Financial News
PRIVATE EQUITY NEWS

Guest comment

New Employee Shareholder Act Offers Tax Efficient Rewards

Helena Derbyshire, Of Counsel, Skadden, Arps, Slate, Meagher & Flom

16 Sep 2013

The reception for the new employee shareholder status has been cold from employers, employee groups (notably the TUC) and even the House of Lords, which passed the Growth and Infrastructure Act 2013 in April after several concessions and rejecting it twice.

But since the law came into force – on September 1, 2013 – there will be scope for some entrepreneurial businesses and employees to take advantage of the provisions.

Proposal

The act allows companies to offer employees between £2,000 and £50,000 worth of shares in the firm or its parent company, both of which can be registered outside the U.K. More shares can be granted, but only gains on disposal of shares worth up to £50,000 at the time of grant will be exempt from capital gains tax. Income tax will not be payable on the first £2,000 in value at the time of grant.

The employee shareholder would then be able to sell those shares at the end of his or her employment, so benefitting from a tax-free lump sum payment and any gain in the shares' value while they have been working in the business.

In return, the employee shareholder forfeits certain employment rights, including the ability to claim unfair dismissal and the entitlement to statutory redundancy pay, and his or her ability to request flexible working under the current statutory scheme is limited to when they return from parental leave.

In order to appease the House of Lords, last minute provisions to avoid coercion were added to the Act: the employee shareholder must obtain independent legal advice on their status and there will be a seven day cooling off period for the employee shareholder to change their mind.

As a result employers will need to take care to ensure that offers of the new status are correctly implemented.

Benefits?

For businesses used to offering equity incentives and seeking greater flexibility in their workforce, the proposal offers a CGT-efficient way of executive reward. Given the cap on unfair dismissal compensation, and need for qualifying service to claim that a dismissal is unfair, executive severance is more about the contract (and pre-negotiated notice terms) than statutory rights in any event: what effectively amounts to a performance-related, share-based top-up on termination of employment with tax benefits might be attractive to both executive employees and their employers.

Further, under the coming Alternative Investment Fund Managers Directive there is a strong (and growing) incentive to structure remuneration based on equity in the employer. Likewise, under the Capital Requirements Directive IV and its application to the financial sector, there is a growing concern that cash bonuses will soon be significantly limited. Accordingly, the employee shares concept is "swimming with the tide" and may make the grant of such shares for regulatory reasons more palatable to both employer and employee.

Finally, for corporate members of LLPs that are currently engaged in incentivisation programmes based on capital retention in the corporate member pending future performance by staff, there is the prospect of the grant of employee shares in the corporate member to reflect accrued and taxed profits from time to time.

While the act has significant wrinkles given the speed of its introduction, its use by a collaborative employer and employee to deliver a tax-efficient compensation framework, as well as a more flexible workforce, may well be something to look forward to, and may disappoint its critics over time.

To view our Forward Features list click here