



TAXREP 14/13

(ICAEW REP 18/13)

ICAEW TAX REPRESENTATION

EMPLOYEE OWNER SHARES CGT EXEMPTION: DRAFT FINANCE BILL 2013 LEGISLATION

Comments submitted on 6 February 2013 by ICAEW Tax Faculty in response to the HM Treasury/HM Revenue and Customs invitation to comment on draft Finance Bill 2013 legislation in the consultation draft *Employee shareholder status: capital gains tax exemption* published on 11 December 2012

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INTRODUCTION

1. ICAEW welcomes the opportunity to comment on the draft Finance Bill 2013 legislation in the consultation draft Employee shareholder status: capital gains tax exemption published by HM Revenue & Customs (HMRC) on 11 December 2012.
2. We should be happy to discuss any aspect of our comments and to take part in all further consultations on this area.
3. Information about the Tax Faculty and ICAEW is given below. We have also set out, in Appendix 1, the Tax Faculty's Ten Tenets for a Better Tax System by which we benchmark proposals to change the tax system.

WHO WE ARE

4. ICAEW is a professional membership organisation, supporting over 140,000 chartered accountants around the world. Through our technical knowledge, skills and expertise, we provide insight and leadership to the global accountancy and finance profession.
5. Our members provide financial knowledge and guidance based on the highest professional, technical and ethical standards. We develop and support individuals, organisations and communities to help them achieve long-term, sustainable economic value.
6. The Tax Faculty is the voice of tax within ICAEW and is a leading authority on taxation. Internationally recognised as a source of expertise, the faculty is responsible for submissions to tax authorities on behalf of ICAEW as a whole. It also provides a range of tax services, including TAXline, a monthly journal sent to more than 8,000 members, a weekly newswire and a referral scheme.

KEY POINT SUMMARY

7. The policy that 'This measure is intended to relieve those individuals taking up the "employee shareholder" status from any CGT charge that might arise on the disposal of shares acquired through the adoption of the new status.' is negated by new subsection 236B(3).
8. We recommend that new section 236B is rewritten to make it consistent with the policy by making it clear to whom the exemption applies, as well as the assets to which it applies.

GENERAL COMMENTS

9. We attach in Appendix 2 some comments on various aspects of employee ownership shares which may be of interest. Some of these were incorporated in the consultation response that we submitted on 8 November 2012 to BIS. We have not checked with legislation already enacted whether the points have been addressed.

DETAILED COMMENTS ON THE DRAFT LEGISLATION

New section 236B

10. The note attached to the consultation draft says under 'Policy Objective' (second sentence) that 'This measure is intended to relieve those individuals taking up the "employee shareholder" status from any CGT charge that might arise on the disposal of shares acquired through the adoption of the new status.'. However, new subsection 236B(3) says 'But an

employee shareholder share ceases to be exempt when the employee disposes of it.’. This appears to remove employee ownership shares from the scope of the exemption when the employee disposes of them, which contradicts both new subsection 236B(1) and the policy behind these amendments.

11. We suggest that new subsection 236B(3) be deleted and the rest of new section 236B be reworded to make it clear to whom the exemption applies, ie the individual to whom they were issued or allotted under an employee shareholder agreement, as well as the asset to which the exemption applies, on the lines of the following:

Possible rewrite of new section 236B:

- (1) A gain which accrues on the disposal of exempt employee shareholder shares by an employee to whom they were issued or allotted under an employee shareholder agreement is not a chargeable gain.
- (2) Shares are exempt employee shareholder shares if.
- they are employee shareholder shares, and
 - the requirements of sections 236C and 236D are met in relation to them.
- ~~(3) But an employee shareholder share ceases to be exempt when the employee disposes of it.~~
- (43) In this section and sections 236C to 236G –
- ‘employee shareholder share’ means a share issued or allotted in consideration of an employee shareholder agreement;
- ‘employee shareholder agreement’ means an agreement such as is mentioned in section 205A(1)(a) of the Employment Rights Act 2006 (employee shareholders);
- ‘employee. and .employer company’, in relation to an employee shareholder agreement, mean the individual and the company which enter into the agreement.’

Other new sections

12. We are not commenting at this stage on the remainder of the draft legislation on this topic; if further comments do arise then we shall make them during the Finance Bill process.

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APPENDIX 1

ICAEW TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM

The tax system should be:

1. Statutory: tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.
2. Certain: in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.
3. Simple: the tax rules should aim to be simple, understandable and clear in their objectives.
4. Easy to collect and to calculate: a person's tax liability should be easy to calculate and straightforward and cheap to collect.
5. Properly targeted: when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.
6. Constant: Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.
7. Subject to proper consultation: other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.
8. Regularly reviewed: the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.
9. Fair and reasonable: the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.
10. Competitive: tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

These are explained in more detail in our discussion document published in October 1999 as TAXGUIDE 4/99 (see icaew.com/en/technical/tax/tax-faculty/-/media/Files/Technical/Tax/Tax%20news/TaxGuides/TAXGUIDE-4-99-Towards-a-Better-tax-system.ashx)

APPENDIX 2

COMMENTS ON VARIOUS ASPECTS OF EMPLOYEE OWNERSHIP SHARES

If the proposal is to be successfully implemented, a number of important issues will need to be addressed:

1. The shares would be exempt from CGT, but there has been no mention of any exemption from income tax. Will the employee still be charged to income tax and NICs on the initial value of the shares? If so, thought must be given to how the tax will be funded. If the shares are “readily convertible assets”, then the tax will be due under PAYE, and attract NICs.
2. Can the shares be awarded under an HMRC-approved ‘Share Incentive Plan’? It appears not – hence our presumption that there is to be no relief from income tax on their acquisition.
3. How will the taxation of the shares fit within the existing tax regime for employment-related securities? If the shares cannot rank as “restricted shares subject to a short-term risk of forfeiture”, then it will not be possible to defer any “up-front” charge to income tax on their initial market value, as would normally be the case (in the absence of a tax election under s431 ITEPA 2003).
4. The use of share options appears to be ruled out, although the announcement refers to participating employees remaining eligible to be granted EMI options (if the company and the individual otherwise qualify).
5. How will the shares be valued? If the normal bases of valuation are used, the shares may be of relatively small value allowing relatively large holdings in smaller ‘start-up’ companies to be acquired at a low initial cost. In effect, this would appear to be, in part, a means of extending the EIS scheme to employees who are not directors – but without the up-front relief from income tax.
6. There must, presumably, be restrictions upon the type of shares to be used. It would otherwise be all too easy to offer a form of “growth share” which would allow the employee to secure disproportionate growth in value with full CGT relief. Conversely, shares of a class with undue restrictions might allow unscrupulous companies to entice employees to forgo employment rights in exchange for shares which prove to be relatively worthless. If the company has third party investors and multiple classes of shares then, presumably, the shares to be used will need to be “ordinary” shares with rights which are no less favourable than those attaching to any other class of shares. Could the shares used be of a class which has more favourable rights than those attaching to shares held by other non-employees?
7. The government will consult on, inter alia, the details of restrictions on forfeiture provisions to ensure that an employee who leaves or is dismissed may be obliged to offer back the shares “at a reasonable price”. It appears therefore that ‘employee pre-emption rights’ (i.e. the obligation to offer shares for sale on leaving) will be permitted, but only on the basis that the price at which the shares are sold must be not less than their “market value” – given that, unless and until any person is able and willing to buy shares in the company, or the company is floated on a public market, the value of a small minority holding in an unquoted private company affording no element of control or influence, is worth “little to man or beast”, one can envisage a pressure to dismiss all those employees holding such shares in advance of an “exit event”, simply to allow controlling holders to increase their stake at little cost. The natural uplift in value, from “minority interest” basis, to “pro rata” basis which accrues upon a sale of the whole of the issued share capital would then be lost to those former employee-owners. It is difficult to see how to protect against such ‘abuse’.
8. What price is to be ascribed to the surrender of employment rights? Will there be a ‘standard tariff’? An employee of a larger quoted company might be enticed to forgo his rights in exchange for, say, £10,000 worth of shares, but how does this compare with an employee of a smaller unquoted company asked to forgo a similar level of employment security, but for shares with an initial value that might, on ordinary valuation principles, be of substantially lesser value? To what degree is it appropriate – or possible – to factor in

- any “hope value” when valuing shares for these purposes? The initial value of shares in a start-up company may be close to zero : is it right that an employee forgo his employment rights in exchange for such a speculative investment?
9. Will part-timers be eligible? If so, on what basis will the value of the shares to be offered to them be assessed relative to those offered to a full-time employee?
 10. This is swapping employment rights for shares. it introduces a new type of relationship between employees and employers.
 11. Employment tribunals will need to assess this relationship and may decide that such employees are in fact entitled to all employment rights because of the ‘facts’ of the case rather than wording of the employment contract. They may say ‘employee wasn’t sufficiently appraised of the situation’. The condoc said this will remove the risk of employment tribunals, but it may not.
 12. Existing employees will have to opt out.
 13. It will be difficult for a tax adviser to give advice on a scheme without the input of an employment lawyer which will incur additional costs. Employees are giving up rights potentially for nothing or possibly in exchange for a future income tax bill.
 14. Employees who want a job will sign anything. Employees won’t understand the difference.
 15. In practice, employers who don’t want to be stuck with employees for ever will use fixed term contracts or take people on through service companies.
 16. This scheme is likely to be used by actual employee/owners who will use it for all their shares because they will then be free from CGT – will be very popular way to avoid all tax on gains.
 17. No indication of maximum shareholding allowed – 90%, 100%?
 18. No restriction by trade type.
 19. How will non-English speaking employees understand?
 20. Large companies with big HR departments will get the admin right. Small companies won’t.
 21. The cost of dealing with these will be huge.
 22. EMI schemes are currently very popular for businesses. Do we need others?