Fair share?

Roderick Ramage queries whether the employee shareholder scheme can become widespread

IN BRIEF

- Will the government's employee shareholder scheme work effectively for UK businesses and their employees?
- Small and medium sized companies are most likely to encounter potential problems in the scheme.

George Osborne's harebrained proposal for employee shareholders, which was announced at the Conservative Party Conference last October, made it to the statute book and came into force on 1 September 2013.

The scheme for employees to be given shares in their employer in exchange for relinquishing certain statutory employment protection rights became law by s 31 of the Growth and Infrastructure Act 2013, which inserted ss 47G, 104G and 205A into the Employment Rights Act 1996 (ERA 1996), of which s 205A is the principal section, whose main provisions I summarise below.

The conditions for an individual to become an employee shareholder are that:

i. he and his employer make an agreement for him to be one;
ii. the employer issues or procures its parent company to issue fully paid shares with a value on the day of issue of not less than £2,000, for which the individual gives no consideration;
iii. the employer or prospective employer gives to him a written statement of the status of an employee shareholder and the terms of the shares;
iv. he is given advice about the terms and effect of the proposed agreement by a relevant independent adviser within the meaning of s 203(3)(c) (settlement, formerly compromise, agreements) of ERA 1996, for which the employer must pay the reasonable costs; and
v. there is a seven days' "cooling off" period between the advice and signing the agreement.

An employee may not be dismissed or subjected to any detriment because of his refusal to accept an offer to become an employee shareholder. Nothing, however, prevents a prospective employer from making the acceptance of an offer of employment conditional on accepting an offer to become an employee shareholder.

The tax arrangements, in the Finance Act 2013, s 55 and Sch 23, are that no liability to income tax arises on the issue of the first £2,000 value of shares, a gain made on the first disposal of an employer shareholder share, whose value immediately after acquisition does not exceed £50,000, is not a chargeable capital gain and no liability to income tax arises on the employer's payment or reimbursement of the costs of advice.

An employee shareholder does not have the right to request to undertake study or training or flexible working, to be unfairly dismissed, or to a redundancy payment. This does not exclude the employee's right to request flexible working on a return to work from parental leave or his rights in respect of a dismissal. The notice periods for notifying the employer of intention to return to work during a maternity leave period, the corresponding provision for adoption leave and for return to work during additional paternity leave are reduced.

The written statement must state or explain the matters set out in sub-paragraphs (a) to (i) of s 205A(5), which cover the employment protection rights relinquished, the notice periods reduced and the rights of the shares (voting, dividends, participation in surplus on winding up, redemption, transfers, pre-emption and "drag-along" or "tag-along").

Osborne's irony

In his conference speech George Osborne said: "This idea is particularly suited to new businesses starting up; and small and medium sized firms. You the company: give your employees shares in the business. You the employee: replace your old rights of unfair dismissal and redundancy with new rights of ownership…Get shares and become owners of the company you work for. Owners, workers, and the taxman, all in it together. Workers of the world unite."

Ironically the small and medium sized companies, expected to benefit most from this scheme, are almost certainly not quoted on a stock exchange, and, for that reason alone, are likely to be more affected than quoted companies by the potential problems in the employee shareholder scheme, such as the following:

- Minority shareholdings in unquoted companies often have a value that is illusory rather than real.
- The valuation of shares in an unquoted company is an uncertain exercise and s 273 of the Taxation of Chargeable Gains Act 1992, which must be applied, gives no guidance on the valuation principles to be applied.
- Dismissed employees might seek to establish that they have employment protection rights on the grounds that the valuation was incorrect and so the value of the shares issued was less than £2,000.
- The existence of minority shareholders in an unquoted company: (a) can dilute the controlling shareholders' rights; and (b) do complicate the regulations by which the company and the shareholders and between the shareholders themselves are governed, if the hazard in (a) is to be avoided by articles of associations, which exclude or minimise employee shareholders' rights to participate in the company's decision making and profits.
- The buy-back of employees' shares involves regulatory compliance and financial resources.
- The cost of the advice to prospective employee shareholders will be substantially higher than the amounts commonly paid for settlement agreements, and the costs in implementing and administering employee shareholdings, eg valuations at the start and on buy-back and the buy-back itself, will also be expensive.
- The employee loses valuable rights in exchange for what can be a relatively small and uncertain benefit, given that the minimum value of the shares is £2,000.
- The employee's loss of employment rights will be particularly acute on the company's insolvency, because he will not receive any redundancy payment or unfair dismissal compensation from the National Insurance Fund and there will be no resources to buy back his shares.

If the employer protects its controlling shareholders' rights, the Chancellor's "new rights of ownership" may be no more than a momentary warm glow, which will dissipate when the employee shareholder realises that a minority shareholder is either a nuisance or an irrelevance. NLJ

Roderick Ramage is a solicitor in private practice at *www.law-office.co.uk* and is the general editor of *Kelly's Legal Precedents*.

Specimen documents for the implementation of the employee shareholder scheme will be included in the forthcoming 2013 supplement to *Kelly's Legal Precedents*, formerly known as *Kelly's Draftsman*.