SHARE PLAN PARTNERS

Employee Shareholder Shares

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From 1 September 2013, it has been open to any company to invite any number of selected employees to enter into a written agreement whereby, in return for giving up certain employment rights, including the right not to be unfairly dismissed (subject to certain exceptions), the company, or its holding company, issues to the employee new fully-paid shares.

In particular, the employee is required to forego rights to:

1. Bring a tribunal claim for unfair dismissal unless:
   - the dismissal is automatically unfair
   - the dismissal amounts to a contravention of the Equality Act 2010 (ie it is discriminatory), and/or
   - the dismissal is by reason of a health and safety requirement or recommendation

2. Receive statutory redundancy pay

3. Request flexible working (other than in the two-week period after a return from parental leave), and

4. Request to undertake study leave or training.

The employee will also be required to give 16 weeks' notice of an intention to return early from maternity leave, additional paternity or adoption leave.

The changes to employment rights result from the acquisition of the shares and are not reactivated when the shares are disposed of.

The employee will, however, have specific protection from being:

1. Subject to any detriment as a result by an act or deliberate failure to act by their employer, and

2.Unfairly dismissed

because they refuse to accept an offer to become an employee shareholder.

Both the individual and the employer must understand which rights an employee shareholder will not have, as this must be communicated in the written statement.

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Also, there is nothing stopping the waived statutory rights being replaced by similar contractual rights. It is open to the employer and the employee to agree these.

Both the individual and the employer must understand which rights an employee shareholder will not have, as this must be communicated in the written statement. However, an employee shareholder still has the following rights:

1. Statutory sick pay
2. Statutory maternity, paternity and adoption leave and pay
3. Unfair dismissal rights where they are classed as automatically unfair reasons, where dismissal is based on discriminatory grounds and in relation to health and safety
4. Minimum notice periods (e.g. if an employer is dismissing them)
5. Time off for emergencies
6. Collective redundancy consultation
7. TUPE
8. Not to have unlawful deductions from wages
9. Paid annual leave
10. Rest breaks
11. The right not to be treated less favourably for working part time or fixed term
12. Not to be discriminated against

The shares may, by the terms of the agreement, be 'restricted' as to the right to transfer them and/or by imposing an obligation to sell them on leaving employment, and they may be a specially created class of 'incentive' or 'growth shares', but the 'market value' of the shares issued (determined after taking account of all restrictions attaching to the shares in the hands of the employee) must be at least £2,000. It is for the company/group to determine the number/value of the shares to be so offered to an individual.

Apart from entering into the agreement, the employee must not give any other consideration for the acquisition of the shares.

Employees having, or treated as having, a 25% 'material interest' in the company or, if different, any holding company, are excluded from benefitting from the tax reliefs described below.

Limited income tax relief on acquisition

The acquisition of the (employment-related) shares by the employee will be taxable in the normal way, but the employee is treated as having given £2,000 consideration for the shares so that, in effect, a charge to income tax and NICs arises on only the value of the shares over and above that £2,000. If the shares are 'restricted securities' (as defined for income tax purposes), the employee will normally be required to join in making an election under s431 ITEPA which will increase the amount on which tax is payable upon acquisition of the shares. The employer company should, in accordance with normal rules, qualify for relief from corporation tax for the full value of the shares issued.

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Exemption from CGT

To the extent that the initial unrestricted market value of such ‘employee shareholder shares’ does not exceed £50,000, there is complete exemption from capital gains tax on any capital gains realised on disposal of the shares. Once an employee has acquired ‘employee shareholder status’ with one employer company, he or she can subsequently acquire employee shareholder status with another unassociated employer company and be issued with further shares of up to £50,000 in that other company qualifying for the CGT exemption. There are some further detailed points concerning capital gains tax in relation to shares acquired under this legislation:

1. The normal rules for transfers between spouses or Civil Partners treating transfers on a no-gain/no-loss basis do not apply so that instead, the rules on transfers between connected person applies with the transferee being deemed to acquire the shares for a consideration equal to their market value at the time of their disposal

2. The normal pooling identification rules do not apply. Instead, if both shares are held which are exempt under the shares for rights rules and shares of the same class are held outside that regime, the employee may determine the proportion of shares sold which will be identified with the shares for rights shares

3. The provisions relating to reorganisations do not apply so instead there will be a disposal of the shares and the new shares acquired will have a base cost of the consideration given for the acquisition of the new shares (i.e. usually the market value of the shares for rights shares transferred).

Issue of new fully-paid shares

The shares may be issued pursuant to the directors’ residual authority to issue new shares (within the, typically, 5%, limit set by shareholders). However, the question arises as to how the shares can be issued as ‘fully-paid’ without the employee paying up the nominal value of the shares. This could be achieved by shareholders approving a capitalisation of distributable reserves and applying them in payment-up of the par value of the new shares. Alternatively, the agreement to forego employment law rights could be taken by the issuing company to be ‘money’s worth’ so as to allow the company to issue the shares as fully-paid.

In the case of a group of companies, a practical solution is for the employer subsidiary to pay to the issuing company the nominal value of the shares.

Private companies – using a special class of share

There is no limitation on the rights attaching to the shares used. It is therefore open to the company to create a special class of “employees’ shares” with restricted rights of transfer and an obligation to sell on leaving. The shares could also be structured as ‘growth shares’ allowing the holder to benefit (for example) from a variable ‘slice of value’ if performance targets are met.

Care is needed in drafting the share rights to ensure that, from the outset, the shares issued to an employee have a restricted market value of £2,000. This might be achieved by having shares which, if targets are not met, convert into shares with an initial guaranteed maximum value of £2,000.

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Post-acquisition dividends

In principle there appears to be no reason why, if the shares acquired are of a distinct class, the company should not pay preferential dividends on such shares. Care would be needed to avoid HMRC asserting that such dividends are properly to be taxed as earnings.

Accounting treatment

The issue of fully-paid shares will need to be recognised in the accounts of the issuing company under the 'share-based payments' rules.

Process

The employee must be given a written statement explaining the rights attaching to the shares. In addition, the statement must specify:

- the employment rights given up; and
- that a minimum 16 weeks' notice must be given of early return from maternity, additional paternity or adoption leave.

The employee must be given the opportunity to take independent advice from a lawyer, trade union official, or advice centre worker, and such advice must be given to the employee, at the expense of the employer (regardless of whether the opportunity or job is taken up in response to the invitation).

There must be a 7-day 'cooling off' period before the agreement becomes effective.

Valuation

HMRC will agree valuations in advance, in particular to ensure that the shares have the minimum £2,000 value.

Buy-back of shares

If the articles of association do not already, the agreement may include restrictions on transfer of the shares and an obligation to offer them for sale on leaving employment. There is an exemption from the normal charge to income tax (as dividend income) upon a sale-back to the company of employee shareholder shares after the employment has ended, notwithstanding that the shares have not then been held for 5 years. Provided the shares are sold back for not more than their market value, no tax charges should then arise.

Is this an opportunity worth offering?

The arrangement was originally aimed at start-up companies and SMEs. In practice, it is likely to be of principal attraction to private-equity backed companies in which there exists the opportunity for substantial growth in value of restricted shares, and management job-security is not a principle concern to the senior employees.

If you see that employee shareholder shares would provide an opportunity for your business then get in touch to discuss this further with a FREE consultation.

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