

Six months ago, “employee shareholder status” was introduced, bringing with it a favourable tax regime for employees willing to forfeit certain of their employment rights in return for free shares in their employer. At the time the regime was introduced it was heavily criticised and there was a high degree of scepticism about likely levels of uptake.

So, six months down the line, how has employee shareholder status (“ESS”) been received?

To recap, under the new employment status, employee shareholders will be gifted at least £2,000-worth of shares in their employer company (or its holding company) in exchange for their forfeiting certain employment rights (primarily the right to claim unfair dismissal, except where the dismissal is automatically unfair or discriminatory, and the right to a statutory redundancy payment).

The tax benefits are potentially very beneficial. The first £2,000 of shares gifted is exempt from income tax and national insurance on allotment. However, most importantly ESS shares worth up to £50,000 at the time of issue will be exempt from capital gains tax on any increases in value.

Since introduction of the rules there have been some welcome clarifications on outstanding issues. For example, BIS has acknowledged that rights sacrificed under an employee shareholder agreement can be re-granted contractually.

At the same time, implementation of ESS arrangements has thrown up some practical and legal issues to be addressed. Shares must be issued to individuals fully paid but the legislation expressly prohibits anything being given by the individual in consideration for the shares. This is a problem for companies which do not have sufficient distributable reserves to pay up the shares. The solution is to use share premium. However, the rules require careful navigation to avoid a technical Companies Act breach resulting in a loss of ESS and the associated tax reliefs.

Another practical point is valuation of the shares. HM Revenue & Customs are prepared to agree a value for ESS shares in advance, and this opportunity is not to be missed. True to their word, HM Revenue & Customs have been turning round valuation requests with relative speed.

Despite ongoing rumblings that the scheme is not proving popular enough and calls from Nick Clegg for ESS to be scrapped, use of and interest in the regime is picking up and we have seen an increase in attention being paid to the advantages it can offer.

So who have been the winners? We are seeing ESS used:

- a) in private equity investments;
- b) as an incentivisation route for management teams in place of traditional option routes; and
- c) for structuring “one-off” equity arrangements for key individuals.

So whilst the future of ESS is uncertain, for now there remains an opportunity to take advantage of the tax benefits and incentivise employees. It may just be a useful mechanism to promote employee ownership after all.

For more information please contact one of the Squire Sanders lawyers listed below.

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