

White Paper Conference  
11<sup>th</sup> October 2023

# Employee Share Schemes

David Pett  
Temple Tax Chambers

# The Vermilion case

- Important, as it relates to the scope of charges to income tax under Part 7, ITEPA 2003 -
- Facts:
  - Mr N, an individual investor, granted a share option over 4 ½% of enlarged issued share capital
  - the company got into financial difficulties
  - other investors willing to ‘bail it out’ if (i) Mr N became a director and (ii) agreed to accept a fresh option grant over a smaller percentage but – as it happened – exercisable up to one year later
  - fresh option agreement made after appointment as director
- The issues:
  - was the opportunity to acquire a share option “by reason of” employment?
  - if not, did the “deeming provision” in s471(3) apply
- Taxpayer won in FTT and CSIH (2 to 1). HMRC won in UTT.
- Appeal of HMRC heard 7<sup>th</sup> February 2023. Decision awaited

# Other recent decisions of the court

## Tribunals

Temple tax  
chambers

- **Moore v HMRC (FTT)** – charge on share option gain: deductible amount
- **Jones Bros (Ruthin) v HMRC (FTT)** - the Grant Thornton “GSOP”
- **NCL and others v R&CC** – deductibility of accounting debits under IFRS2 (Supreme Court)
- **Ponticelli v Anthony Gallagher (CSIH)** – loss of benefit of participation in a SIP upon a TUPE transfer
- **Bhaur v Equity First Trustees (CA)** – misuse of an EBT: a salutary tale of family woe!

## Moore v HMRC [2023] UKFTT 00399 (TC)

- Company sold for US\$200m
- Taxpayer vendor also negotiated an award of RSUs in the acquiring company
- Claimed that part of the value of the shares sold was given as consideration for the RSU awards so as to be deductible in calculating the taxable gain on exercise (subject to IT/NICs under PAYE) of the RSUs
- Whilst that could have been possible, the documentation showed that the RSUs were for future employment, and were not consideration given for the shares sold
- Like the **Charman** case [2022], this is an example of an appeal which should not have been taken: had he won, it appears that the value of the RSUs would have been charged to income tax under Chapter 3D as he would have sold his shares for more than was paid pro rata to other vendors (per **Gray's Timber**)

# The Grant Thornton “GSOP”

- Widely-marketed scheme based on the exclusion of a “contract for differences” or a “contract similar to a contract for difference” not being within the definition of a “security” for Part 7 purposes
- So, if an employee benefits from the acquisition and disposal of a CfD under which the amount of benefit or loss is, or is directly proportional to, growth in the value of shares in the company, there would be no IT on acquisition at an undervalue, and no IT on the gain realised
- That remains the case!
- The problem was that the GSOP awards were structured on the basis that, whilst growth hurdles triggered a payout, the quantum was not directly linked to the growth

# Jones Bros (Ruthin) and others v

## HMRC – FTT [2022] – a test case re the GSOP

- HMRC challenged the schemes on the basis that the operation of the contracts meant they were not CfDs or similar
- The payouts were not directly proportional to the movement in value of the reference asset, and the balance of risk (of upside gain vs downside loss) was not equal
- If the employee were obliged to make a payment under the contract, there was evidence that they would receive a bonus in any event
- So, were they to be taxed on acquisition as “securities”?
- No: they were in substance arrangements for the payment of deferred cash bonuses and fell to be taxed as such

# Issues with so-called “growth share

- Creation and issue of a class of share, the IUMV of which is acceptably low but which, if hurdle values are achieved, become equal in value to the ordinary shares in issue
- Difficult to draft properly
- Requires the rights and restrictions to be inherent class rights (as opposed to “restrictions” per s423) and, in my view, therefore need to be set out in the articles
- Must make a s431(1) tax election on acquisition
- Not sufficient to rely on the company law principle in *Re Duomatic*, that unanimity of agreement of all members is equivalent to the passing of a special resolution
- Problem of HMRC using hindsight in challenging the initial UMV
- Do not draft as “convertible securities”!

## NCL & others v R&CC [2022] STC 599 (SC)

- CT deductibility of accounting debits for share option grants under IFRS2
- Options granted by an employees' trust, but employer companies within the Smith & Williamson group obliged to recognise under IFRS2
- Claims allowed as:
  - Profits to be determined in accordance with ord acc principles – s54 CTA 2009
  - No requirement that expense had to be “incurred”
  - Debits incurred for the purposes of the trades and were income, not “capital”, expenses
  - Grant of options was not an “employee benefit contribution” per s1290
- **Remember:** since 2013, if CT relief available for share option gains, no other relief available under general principles – s1038 CTA 2009

# Share schemes and TUPE transfers

- **Ponticelli Limited v Anthony Gallagher** [2023] CSIH 32 (Decision dated 15 August 2023)
- Employee had entered into a subsisting contractual agreement to participate on an on-going basis, by making monthly deductions from salary to be accumulated and used to buy shares in Total group under a SIP
- The business in which he was engaged was sold outside the Total group and his employment was transferred under TUPE
- Ct of Session upheld his claim for compensation for loss of being able to participate in a similar scheme (which his new employer could not have established even if they wanted to!)
- Is this of wider application?
- How is a right to participate in an “evergreen” SIP to be valued?

## Open Consultation by HMRC (now closed) on EOTs *and* the taxation of EBTs

- Its purpose was to ensure that the reliefs are targeted closely at incentivising EOTs as a employee ownership business model while preventing the reliefs from being used for unintended tax planning
- 11 qus on EOTs, but only 3 on the taxation of EBTs generally
- My responses (2) are available on [www.davidpett.tax](http://www.davidpett.tax)

# Suggested changes to the taxation of EBTs

- See responses at [www.davidpett.tax](http://www.davidpett.tax)

## IhT: reform s86 IhTA

- Confirm the judicial views re family-succession planning as per ***Barker v Baxendale-Walker***, and the ***Bhaur v First Equity*** cases

## CGT: why not “level the playing field as between the use of offshore and UK trustees?”

- ss144ZA and 239ZA effectively discriminate ***against*** the use of UK trustees

# The misuse of EOTS

- Rather than Mr T sell X Ltd to a trade buyer (Z) for £10m,
  - First, he sells 51% to an EOT for, say, £5m free of CGT (of which, say, £4m is left outstanding) retaining control of the trustee and, after 2 clear tax years, sells to Z his 49% and has the EOT sell its 51%
  - If there remains anything in the trust fund after the trustees have paid both the outstanding consideration and the CGT (calculated by reference to T's base cost), it can be distributed amongst those employees (and ex-employees who have left within the past 2 years) **subject to IT/NICs**
  - The sale price paid by Z to the trustees will be enhanced by the value of the CT deduction due to X Ltd for any such distribution
  - Mr T receives the £5m tax-free and the additional consideration from Z subject to BADR (if applicable)....if Mr T has not already fled abroad.....

# The “political” divide

- EOTs have become a “Marmite” subject, with a widening division between:
  - those who support the idea that *“for so long as a worker gives his labour, he should share in the growth in value to which he contributes”* i.e. direct employee share ownership a la Tesco; and
  - those who see wider political and social benefits from collective share ownership through a trust, regardless of the ability of individual employees to participate in growth i.e. the “John Lewis Partnership” model

Do you read “The Oldie”?

Do have a read of the article “*I once met John Lewis*” by John de Bruyne  
on page 52 of the August 2023 edition!