers (Official Gazette of the Republic of Slovenia, No. 64-3118/97)12 are commonly recommended guidelines by employer organizations and the Slovenian managers' guild13 to competent bodies of commercial companies and to managers for the conclusion of individual contracts of employment for managers. They are intended for use in all commercial entities established under the Law on Commercial Companies.

Managers according to these criteria are management workers and workers with special authorizations and responsibilities, and procurators, if they are employed with that company. These provisions can partially also be used for concluding contracts with high-level experts.14 The purpose of these criteria is to include in individual contracts of employment stimulative compensation for managers as a result of successful management and to make their benefits co-dependent on:

· the business results of commercial companies;

· the salaries of persons employed in these companies; and

· the economic situation in the country.

In cases of crisis management, the contracting parties to an individual contract of employment may also apply different criteria for compensation of managers. Since the general collective agreement for commercial activities fully, and collective agreements for commercial activities partly, excludes managers and workers with special authorizations and responsibilities, the parties who signed the criteria concluded a special agreement between representatives of employers and the guild organization of managers. This agreement defines those entitlements from collective agreements for commercial activities that also apply to those employed under individual contracts, on the condition that these entitlements be included in the individual contract. According to the criteria, a management worker is a person performing the tasks of management for the employer (chairman and members of the board in joint-stock companies, general managers of limited liability companies, and the management of other companies). A worker with special authorizations and responsibilities pursuant to the criteria is an employee who is defined as such by an act of the employer, the founding contract of a company or the constitution of a company. According to the criteria, a company act is a general or individual act of a body of the company, defining:

· the tasks of management workers and workers with special authorizations, the content of their authorizations;

· the criteria for determining the number and type of high-level experts and areas of expertise, and for which a non-typical contract of employment can be concluded; or

· the criteria for determining whether they have satisfied the work results required.

The body competent for concluding an employment contract is the body which is, given the company's status according to status and labor legislation, competent for concluding individual contracts of employment. These bodies are usually those competent for the selection and appointment of these workers. An individual contract of employment or an individual contract is a contract of employment which an employer may conclude with managers and high-level experts. The basic salary is the salary (in gross amounts) agreed in the individual contract of employment for each individually appointed manager or high-level expert. Individual contracts of employment with board members or general managers of limited liability companies are concluded by the legally authorized body of a commercial company: for joint-stock companies the Supervisory Board, for other types of companies the shareholders' assembly. An individual contract with a procurator is concluded by an authorized management worker on the basis of a resolution on appointment. Individual contracts with other managers and high-level experts are concluded by an authorized management worker within the scope of his competencies. An individual contract is concluded for the period for which managers are appointed.

Obligations and rights of managers

The basis for acquiring compensation and other rights under an individual contract is the fulfillment of the obligations and responsibilities taken on by the manager. This is defined by the annual or several-year economic plan of the company, the company's goals, the rehabilitation program or otherwise. A manager's obligations must be defined for one business year, so as to provide the possibility of measuring realization of these obligations. The contracting parties to an individual contract of employment agree on the manner of monitoring the fulfillment of obligations on the basis of quarterly business results and the annual business report and the closing balance. The planned profits and return on investment are the most important criteria for monitoring completion of obligations and constitute the basis for profit sharing. Because of the possibility of monitoring the fulfillment of obligations which define the salary, the contracting parties also define other criteria in the individual contract:

· improvement of the economic position of the company or enterprise within the activity area, branch, group or subgroup, measurable by indexes which are characteristic for the company's activity;

· comparison of profits and capital yield of the company with other similar commercial companies;

· fluctuations in profits compared to the previous business year;

· increase in exports;

· maintaining and increasing the number of jobs;

· reducing negative business results; or

· other criteria.

For managers in commercial companies in crisis, the obligations in an individual contract are defined for the time until losses are overcome and usually for an additional three-year period of the company's positive operations.

Salary and other compensation

The basic salary for presidents of the Management Board and general managers is determined as follows: half of the basic salary is in line with the average salary in the Republic of Slovenia (PPS), while the other half of the basic salary is set according to the average salary per employee within the commercial company (PPP). The most recent data on three-month averages is taken into account. The basic salary is determined by multiplying the basis described above by an appropriate factor, depending on the company's size.

· small-sized companies = (PPS + PPP):2 x 4

· medium-sized companies = (PPS + PPP):2 xÊ6

· large companies = (PPS + PPP):2 x 8

When defining the size of a company, the criteria of Article 51 of the LCC are applied. In commercial companies operating with an above average rate of return for the branch or activity group, the basic salary can be increased by a maximum of 25%. The competent body may, at its own discretion, also take into account other company-specific criteria for increasing the basic salary up to half of the mentioned maximum. In companies incurring losses or with a considerably lower rate of return than the branch or activity group average, the competent body may reduce the basic salary by a maximum of 25%. In medium-sized or large companies, the basic salary of the chairperson of the board or general manager should not be lower than the basic salary of the highest tariff class in the tariff annex to the general collective agreement for commercial activities, increased by 20%. In smaller companies, the basic salary of the company manager can also be lower.

The basic salary for board members and workers with special authorizations is defined at an appropriate lower level than the salary of the chairperson of the board and the general manager of the commercial company. The scope of authorizations of members of the board and other managers, the difficulty level of their tasks and the direct responsibility for their completion are taken into consideration. According to the criteria, the basic salary of these managers should not be lower than the starting salary for the highest tariff class in the pertinent commercial company pursuant to the general collective agreement for commercial activities, increased by 10%.

The basic salary for high-level experts is defined by the contracting parties in view of the importance of the expert for the company. The basic salary of such an employee cannot be lower than the starting salary of the tariff class of the expert's position. The contracting parties to an individual contract of employment agree as to the flexible part of the salary which depends on current business results. If planned business results are not attained, the basic salary may be reduced accordingly, while it may be increased accordingly if the planned business results are exceeded.

The criteria for calculating the decrease or increase in the flexible part of the salary are defined in advance in the individual contract of employment in line with company acts. Profit sharing, defined by the commercial company's competent body in accordance with the LCC, depends on the following:

· completion of the tasks and obligations taken on with the individual contract of employment;

· the capital/profit ratio;

· any increase in capital value; and

· other indexes.

In commercial companies operating in a crisis, the competent body may, exceptionally, award the managers or only certain managers a special bonus due to a considerable reduction in negative business results in line with the rehabilitation plan or other business plan. Managers are usually rewarded through profit sharing when the commercial company begins operating positively. The chairperson of the board or the general manager entitled to a profit share due to good business results is entitled, depending on the company's profit-sharing policy, to no more than 30% of his annual compensation from this source. Other managers receive a proportionally smaller share, considering their obligations, authorizations and responsibilities. A profit share is paid either in cash or in stock or stakes in the commercial company, or both; there is also the possibility of a deferred payment. The commercial company's competent bodies decide on the criteria for profit sharing, the manner and time of payment, in accordance with the profit-sharing policy. The profit share to be paid out in cash may, with the consent of both contracting parties, be retained in the commercial company for a certain period, and a period may be prescribed during which the recipients must retain the stock or stakes received as profit shares.

Other possible benefits for managers

The individual contract of employment may also include the following benefits for managers (or only certain ones):

· additional education;

· preventive medical check-ups and preventive health care;

· reimbursement of special additional expenses for business trips and entertainment expenses;

· scope and type of life, accident or pension insurance;

· purpose-specific credits;

· use of a company vehicle for personal needs;

· membership fees for managers' associations and clubs; and

· other benefits.

Benefits are defined in the individual contract of employment taking into consideration the economic position of the company or enterprise. Pursuant to the Criteria for Individual Contracts, managers are entitled to the following:

1. in the event of dismissal without substantial grounds, the Law on Commercial Companies stipulates a payment of no less than 24 times the last monthly salary;

2. in the event of agreed termination of the mandate prior to completion of the period for which they were appointed (long-lasting illness, permanent inability to work, and other justified reasons) 6 times the last monthly salary;

3. in the event of termination of the mandate on the manager's own request and with a positive evaluation of the competent body 6 times the last monthly salary;

4. in the event of termination of the mandate and of employment due to retirement 6 times the last monthly salary;

5. a manager whose individual contract of employment terminated is entitled to receive the same salary as the final month prior to the termination of his mandate for another 3 months if posted to another position with a lower salary; and

6. a manager is entitled to receive severance pay only once from the same employer or within a system of connected companies.

If, upon termination of the manager's employment, the commercial company enforces the competition clause defined in the contract in accordance with the law, a manager or high-level expert is entitled to damages due to reduced capacity to generate income. The basis for calculating damages is the average salary for the last three months, defined in the individual contract. Damages are paid for the duration of the competition clause.

II. PARTICIPATION BY EMPLOYED PERSONS AND MANAGEMENT IN PROFITS AND ENTERPRISE RESULTS IN SOME EU COUNTRIES, THE USA AND SLOVENIA

Brief overview OF selected EU countries

Pepper report

According to the Report of the Commission of the EC on promoting participation by employed persons in profits and enterprise results15, active campaigns to promote employees' participation can be found in France, the UK, Finland, the Netherlands and Ireland. Countries like Germany and Italy refer in this respect to the responsibility of the social partners. In Ireland a specific national program was launched.16 Council recommendation (92/443 EEC) of 27. 7. 1992 on the promotion of participation by employed persons in enterprise results called on member-states to:

- ensure that legal structures are adequate to allow the introduction of the financial participation referred to this recommendation;

- consider the possibility of incentives such as fiscal and other financial advantages that encourage the introduction of certain schemes;

- encourage the use of such schemes by facilitating the supply of adequate information to all relevant parties;

- take account of the experience gained in another states, when deciding on which participation schemes to promote;

- ensure that in the context of the laws and regulations and practice existing in the member-states the parties concerned have a wide range of options and arrangements available, whose implementation would, when suitable, be the subject of consultations between employers and employed persons or their representatives;

- ensure that this choice can be made at the level which takes into account national collective bargaining legislation; and

- enhance management and labor awareness of the above matters.17

In summary, the following PEPPER schemes can be distinguished:

PS profit sharing

SBS share-based profit sharing

BPS bond-based profit sharing

CBS cash-based profit sharing

DBS deferred profit sharing

ESO employee stock ownership

SO stock options

DSO discretionary share options

ESOP employee stock ownership plans

EBO employee buy out

A brief presentation now follows of the situation in Germany, France and the United Kingdom, with reference to the PEPPER 2 report. Germany

German legislation provides no incentives for profit sharing, however the German government recently took the initiative to develop legislative regulation in which individual firm level schemes can be promoted, developed, disseminated and sustained in the context of central agreements between the social partners.

In addition, the income tax law enables employees, who are offered price-reduced shares by their employers, to receive in relation to these benefits exemptions from tax and social insurance payments up to a maximum tax free amount of DEM 300 on the condition that companies subsidize the acquisition at up to 50% of the interest value and that the shares are frozen for period of 6 years.

In 1995 the German government appealed to the social partners to consider employee share ownership and other related schemes as part of their wage agreements.

France

Since the end of the 50s France legislation offers a legal framework and generous tax advantages to a variety of financial participation forms: voluntary cash-based profit sharing, deferred profit sharing, employee share ownership plans and company saving plans. Further to the already substantial tax benefits, a law of 1994 particularly increased the tax advantages for deferred profit sharing and company saving plans.

The 1994 law has reinforced and adopted some of the conditions to be fulfilled for tax relief (including social security), such as:

- the collective and valuable character of the scheme;

- the principle of no substitution for other forms of remuneration; and increasing the maximum proportion of the total payroll allocated as profit sharing to 20% (10% since 1990); the principle of uniform calculations for all categories of employees18.

Deferred profit sharing has been an important vehicle for financial participation in France. France is the only European country where participation in company profits is obligatory for companies of a certain size. All firms with a minimum workforce of 50 employees (100 in 1990) are required to establish a deferred profit sharing fund.

United Kingdom

Since 1978 the significant growth of financial participation in the UK has been encouraged in legislation offering tax concessions to approved profit sharing and employee share ownership schemes. Employees and employers can decide which scheme allows them to promote financial participation in the best way on a voluntary basis.

In the 1995 Finance Act significant changes were made to the eligibility criteria for all five of the United Kingdom's employee financial participation schemes providing tax relief.

The 1996 Finance Act introduced a new company share option plan aimed at middle managers and those in middle and lower income ranges. Profit-related pay (PRP) schemes link part of employees' pay to changes in the profits of the business they work for.19

Approved employee share schemes allow employees to receive shares for free or at reduced price from their employer without being income taxed on the value of those shares. The company's costs arising from setting up approved schemes are also tax deductible20.

In addition to all these employee schemes, the Finance Act of 1984 offered tax relief on approved discretionary share options schemes (executive share option schemes).21

Apart from the statutory schemes described above, they are many profit-sharing and share option schemes in existence that are not approved. Conclusions of the 1996 PEPPER 2 report

Individual EU countries still range from those strongly or partly in favor of PEPPER, to those with no defined view. France and the UK have a long tradition in encouraging financial participation and they have also aimed towards variety in the schemes available.

In other countries such as Belgium, Denmark, Germany, Greece, Spain, Italy, Luxembourg, Portugal, Austria and Sweden the governments have discussed PEPPER, but official government support has been limited or lacking. Most of these governments have declared that these schemes are mainly the responsibility of the social partners or the employers and employee representatives within individual firms.

In Belgium, the government announced initiatives for legislation, in Ireland, the Netherlands and Finland there appears to be a development towards increased government support for participation by employed persons in profit and enterprise results.

The exceptions of France and the UK legislation in EC countries only favor certain schemes. The share ownership is most in favor, while cash-based profit sharing is less in favor. Several countries have reported that the trend towards privatization of public bodies has given rise to greater interest in employee participation schemes. In Portugal, specific schemes were developed in 1989 to provide for the issue of shares to employees when their public organization was privatized. In Denmark, privatization appears to have led to remuneration systems more closely related to the performance of the privatized firms and to possibilities to issue employee shares. In Ireland, the adoption of employee share ownership schemes has received greater attention in view of the risk participation by employees in a few high profile semi-state organizations. The acquisition of shares by employees in Italy has been encouraged as public undertakings have been gradually privatized. The same can be seen in the UK and the Netherlands. These suggest that governments can set up participation schemes as part of privatization development, thus getting and gaining experience and creating awareness of the possibility of those schemes for a wider audience.22

Financial participation in the usa

Selected data

It is well known that institutional investors in the US currently control 45-50% of the stock market. Different kinds of pension funds (public and private), mutual funds, insurance companies, etc manage so-called other people's money (for example 43% of these assets belong to pension funds, which manage workers' savings).

Out of 7,000 corporations whose stock is publicly traded on securities market or a Stock Exchange in 1990, (NYSE: 1762, AMEX: 833, OTC:4277), approximately 1,000 or 14.28% are employee owned ranging from, for example 4% (K Mart Corp.) up to 73% (Weirton Steel Corporation), but the average is about 10%. These 1,000 corporations constitute 29% of the market value and provide 20% of the jobs.23 According to the same data, 12.5% of the private sector workforce, or some 10.8 million American workers, own stock in corporations in which employee ownership exceeds 4%.

It is important to note that in 1974 only 13 public corporations reported that employee benefit plans were their largest stockholders, and only one plan (Sears, Roebuck & Co.'s profit-sharing plan attained 20% ownership. Five others Ford, US Steel, Textron, Mc Donnell Douglas and Burlington Industries averaged 12%24.

By 1981, employee investment funds were among the top stockholders in 69 Fortune 500 corporations and attained close to 20% ownership in just 11 cases. According to the same data, over 20 times more corporations are more than 20% employee owned. Some 41% of these corporations either have 15% or have stated that their employee plans are the dominant holder25.

What we can conclude from these figures is that the increasing process of employee financial participation in the USA that we have been witnessing since the early seventies, namely in the last three decades, was caused neither by mandatory rules nor by a legislative framework of any other kind. It was stimulated by tax incentives initiated by the federal government in order to promote employers' engagement in the social security of retired workers.

The US example may well serve as proof that no mandatory legislation is needed to promote employee financial participation if sufficient incentives exist within the overall economic condition of a country.

Different forms of financial participation in the US26

As concerns financial participation in the US, in practice several ways have developed, again without having any legal instructions or patterns, as for instance, different kinds of pension and retirement plans, stock ownership plans, contributions of any kinds given by the employer or employee side, savings a part of a salary, distribution or sale of corporate shares, stock option plans, etc. It is absolutely important to understand that tax incentives have played the crucial role in implementation of these concepts in real life and that no mandatory rule could provide a stronger push than that. In addition, the federal government is trying to avoid risks by limiting the percentage of assets invested for these purposes, enjoying tax advantages of up to an average 10%, and by paying insurance costs in some cases.

There are two forms of pension plans known in the US, a defined benefit plan and a defined contribution plan. The first refers to a retirement plan in which the cost of the benefit is not defined for the corporation, while it is clearly defined for the employee (usually a percentage of the previous year's salary). The employer agrees to contribute funds to an investment fund in money, stocks, bonds, real estate, etc. Depending on how those investments perform is the cost of a corporation's contribution.

In the case of defined contribution plans, a corporation contributes a fix sum to the investment trust and opens an account in the name of each employee. When an employee retires, she or he receives the assets plus the appreciation and income they generated. The income is tax free until withdrawn on retirement.

Leveraged Employee Stock Ownership Plan creates employee ownership by borrowing money (usually for five to ten years) to purchase corporate stock for employees while repaying the loan out of profits. Described in Section 4975 of the Internal Revenue Code, an ESOP is a defined contribution plan that invests primarily in the stock of the corporation in which an employee works. A corporation sets up a trust that manages the borrowed assets and invests them. As the loan is paid back, the shares of stock are allocated to employees' individual investment accounts.

According to the IRC, each year a corporation receives a tax deduction for repayments of loan principal because this loan is used for the benefit of employees, namely shares of corporate stock. The allocation of shares to employees is seen as deferred compensation, a benefit expense to the corporation under the Employee Retirement Income Security Act (ERISA). The upper limit of this deduction is 25% of the **W 2** just check that this is right, it is in any case an unexplained acronym, MB** compensation of participating employees, which is higher than for employee benefit plans. Dividends paid on the employee-held stock are also tax deductible under Section 404 (k) of the Internal Revenue Code.

401 (k) plans create employee ownership by purchasing corporate stock with employees' savings, as deducted from their salaries, plus the corporation's matching contributions and bonuses to the employee through the plan. The name 401 (k) refers to the relevant section of the Internal Revenue Code. The corporate tax incentives for 401 (k) plans allow company deductions for contributions up to 15% of the W 2 income of participating employees.

Deferred-profit-sharing plans create employee ownership by investing all or a portion of the corporate profits shared with employees in a retirement trust fund that buys corporate stock. Profit-sharing plans have substantially the same tax breaks as 401 (k) plans, allowing employer deductions for contributions up to 15% of total W 2 compensation for participating employees.

Employee stock purchase plans create employee ownership by simply selling shares to employees based on the belief that will mean more to employees if they pay directly with current savings. There are no special tax advantages for this model, which is criticized in theory.

Stock-bonus plans create employee stock ownership when a corporation contributes stock or cash to purchase stock. It is in a sense an ESOP that does not borrow money for share acquisition. Corporations obtain a tax deduction of up to 15% of the W 2 earnings of participating employees. Individual purchases of stock by employees also create employee ownership, but no tax incentives exist for this is the most simple, direct way of creating employee ownership.

Stock-option plans have traditionally been the most popular form of providing executives with an ownership interest. Options give participants the right to purchase shares in their corporation between certain dates at a price fixed by the corporation. The Internal Revenue Code distinguishes between a nonqualified-stock option (NSO) and incentive stock options (ISO) and a Section 423 plan. There are special conditions for tax incentives that must be fulfilled as regards the amount and price of shares, and the period in which the option must be exercised. Regulations also refer to the issue of participation of all employees that were employed in the corporation during a prescribed period of time.

Proposed new system of profit sharing for employees and managers in Slovenia

The Draft Law on Profit Sharing of Employees (LPSE) of Slovenia 27regulates the forms of profit sharing where the company or employees (workers and managers) are entitled to tax deductions or other benefits pursuant to special laws. Under the draft LPSE, profit sharing is voluntary. The draft law pertains to workers (employees) employed and subject to the tariffs section of the collective agreement, as well as to board members, general managers, and others to whom the tariffs section of the collective agreement does not apply. In short, the draft LPSE applies to both employees and directors/ managers. The question of which employees are entitled to profit sharing is regulated by a special contract. This contract may also stipulate any special requirements for acquiring this entitlement, e.g. a person must be employed by the company for a certain period of time although the law does not allow this period to exceed 6 months.

However, the draft LPSE does not apply to public undertakings of a certain corporate type or their employees and directors. This mainly involves companies under state control.

For example, the draft LPSE does not apply to companies whose sole shareholder or partner is the Republic of Slovenia or a municipality, or where the Republic of Slovenia is the owner of the sole shareholder or partner. The proposed law also does not apply to companies whose activity is organization of special games of chance, the Lottery of Slovenia, and investment companies established in line with the Law on Investment Companies and Management Companies.

Contract on profit sharing

The relationship between a company and those entitled to profit shares is defined by a contract as regulated by the draft LPSE. The draft LPSE stipulates certain requirements for profit-sharing contracts, to which tax deductions apply:

· the contract may stipulate the payment of a maximum 20% of the profits of the financial year, which must not exceed 10% of the annual sum of salaries paid in the company in the past year;

· individual employees may not receive more than their average monthly salary for the past year; and

· profit shares may only be paid after a certain time period, as set out in the contract, and which may not be shorter than 3 years.

If the profit-sharing contract entitles the employees to a profit share higher than that allowed by the law, tax deductions only apply to that part which does not exceed the amount allowed. Profit shares can be paid out:

· in cash; or

· in shares issued by the company, in an amount corresponding to the profit share to which the employees are entitled, within the time and in the manner set out in the contract.

The contracting parties are the company on the one hand, and the employees on the other. The LPSE expressly stipulates, in addition to the competencies of the assembly of the joint-stock company regulated by the LCC, that the assembly of the joint-stock company is competent for decisions on concluding such a contract.28

On the employees' side and on their behalf, the workers' council decides on concluding the contract and on profit sharing. Only if the company has no workers' council does the competent body of the trade union decide on concluding the contract, however only on the condition that at least 50% of all employees are its members. The initiative for concluding a contract may be given by:

· the company management;

· the procurator or several management workers together;

· shareholders holding at least one-twentieth of the capital stock; or

· the workers' council or trade union.

The elements of the contract on profit sharing are legally defined as follows:

· subject of the contract;

· level of compensation for use of funds by the company;

· criteria for determining the share of funds to which an individual employee is entitled in profit sharing;

· the profit-sharing scheme agreed by contract;

· the purpose of consuming funds from profit sharing in the company or the investment policy;

· the due date of payment; and

· termination of the contract.

The profit-sharing scheme, forming an integral part of the contract on profit sharing, defines:

· the employees' entitlements from profit sharing;

· the manner and deadlines for claiming these entitlements; and

· the method of informing employees.

The law states that the profit-sharing scheme must be equal for all employees, it does however allow payment for directors to be defined in a contract in the form of shares. The contract may cover profit sharing for one or several consecutive financial years. As to what share of the profits each employee is entitled, the law prescribes the principle of proportionality with the individual's average monthly salary for the past year, increased by the supplement for the person's working period corrected by the employee's tenure in the company, although the contract may also set this out differently. However, the law does prescribe as obligatory the principle of proportionality with the employee's tenure in the company. Employees are entitled to receive payment of the profit share on the day of adoption of the resolution on profit distribution, provided payment was decided on.

Profit-sharing schemes

According to the draft LPSE, profit shares can be paid in either:

· cash; or

· stock

· alternatively; or

· combined

In the so-called cash scheme, the employee's entitlements to a share of the profits are paid in cash, while in the so-called stock scheme the employee is entitled to ordinary shares registered in the company's name (the provisions on public sales of shares of the law regulating the securities market do not apply to these shares). It is essential for the stock scheme that the contract refers to the price that employees pay for the stock on the due date of their entitlement to a share in the profits. That price can be set out as:

· the last market price; or

· a fixed price.

However, the price of stock issued on the basis of the stock scheme must not be lower than the last market price for shares already issued by the company.29 The law defines an alternative whereby the profit-sharing scheme gives the employee the right to choose between:

· purchasing a certain number of ordinary shares registered to the company and issued by the company, on a certain day at a pre-defined price; and

· in the amount corresponding to the share of profits paid out in cash.

Also with these so-called alternative schemes the contract must contain the price of shares to be issued by the company on the basis of this scheme if an employee takes up his buy-option, and the deadline for claiming this entitlement. If the employee does not take up his buy-option within the option deadline, the company must pay him his share of the profits in cash (Article 17 LPSE). The draft LPSE defines the combined scheme as profit sharing giving the employee the right to:

· payment in cash of part of the profit share he is entitled to; and

· partly in the form of ordinary shares registered to the company and issued by the company.

Funds from profit sharing

From the day of acquiring the entitlement to funds from the profit share until the date due for these entitlements, defined by the law as a moratorium period for entitlements, these funds are managed by the company.30 It must be observed here that the funds must be invested so that the total investment in an individual form must not exceed 25% of the total funds from profit sharing, while the amount of investment in securities issued by the same person may not exceed 5% of the total investment in securities.

Alongside the funds which the company manages, it must also pay compensation for their use in an amount not lower than the interest rate for savings sight deposits as applied by commercial banks, but not higher than the interest rate for natural persons' fixed 12-month deposits. An additional legal requirement for managing funds from profit sharing is a guarantee of auditing even if not required to do so by law.31 Profits generated by managing funds from profit sharing go to employees, whereby the amount exceeding the legally defined upper limit of compensation as set out by the draft LPSE belongs to the company. The company must also cover any losses incurred through the management of these funds.

Taxation of funds from profit sharing

The draft law states that no contributions are payable from payments of profit shares which are in accordance with the law, however it refers to the special law regulating the payment of social security contributions. Additionally, the draft LPSE envisages that the funds from profit sharing, again in line with a special law regulating assessments, are acknowledged as an expense for purposes of paying tax on profits by legal persons. In addition to this, the employee is entitled to personal income tax deductions for profit sharing in accordance with the law regulating this area. However, the draft LPSE stipulates that directors, i.e. those employees not subject to the collective agreement, are entitled to tax deductions only in case of profit sharing paid in the form of stock. The level of tax deductions depends on the manner of payment of profits and the duration of the period for which this payment is deferred. This means that the draft LPSE sets out only the principles of tax deductions, while the actual regulation of these deductions remains with the pertinent tax legisaltion.17 The contract must be recorded in a special register kept by the competent tax authority; the register must contain a main book intended for recording the data required by law, and a collection of documents, i.e. contracts and other documents, for which the law states that they must be presented to the register or kept in the collection of documents. j

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