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6 February 2013

Dear Sirs,

**Draft Finance Bill 2013 - Employee shareholder status: capital gains tax exemption**

***Introduction***

We are the Quoted Companies Alliance, the independent membership organisation that champions the interests of small to mid-size quoted companies. Their individual market capitalisations tend to be below £500m.

The Quoted Companies Alliance is a founder member of **EuropeanIssuers**, which represents over 9,000 quoted companies in fourteen European countries.

The Quoted Companies Alliance Share Schemes and Tax Expert Groups has examined your proposals and advised on this response. A list of members of the expert groups is at Appendix A.

***Response***

We welcome this opportunity to comment on the draft legislation implementing the employee shareholder status.

As we mentioned in our response to the BIS consultation in November 2012 (enclosed), we believe that this new employment status is only likely to be attractive to individuals in a very limited range of circumstances and could introduce added complexity for small growing companies - without a significant added benefit either to the company or the employee. We also note that the majority of respondents to the BIS consultation did not welcome the proposed scheme, and so we would query why the Government is still pursuing the policy.

We would prefer not to see employee share ownership linked to changes in employment law. We believe that it would be more beneficial for businesses and employees if HM Treasury and BIS explore reforming capital gains tax (CGT) reliefs, such as Entrepreneurs' Relief, as a way to encourage employee share ownership. We would suggest:

The Quoted Companies Alliance is the independent membership organisation that champions the interests of small to mid-size quoted companies.

**Short-term proposals:**

- Abolish the condition that the shareholder must have 5% of the voting rights and 5% of ordinary share capital in the company in order to qualify for the relief ('5% Requirement').
- Have the relief applied from the date shares are acquired, or the date the option is granted (rather than exercised) for HMRC "approved" schemes, including Enterprise Management Incentive Schemes.
- To fund the above relaxations and to promote long-term investment, extend the current holding period from one year to two to three years.

**Long-term proposals:**

- Rebrand Entrepreneurs' Relief as 'Stakeholders' Relief' to identify those parties that make a meaningful contribution to the success of a business and more clearly align employee and shareholder interests to promote long-term growth and employment.
- In addition to employees and officers, target this relief for long-term investors:
  - Remove the 5% Requirement and the condition that only officers and employees can qualify for CGT Entrepreneurs' Relief.
  - Introduce a three to five year holding period for shares for persons other than employees/officers to attract and reward long-term investment.
  - Consider targeting this relief to the SME sector.<sup>1</sup>

This would encourage the alignment of employee and management goals in driving growth and provide a reduced capital tax rate without employees having to give up employment rights.

Regardless, we have commented below on the drafting of the legislation, where we believe that there is still complexity or uncertainty as to how the status will work:

1. HMRC has made changes to CSOP legislation to equate material interest at 30%, while the material interest test of the employee shareholder status is 25%. This suggests a lack of co-ordination and a movement away from tax simplification to have a different test. We suggest that it be consistent with the CSOP legislation.
2. We have concerns surrounding the definition of an employee under this new scheme. It seems that employee and employer is defined by reference to the entering into of an employee shareholder agreement which is under the Employment Rights Act 2006 (new section 205A(1)(a)). We note that the reference to the Employment Rights Act 2006 in the draft legislation is incorrect – it should be

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<sup>1</sup> For more information about these proposals, please see our 2013 Budget Representations:

<http://www.theqca.com/about-us/responses/66112/quoted-companies-alliance-2013-budget-proposals.shtml>

the Employment Rights Act 1996<sup>2</sup>. Furthermore, the meaning of employee for the purposes of the employment law has been subtly different from the interpretation for income tax purposes, so there is an immediate concern.

Also, directors will be treated as if employees for tax purposes, but may or may not be employees for employment law purposes. The classic situation is a non-executive director who receives fees will pay income tax/CGT on gains on any shares received and yet may or may not be an employee for employment law purposes. It is possible that the Government's intention is to remove such directors from this legislation. On the other hand, this is confused in the draft legislation by the reference in the new section 236C(5)(b)(identifying whether an employee has been engaged by an associated company within 2 years) to 'engaged in any office or employment (including engagement under a contract for services)'.

3. Where several shares have been acquired there is a refreshingly simple identification rule where some shares held of the same class in the company are exempt employee shareholder shares and there is a part disposal. In that situation the employee may determine what proportion will be exempt shares and which are not. There does not seem to be any formal election arrangement for this.
4. It is noted that, whereas section 127 of TCGA can be used in a reorganisation to prevent a disposal and a liability arising on what is often a share swap situation, it will not apply to employee shareholdings. For employee shareholders, there would be no CGT liability expected if the reorganisation was treated as a disposal. However, from the draft legislation, it appears that going forward the employee shareholder will continue to accrue a liability in respect of future gains, as the new shareholding will not be treated the same as the original holding.

We believe that this could be open to abuse. For example, A enters into an employee shareholder agreement in January 2014 giving up employment rights in return for £10,000 worth of shares (paying the appropriate income tax and national insurance contributions on receipt). If the Group is restructured in January 2015 when the shares are worth £12,000 and new shares of equal value are issued in a new holding company, any further gains in respect of the new shares seem to fall outside the protection of the employee shareholder legislation. We would then need employment law to be considered to state whether the employee shareholder agreement is still valid and the employment rights remain restricted, if A remains in the same employment or if A moves to a different position within the same Group.

Also with regards to share swaps, it is usual (more often than not) for a flotation to involve adding a new top company onto an existing group structure, so that the new top company is the company which is floated. If the share-for-share rules do not apply to employee shareholder shares, then employee shareholders would lose their exempt shares just at the point of float – when the business most wants to incentivise those employees and when value from their work can begin more fully to be realised. It makes no policy sense for the exemption to apply to currently quoted

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<sup>2</sup> We note that the reference is correct in the Infrastructure and Growth Bill:

[http://www.publications.parliament.uk/pa/bills/lbill/2012-2013/0072/lbill\\_2012-20130072\\_en\\_5.htm#pb3-l1g27](http://www.publications.parliament.uk/pa/bills/lbill/2012-2013/0072/lbill_2012-20130072_en_5.htm#pb3-l1g27)

**HMRC**

**Draft Finance Bill 2013 – Employee shareholder status: capital gains tax exemption**

**6 February 2013**

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companies with employee shareholders, but not to apply for new companies seeking a listing on public market, simply because the listing process involves a new top company for other, non-tax, reasons.

If you would like to discuss any of these issues further, we would be happy to attend a meeting.

Yours faithfully,

A handwritten signature in blue ink, appearing to read 'TW', is positioned above the typed name.

Tim Ward  
Chief Executive

**Quoted Companies Alliance Share Schemes Expert Group**

Nicholas Stretch (Chairman)	CMS Cameron McKenna LLP
Fiona Bell (Deputy Chairman)	RM2 Partnership Limited
Barbara Allen	Stephenson Harwood
Simon Allum	Lewis Silkin
Martin Benson	Baker Tilly
Danny Blum	Eversheds LLP
Stephen Chater /Robert Postlethwaite	Postlethwaite & Co
Christopher Connors	Charles Russell LLP
Karen Cooper	Osborne Clarke
Jared Cranney	Interior Services Group plc
Vanessa Cundy Cooper	KPMG LLP
John Daughtrey	Equiniti
Michael Deeks	Olswang
Matthew Findley	Pinsent Masons LLP
David Firth	Penna Consulting PLC
Philip Fisher	PKF (UK) LLP
Amanda Flint	Grant Thornton UK LLP
David Fuller	CLS Holdings PLC
Andy Goodman	BDO LLP
Paula Hargaden	Burges Salmon
Daniel Harris	Ernst & Young LLP
Colin Kendon	Bird & Bird LLP
Michael Landon/Nigel Mills	MM & K Limited
Peter Mossop/Collum Spillane	Sanne Group
Nick Wallis	Smith & Williamson Limited

**Quoted Companies Alliance Tax Expert Group**

Neil Pamplin (Chairman)	Grant Thornton UK LLP
Michael Bell	Osborne Clarke
Chris Bond	PKF (UK) LLP
David Boyd	Mazars LLP
Nick Burt	Nabarro LLP
Sarah Buxton	Bryan Cave LLP
Jason Collins	Pinsent Masons LLP
Tim Crosley	Memery Crystal LLP
Sam Dames	CMS Cameron McKenna LLP
Paul Fay	Crowe Clark Whitehill LLP
David Gubbay	Dechert
Natasha Kaye	Olswang
Lindsey Kутten	PricewaterhouseCoopers LLP
Joseph Litten	Ernst & Young LLP
James Mottram	K & L Gates LLP
Andrew Prowse	Field Fisher Waterhouse
Amanda Solomon	Charles Russell LLP
Vijay Thakrar	Deloitte LLP

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12 November 2012

Dear Ms Lovitt,

**BIS - Consultation on implementing employee owner status**

***Introduction***

We are the Quoted Companies Alliance, the independent membership organisation that champions the interests of small to mid-size quoted companies. Their individual market capitalisations tend to be below £500m.

The Quoted Companies Alliance is a founder member of European **Issuers**, which represents over 9,000 quoted companies in fourteen European countries.

The Quoted Companies Alliance Tax and Share Schemes Expert Groups has examined your proposals and advised on this response. A list of members of the Expert Group is at Appendix A.

***Response***

We welcome the opportunity to respond to this consultation. Overall, we would prefer not to see employee share ownership linked to changes in employment law.

We believe that the introduction of this new category of employee owner could add an additional layer of complexity – with businesses having to manage and work out which category each employee falls within and the rights attached to it – without much added benefit to the company or employee.

While this consultation does not focus on tax issues specifically, it seems that employee owners would still have to be able to pay the tax on the original gift of the shares or pay the market value, neither of which may be attractive to the majority of employees. As such, the tax benefit of having capital gains tax waived will most likely be outweighed by having to pay national insurance contributions at the outset and by having to give up a number of employment rights.

We believe that it would be more beneficial for businesses and employees if HM Treasury and BIS explore reforming capital gains tax (CGT) reliefs, such as Entrepreneurs' Relief, as a way to encourage employee share ownership, and have included suggestions of how to do this in our response.

If you would like to discuss our submission, we would be happy to attend a meeting.

Yours sincerely,



**Tim Ward**  
**Chief Executive**

The Quoted Companies Alliance is the independent membership organisation that champions the interests of small to mid-size quoted companies.

A company limited by guarantee registered in England  
Registration Number: 4025281

**MEMBERS OF THE QUOTED COMPANIES ALLIANCE TAX EXPERT GROUP**

Neil Pamplin (Chairman)	Grant Thornton UK LLP
Chris Bond	PKF (UK) LLP
David Boyd	Mazars LLP
Nick Burt	Nabarro LLP
Thomas Byng	Deloitte LLP
Jason Collins	Pinsent Masons LLP
Tim Crosley	Memery Crystal LLP
Sam Dames	CMS Cameron McKenna LLP
Paul Fay	Crowe Clark Whitehill LLP
Natasha Kaye	Olswang
Lindsey Kutten	PricewaterhouseCoopers LLP
Joseph Litten	Ernst & Young LLP
Amanda Solomon	Charles Russell LLP
Vijay Thakrar	Deloitte LLP

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Nicholas Stretch (Chairman)	CMS Cameron McKenna LLP
Fiona Bell (Deputy Chairman)	RM2
Barbara Allen/Anika Chandra	Stephenson Harwood
Simon Allum	Lewis Silkin
Martin Benson	Baker Tilly
Danny Blum	Eversheds LLP
Ian Brown	Hewitt New Bridge Street
Stephen Chater/ Robert Postlethwaite	Postlethwaite & Co
Christopher Connors	Charles Russell LLP
Karen Cooper	Osborne Clarke
Jared Cranney	Interior Services Group plc
John Daughtrey	Equiniti
Michael Deeks	Olswang
David Firth	Penna Consulting PLC
Philip Fisher	PKF (UK) LLP
Amanda Flint	Grant Thornton UK LLP
David Fuller	CLS Holdings PLC
Andy Goodman	BDO LLP
Paula Hargaden	Burges Salmon
Daniel Harris	Ernst & Young LLP
Colin Kendon	Bird & Bird LLP
Michael Landon /Nigel Mills	MM & K Limited
Peter Mossop/Colum Spillane	Sanne Group
Paul Twist	KPMG LLP
Nick Wallis	Smith & Williamson Limited

## Consultation on implementing employee owner status

### Response Form

A copy of the **Consultation on implementing employee owner status**: can be found at:

<http://www.bis.gov.uk/Consultations/consultation-on-implementing-employee-owner-status?cat=open>

You can complete your response online through SurveyMonkey :

(<https://www.surveymonkey.com/s/5QJQ935>)

Alternatively, you can email, post or fax this completed response form to: **Email:**

[implementing.employee@bis.gsi.gov.uk](mailto:implementing.employee@bis.gsi.gov.uk)

### Postal address:

Paula Lovitt MBE  
Department for Business, Innovation and Skills (BIS)  
3 Floor Abbey 1  
1 Victoria Street  
London SW1H 0ET  
**Fax:** 0207-215 6414

The Department may, in accordance with the Code of Practice on Access to Government Information, make available, on public request, individual responses. The closing date for this consultation is: **8 November 2012**



**Your Details:**

**Name:** Tim Ward

**Organisation:** Quoted Companies Alliance

**Address:** 6 Kinghorn Street, London, EC1A 7HW

**Telephone:** 020 7600 3745

**Fax:** 020 7600 8288

**Please tick the boxes below that describe you as a respondent to this:**

Business Representative Organisation/Trade Body

**Question 1: How can the government help businesses get most out of the flexibility offered and the different types of employment statuses?**

**Comments:**

Flexibility is important to business, especially small and mid-size businesses; but simplicity and certainty is also vital.

We believe that the introduction of this new category of employee owner could add an additional layer of complexity - with businesses having to manage and work out which category each employee falls within and the rights attached to it - without much added benefit to the company or employee.

Furthermore, the cost of implementation of the employee owner status is likely to be greater than if companies wanted to implement the Enterprise Management Incentive (EMI) scheme. There will need to be extensive drafting of terms and conditions, subscription letters, s.431 elections, and in private companies, changes to articles and shareholders' agreements, as well as more complex employee communications.

While this consultation does not focus on tax issues specifically, it seems that employee owners would still have to be able to pay the tax on the original gift of the shares or pay the market value, neither of which may be attractive to employees. As such, the tax benefit of having capital gains tax waived, will most likely be outweighed by having to pay national insurance contributions at the outset and by having to give up a number of employment rights.

We would prefer not to see employee share ownership linked to changes in employment law. We believe that it would be more beneficial for businesses and employees if HM Treasury and BIS explore reforming capital gains tax (CGT) reliefs, such as Entrepreneurs' Relief. We would suggest:

**Short-term proposals:**

- Abolish the condition that the shareholder must have 5% of the voting rights and 5% of ordinary share capital in the company in order to qualify for the relief ('5% Requirement').
- Have the relief applied from the date shares are acquired, or the date the option is granted (rather than exercised) for HMRC "approved" schemes, including Enterprise Management Incentive Schemes.
- To fund the above relaxations and to promote long-term investment, extend the current holding period from one year to three years.

**Long-term proposals:**

- Rebrand Entrepreneurs' Relief as 'Stakeholders' Relief' to identify those parties that make a meaningful contribution to the success of a business and more clearly align employee and shareholder interests to promote long-term growth and employment.
- In addition to employees and officers, target this relief for long-term investors:
- Remove the 5% Requirement and the condition that only officers and employees can qualify for CGT Entrepreneurs' Relief.
- Introduce a five year holding period for shares for persons other than employees/officers to attract and reward long-term investment.

- Consider targeting this relief to the SME sector.

This would encourage the alignment of employee and management goals in driving growth and provide a reduced capital tax rate without employees having to give up employment rights.

**Question 2: Do businesses feel able to use all three employment statuses? If not, what restricts the use of different statuses?**

**Comments:**

Beyond a core group of directors, founder shareholders and very senior employees who may be able to suffer a short-term tax hit for a longer term capital gains tax advantage, it is difficult to see who would benefit from this.

There is very little incentive for an employee or prospective employee to take up the proposed employee owner status. Many companies would be able to offer qualifying Enterprise Management Incentive options that would provide a CGT basis of taxing the growth in value of the shares without an upfront tax charge and restricted employment rights.

**Question 3: What restrictions, if any, do you think should be attached to the issue of shares or types of shares?**

**Comments:**

As noted in our response to Question 1, we would prefer the Government explore alternative ways to provide capital gains tax relief for all employees, as it is difficult to see who would benefit from the new employee owner status.

However, if the Government pursues this policy, there should be no restrictions attached to the type of shares to be used. Limits on the classes or restrictions on shares will wipe out the cost benefits of these arrangements by imposing compliance in terms of professional costs and the time taken to ensure the legislative requirements are met.

From a tax perspective, whether there are restrictions or not, Part 7 of ITEPA will pick up tax on manipulations in rights and restrictions or conversion rights. Any residual risk might be covered by a general anti-abuse provision applying to these proposals.

**Question 4: When an employer buys back forfeit shares, should this be at full market value or some other level (eg. a fraction of market value) should some other level be allowed in certain circumstances?**

**Comments:**

For commercial reasons small private companies will have transfer restrictions requiring forfeiture or transfer for nil or nominal sums for bad leavers (usually anyone leaving voluntarily or for misconduct rather than for retirement, ill health, etc). Quoted companies can achieve this in similar ways.

To impose specific requirements as to market value related buy backs could prohibit the company from funding the buy back if it could not raise sufficient finance, thus leaving a small company with an awkward minority shareholder. Further, the costs of valuation, both for the company and HMRC, and the time involved agreeing the value, would be a disincentive to taking up the proposed shares in the first place. Pre-transaction valuations would be essential.

We would query what the position of stamp duty on a buy back would be if, for example, a company arranged for an existing shareholder to purchase the shares of a departing shareholder, would there be any relief if the acquirer was obliged to pay market value? Also, if market value were a requirement, would this be on the basis of actual market value or unrestricted market value and would there be the usual assumption of a willing buyer and willing seller even though it was a forced sale or purchase?

Finally, if a purchaser is in fact paid more than the market value (inadvertently, perhaps needing to purchase quickly as an employee owner left and before the values could be agreed with HMRC) would there be any additional income tax or other liability arising for the employee owner?

**Question 5: How should a company go about carrying out a valuation of the shares? What would the administrative and cost impact be for a company if an independent valuation was required?**

**Comments:**

Our members are quoted companies and therefore valuation is a much easier exercise for them than private companies. We note however that the Nuttall Review on Employee Share Ownership highlights the various difficulties with valuation of shares for private companies. The costs of valuation, both for a private company and HMRC, and the time involved agreeing the value, may be a disincentive to taking up the proposed shares in the first place.

**Question 6: The Government would welcome views on the level of advice and guidance that individuals and businesses might need to be fully aware of the implications of taking on employee owner status.**

**Comments:**

The situation proposed seems comparable to the requirements for a departing employee to be independently advised in the context of a compromise agreement.

The employee owner would need advice on the reduction in legal rights, the tax and national insurance implications and also, perhaps, independent financial advice on the proposed investment. This is not advice the company could offer. As such, the cost and inconvenience of having to seek advice might be a deterrent.

In terms of potential employee owners seeking advice, we would query whether the costs of providing this, if borne by the employing company, be a taxable benefit for the employee or a corporation tax deductible expense for the company?

In addition, we would query whether advice sought by a potential employee owner would be classed as 'investment business' under FSMA 2000? Whilst there are exemptions for employees' share schemes, as defined in section 1166 of Companies Act 2006, an arrangement for a single person, who is not categorised as an employee, would not appear to fall within the definition of an employees' share scheme.

Depending on the answers to the above queries, the cost and inconvenience of having to seek advice might be a deterrent.

**Question 7: What impact will allowing individuals limited unfair dismissal protection and equity shares have on employers' appetite for recruiting?**

**Comments:**

We are unsure as to how it would affect recruitment.

However, we would query whether a company would be required to include details in any advertisement for a job or job specification that the position will be as an employee owner?

**Question 8: What benefits do you think introducing the employee owner status in with limited unfair dismissal rights will have for companies?**

**Comments:**

We believe the benefit for companies is limited, as companies do not engage employees expecting to dismiss them.

In any event, we would query whether the company still could remain at risk for breach of contract or wrongful dismissal claims on a dismissal?

**Question 9: Do you think these benefits will be greater for larger, smaller or start-up businesses?**

**Comments:**

As mentioned in our response to Question 2, the application of employee owner status may be appropriate for a core group of directors, founder shareholders, very senior employees, or even non-executive directors of larger quoted companies (where the UK Corporate Governance Code or investor guidelines recommends the holding of shares by non-executive directors during the office and for at least one year thereafter, aligning such director's interests with shareholders).

**Question 10: What impact, if any, do you think the employee owner status will have on employment tribunal claims, e.g. for discrimination?**

**Comments:**

We have no comments on this question.

**Question 11: What impact do you think introducing the employee owner status with no statutory redundancy pay will have for businesses, in particular, smaller businesses and start up businesses? What negative impacts do you anticipate and how might these be mitigated?**

**Comments:**

We have no comments on this question.

**Question 12: What impact will this change to maternity notice period have on employers?**

**Comments:**

We have no comments on this question.

**Question 13: What, in your view, would employers do if employees wish to return early without giving 16 weeks' notice?**

**Comments:**

We have no comments on this question.

**Question 14: How will these changes impact on a company's payroll provisions?**

**Comments:**

We have no comments on this question.

**Question 15: What effect will a compulsory 16 weeks' early return notice period have on the length of maternity leave that mothers take or adoption leave that parents take?**

**Comments:**

We have no comments on this question.

**Question 16: Do you think 4 weeks is the right period? If not, why not? What would be the impact of a shorter or longer period?**

**Comments:**

We have no comments on this question.

**Question 17: What impact do you think this proposal would have on the ability of employee owners to access support for training?**

**Comments:**

We have no comments on this question.

**Question 18: Do you have any comments on the Government's intention not to amend Company Law to implement the employee owner proposal?**

**Comments:**

We believe that BIS will have to amend Company Law in some form to implement the employee owner status.

As mentioned in our response to Question 6, we are doubtful that an arrangement for a single employee owner could ever fall within the section 1166 Companies Act definition of employees' share scheme. As this definition is used for other subsidiary legislation, for example the FSMA 2000 (Financial Promotions) Order 2005, communication with the individual employee owner as a potential investor would have to comply with those regulations unless it falls under one of the exemptions, e.g. that it is relating to participation in an employee share scheme.

**Question 19: The Government welcomes views on particular safeguards that would need to be applied, in order to minimise opportunities for abuse.**

**Comments:**

Under this arrangement an employee owner might receive shares on which significant tax is paid at the outset. A change of ownership of the majority of the shares might then cause the employee owner to be ousted unfairly and the shares becoming worthless due to market conditions or due to the share transfer rights. If this situation is combined with the employee owner having no right to compensation for loss of office and no right to the repayment of the tax (and possibly national insurance) paid on acquisition of the shares, then there is scope for the employee owner getting a very bad deal.

Further, as mentioned in our response to Question 2, there is very little incentive for an employee or prospective employee to take this route. Many companies, especially small and mid-size quoted companies, would be able to offer qualifying Enterprise Management Incentive (EMI) options that would provide a CGT basis of taxing the growth in value of the shares without an upfront tax charge and restricted employment rights.

**Question 20: The Government welcomes views on whether the existing tax rules which apply to share-for-share exchanges (such as might happen when a company is taken over) and schemes of reconstruction should apply where shares issued in return for taking up the new status are involved**

**Comments:**

There would need to be legislation to permit the tax treatment to pass to new shares acquired by virtue of the original holding.

**Question 21: What impact do you think the proposal will have on labour market flexibility – that is, in relation to hiring and letting people go?**

**Comments:**

We have no comments on this question.

**Question 22: Would you be likely to take up the new status? What would the impact of the status be on your business?**

**Comments:**

We have no comments on this question, as we represent small and mid-size quoted companies collectively.

**Question 23: What are your views on the take-up of this policy by:**

**a) companies?**

**b) individuals?**

**Comments:**

As mentioned in our response to Question 1 and 19, we believe that the take up by employees (ie individuals) will be limited, as there already numerous CGT tax benefits available to employees, without having to give up some of their employment rights and pay income tax on the shares at the time of grant.

**Question 24: What are your views on the equality impact assessment? Are there other equality and wider considerations that need to be considered?**

**Comments:**

We have no comments on this question.

**Question 25: Thank you for taking the time to let us have your views. We do not intend to acknowledge receipt of individual responses unless you tick the box below.**

**Please acknowledge this reply - Yes**

**Question 26 : At BIS we carry out our research on many different topics and consultations. As your views are valuable to us, would it be okay if we were to contact you again from time to time either for research or to send through consultation documents?**

**Yes**

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