



# Employee Incentives & Share Plans

## *Employee Shareholder Status*

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## Agenda

- Key points
- Tax on acquisition.
- Capital gains tax.
- Importance of section 431 elections.
- Corporation tax.
- Material interest.
- Valuations
- Controversy and future.

## Key points

- Basic concept – employees receive an issue of at least £2,000 worth of shares in their employer (or its parent undertaking) in return for giving up certain statutory employment rights, most notably unfair dismissal.
- For shares with an unrestricted market value on acquisition of up to £50,000 or less, there is an exemption from capital gains tax on disposal.

## Tax on acquisition

- Subject to income tax under s226A ITEPA.
- Taxable amount is the actual market value of the shares (taking into account restrictions) less £2000.
- Thus general rule is that employee is regarded as having paid £2,000 for the shares. This amount is thus exempt from income tax and NICs.

## Tax on acquisition – multiple days

- If acquisitions take place on multiple days then payment is due the first day that the employee acquires £2000 or more of shares.

## Tax on acquisition – issuance

- Shares must be new issue.
- BIS statement suggested otherwise but this is not part of the law.

## Tax on acquisition – no other consideration

- Employees may not give any other consideration for the shares other than the deemed £2000 and entry into the employee shareholder agreement.
- Great care needed on this issue in a general employment and wider capacity. What counts as consideration here?
- Potential “dry income”.

## Tax on acquisition – interaction with ERS

- Income tax charge determined by reference to “actual market value” taking into account any restrictions.
- Thus, there is the potential for the restricted securities regime to the extent the unrestricted market value is greater than the £2000 deemed to have been paid for them per their actual market value.

## Tax on acquisition – interaction with ERS

- Section 431 elections thus desirable to secure CGT benefits discussed below.
- Adds to the potential “dry income” issue.
- However, could make a big difference.

## Capital Gains Exemption – interaction with ERS

- See s236B-G TCGA.
- Gains on the first £50,000 worth of employee shareholder shares exempt from CGT.
- Value of £50,000 determined by reference to the value of shares acquired on the day the limit was exceeded.
- Unrestricted market value is the determining factor here.

## Capital Gains Exemption – interaction with ERS

- If unrestricted market value on acquisition is greater than £50,000 then exemption will apply to appropriate proportion of shares on the day the limit was exceeded.
- Thus if acquire £100,000 of shares then £50,000 worth will be eligible for exemption.
- Eligibility for a CGT exemption is of little help if within income tax regime; thus elections can be vitally important.

## Example - facts

- Fred acquires employee shares with an actual value of £25,000 and an unrestricted value of £75,000 in one acquisition.
- Fred pays income tax on £23,000 using the £2,000 deemed payment but makes no election.
- He later sells the shares for £200,000.
- Significant gain. Credit given for £2000 deemed payment and other amounts charged to income tax in determining base cost.

## Example - result

- Two thirds of the gain is *eligible* for the ESS CGT exemption and one third is not – this represents the fact that the first £50,000 of value is eligible but the additional £25,000 is not.
- However, since Fred only paid one third of the IUMV on acquisition, two thirds of the gain is subject to employment income tax treatment under section 431 ITEPA.

## Example – result(2)

- Fred will be eligible for a full CGT exemption on one third of his gain.
- However, the remaining two thirds will be subject to employment income tax treatment.
- If Fred had made an election he would have been eligible for a full CGT exemption on two thirds of the gain and CGT on one third.

## Importance of elections

- In instances where restricted securities are involved section 431 elections are vital.
- However, they could be unattractive in certain instances.
- Will employees want no employment rights and a larger up front tax charge?

## Corporation tax deductions

- Employer corporations entitled to relief in respect of employee share acquisitions.
- The £2,000 deemed consideration is ignored.
- Again, renders elections important for employers in many cases.
- Remember annual reporting to HMRC.

## Material interest

- If an employee or a person connected with that employee has a “material interest” in the employing company or its parent undertaking then exemptions do not apply.
- Broadly 25%.
- Extends to rights to acquire interests and rights held within the past year.

## Material interest

- Note that an individual can have a material interest in another company within the group if it is not the employer or parent undertaking.

## Valuation issues

- As can be seen – value of at least £2,000 needed but also want to keep value low for ERS reasons.
- Put options have been used by some “start up companies” in which the £2,000 threshold would be difficult or would result in a breach of the material interest requirement. Accepted by HMRC.
- HMRC can be approached on value.

## Potential loss of relief

- Be aware of share reorganisations, changes of control etc.
- Tax advantages can be lost but employment rights are not regained.

## Employment/corporate

- Procedure is vital here.
- Employees must have the opportunity for independent legal advice paid for by employer (tax exempt).
- Real need to understand what employee is sacrificing.
- Outside scope of this talk.

## Controversy

- George Osborne announcing “shares for rights” in 2012.

*“This idea is particularly suited to new businesses starting up; and small and medium sized firms. It’s a voluntary three way deal. You the company: give your employees shares in the business. You the employee: replace your old rights of unfair dismissal and redundancy with new rights of ownership. And what will the Government do? We’ll charge no capital gains tax at all on the profit you make on your shares. Zero percent capital gains tax for these new employee-owners. Get shares and become owners of the company you work for. Owners, workers, and the taxman, all in it together. Workers of the world unite.”*

## Controversy(2)

- Paul Johns, IFS

*“it has all the hallmarks of another avoidance opportunity”*

- Lord O’Donnell, House of Lords.

*“we know that in the old days the price of slavery was 20 or 30 pieces of silver. Is it now £2,000?”*

## Who does this attract?

- Higher earners in more senior positions are far less likely to be concerned about the loss of employment rights.
- Higher earners in more senior positions are far more likely to be in a position to meet a substantial “up front” income tax charge on the making of an election.
- Higher earners in more senior positions are likely to secure more significant gains later.

## Private equity

- Employee shareholdings can be especially attractive in private equity fund investee companies.
- Potential for significant tax savings on sweet equity.
- Potential for multiple use in certain cases (if investee companies not associated)

## Private equity

- PE industry slow to take up ESS.
- Bad publicity was a concern.
- European Capital led with the Whitworth deal in September 2013.
- Now commonplace, especially given changes to carry.

## Anti-avoidance lite

- No restriction on type of share – growth shares etc. can be ESS shares.
- Can apply to overseas companies.
- No TAAR.

## Start ups and SMEs?

- Threshold of £2,000 a challenge for a typical start up.
- Will lower paid employees really be happy to give up their employment rights?
- What about paying the tax charge on dry income?
- What about costs for SMEs of meeting reasonable independent legal advice.

## Start ups and SMEs?

- Gaining ground with more “medium” end of SMEs  
– generally better placed to take advice on contracting rights back, meet costs of independent advice etc.

## Future

- On implementation this was due to be subject to monitoring by the Treasury.
- General view is that it has a “shelf life” in its current form.
- GAAR?

## Conclusion

- Dealt here with tax issues.
- Corporate/employment equally important.

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