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labour and employment lawflash

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## Update on UK Employee Shareholder Provisions

*The new provisions are now in force and allow UK employees to give up certain employment rights in return for shares in their employer (or its parent), but important questions remain unanswered.*

On 1 September, the new employee shareholder provisions<sup>1</sup> came into effect by way of the Growth and Infrastructure Act 2013 (Commencement No. 3 and Savings) Order 2013.<sup>2</sup> The relevant employment provisions are contained in a new section 205A of the Employment Rights Act 1996. To coincide with the new law coming into effect, guidance has been issued by Her Majesty's Revenue and Customs (HMRC)<sup>3</sup> and the government's Department for Business, Innovation and Skills (BIS).<sup>4</sup> The HMRC guidance covers the basic tax treatment of employee shareholders' shares and confirms that an employer that intends to award shares can seek to agree to a valuation of those shares with HMRC. The BIS guidance sets out the process that both employers and employees must follow when considering whether to offer or accept shareholder status. The BIS guidance also restates the employment rights that shareholders will be giving up if they choose to accept employee shareholder status.

Whilst advisors in this very new and potentially complex area of law will undoubtedly welcome *any* assistance to demystify the new provisions, the HMRC guidance and the BIS guidance are relatively brief and leave many important questions unanswered. Some of the remaining areas of uncertainty are considered below.

- **Transfer of Undertakings (Protection of Employment) Regulations (TUPE) transfers.** A myriad of issues arise in the context of what would happen to employee shareholders (and their shares) if their employment were to transfer from their current employer (the transferor) to a new employer (the transferee) pursuant to a TUPE transfer. For example, would the transferor be obliged to buy back the shares, and, if so, should the value of these shares be based on the pre- or post-transfer financial position of the transferor? Another unresolved matter is whether the new provisions require the transferee to offer equivalent shares to the employee shareholders. Furthermore, what would happen if the transferee did not have any share capital to offer such shares, and, even if it did, would it be obliged to employ the transferring individuals as employee shareholders if it did not already offer such status to its own employees? The new guidance fails to address these issues in any way.
- **Termination of employment.** Neither the legislation nor the guidance documents specify what should happen to employee shareholders' shares on termination of employment. Instead, these matters are left open for determination by the employers. Accordingly, it is for the employers to consider matters such as whether their own schemes mandate the buyback of shares on termination of employment or whether transfer of shares to third parties is permitted. Equally, the legislation does not contain any "leaver" provisions and gives considerable scope to employers to prescribe applicable "good leaver" and "bad leaver" terms. Notably, any terms applicable to the buyback of shares and/or leaver provisions do not have to be contained in the

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1. In our 13 May 2013 LawFlash, "Employee Shareholders: It's Happening, but What Does it Mean?", available at [http://www.morganlewis.com/pubs/LEPG\\_LF\\_GrowthInfrastructureAct2013\\_13may13](http://www.morganlewis.com/pubs/LEPG_LF_GrowthInfrastructureAct2013_13may13), we set out the headline features of the proposed new employee shareholder scheme. We also highlight the areas of uncertainty surrounding the practical operation of the scheme.

2. View the order at [http://www.legislation.gov.uk/ukSI/2013/1766/pdfs/ukSI\\_20131766\\_en.pdf](http://www.legislation.gov.uk/ukSI/2013/1766/pdfs/ukSI_20131766_en.pdf).

3. View the HMRC guidance at <http://www.hmrc.gov.uk/employeesshareholder/>.

4. View the BIS guidance at <https://www.gov.uk/employee-shareholders>.

statement of written particulars upon which employees must seek independent legal advice before agreeing to employee shareholder status. However, it is assumed that any advisor would need to know these details when assessing the relative merits of the share offering.

- **Value of shares on forfeiture.** When making share awards, employers may propose share valuations to HMRC, and, where possible, HMRC will seek to agree these valuations. However, neither the legislation nor the HMRC guidance addresses the question of the price that companies must pay when the shares are forfeited, and neither prescribes that reasonable consideration should be paid when shares are bought back by employers.

It is therefore left for employers to determine how a fair price for buyback of shares will be determined. Whilst most employers are likely to clarify this mechanism in the shareholder agreement and/or their corporate constitution and seek to determine a fair valuation at the relevant time, there seems to be considerable scope for less scrupulous employers to “undervalue” shares that they buy back from exiting employees.

- **Termination costs.** One of the original aims of employee shareholder status was to enable businesses to create a more flexible workforce, in part, by reducing the costs of dismissing employees. However, even though a properly executed employee shareholder relationship will prevent employees from being eligible to (i) bring unfair dismissal claims and/or (ii) receive statutory redundancy payments, it remains to be seen whether termination costs will in fact be reduced. With the option of an unfair dismissal claim no longer available, exiting employees are more likely to consider alleging that their dismissals were an act of unlawful discrimination, regardless of whether or not the facts support such a complaint. Moreover, where the value of shares rises significantly between the date on which they are awarded and the date on which an employer is contemplating the dismissal of a shareholder, the cost to the employer of buying back the shares could be so prohibitively high that it, in fact, deters or prevents the employer from being able to dismiss the employee.

Initial reaction to employee shareholder status has been fairly negative, largely because of the valuable employment rights that employee shareholders will lose and because of the potential for the scheme to create a two-tier workforce in which employee shareholders are particularly vulnerable to dismissal (e.g., in a redundancy selection exercise). However, criticism of the scheme has also been fuelled by the lack of certainty surrounding various aspects of the scheme for both employers and employee shareholders alike. Whilst it was hoped that the new guidance from HMRC and BIS would provide some much-needed clarity on these issues, many questions remain unanswered.

## Contacts

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