

# Growth Shares

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Is “best estimate” met in an external valuation, even if not forward looking?

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# PAYE – best estimate

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## Background

- Where growth shares (or any shares) are issued/acquired by employees and the shares are readily convertible asserts (RCAs) the employer is obliged to operate PAYE, i.e. pay income tax, NI etc to HMRC within 4 – 6 weeks of the taxable event.
- Not dealing with RCAs in this session, but broadly, to be RCAs, the shares need to be marketable or arrangements in place which could lead to them being marketable or no corporation tax deduction would be available (e.g. the company is a controlled company)
- Therefore, employers need to assess the market value of the shares in order to operate PAYE correctly. This is often addressed by instructing a third party valuer (the focus of this session) or an internal valuation by, for example, the CFO.

## Valuation test

- Any undervalue at grant will be taxed as earnings under s.62 ITEPA 2003.
- Where an election under s.431 ITEPA 2003 is made market value will be the unrestricted market value (UMV); i.e. ignoring the impact of restrictions such prohibition transfer, good/bad leaver. Standard practice for such elections to be made and for forfeiture restrictions to last more than 5 years.
- UMV for these purposes uses the capital gains tax definition of market value (see s.421 ITEPA 2003 and ss 272 and 273 TCGA 1992)
- S.273(1) TCGA 1993 – “ ... The price which the asset might reasonably be expected to fetch on a sale in the open market”
- S.273(3) – “ ... it is assumed that ... there is available to the prospective purchaser ... all the information which a prudent prospective purchaser ... might reasonably require ... “

# PAYE – best estimate

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## Best estimate

- S.696 ITEPA – where income is provided in the form of an RCA the PAYE is assessed “ ... on the basis of the best estimate that can reasonably be made ... “
- As this is an estimate, HMRC are not precluded from accepting that the employer has made a “best estimate” but dispute the valuation with the employee. Any liability is then a self assessment matter
- What constitutes the employer’s best estimate?
- Not defined
- Employer needs to take reasonable care to operate PAYE correctly
- Why a forward looking approach (e.g. PWERM or Black Scholes):
  - HMRC acknowledge that a buyer of a small uninfluential minority holding would normally only be entitled, when considering the value of the shares, to published financial information (SVM114040).
  - However, it is necessary to consider the nature of the investment. HMRC guidance states:

“ ... due to the nature of the investment any prudent purchaser would require further information and demand as a condition of buying. An example of such an investment would be where the value is wholly dependent on the company achieving a growth target and where there is some provision for an early exit. Such arrangements are commonly called “Growth Shares”. Clearly in such circumstance the growth prospects are intrinsic to the investment and so no one would proceed without access to additional information such as company forecasts.” SVM114040
- See also *Netley v HMRC* [2017] UKFTT 0442 (TC) – AIM listed with thin market. Netley argued that this was a growth stock and so should be valued with forecasts. FTT rejected this citing the SAV Manual referring growth shares was to a special type of share. However, the Tribunal did endorse HMRC’s approach to growth shares (see above)

# PAYE – best estimate

Circumstances	Best estimate – yes/no/ maybe
Independent 3 <sup>rd</sup> party valuation using forward looking methodology	Yes
Independent 3 <sup>rd</sup> party valuation using current value method (“CVM”), e.g. EBITDA * market multiple to derive current EqV but company has given clear scope (e.g. UK tax valuation of the growth shares) and the valuer has the right expertise. Valuer acknowledges the forward looking approach and explains why it is not appropriate	Likely, yes
Scope and work not focused on UK tax valuation of growth shares and/or valuer does not have the expertise	Unlikely as lack of care taken
Does the valuation take into account all relevant facts, e.g. exit preparations/discussions	Unlikely

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