

Insight: Employment & Benefits

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Government gives go ahead for new employment status

On 3 December 2012, the UK Government published its response to a consultation paper on the Chancellor's proposal for implementing a new "employee shareholder" status. Whilst acknowledging that only "a very small number of responses welcomed the scheme", the Department for Business Innovation & Skills ("BIS") still intends to proceed with implementing the new employment status.

The new employment status

Currently, the two main categories of employment status in the UK are 'employee' and 'worker'. Whether an individual is an employee or a worker determines what rights and obligations the individual may have; for example, workers do not enjoy the same right as employees to statutory redundancy pay and maternity pay, or to protection from unfair dismissal.

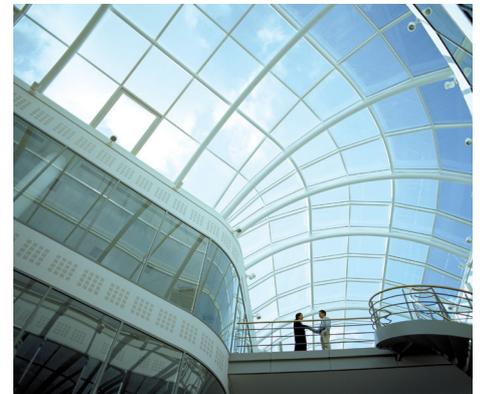
Under the proposed third type of employment status, individuals may exchange certain UK employment rights for rights of ownership, in the form of shares, in the business in which they work. Any gains that the individuals make on the first £50,000 worth of shares will be exempt from capital gains tax ("CGT").

Reduced employment rights

The consultation paper proposed that an employee shareholder would not have access to the following employment rights:

- unfair dismissal rights (except for reasons that are automatically unfair or that relate to discrimination);
- statutory redundancy pay; and
- flexible working and time off for training.

Employee shareholders would also have to give, where relevant, 16 weeks' notice of their intention to return to work early from maternity, paternity or adoption leave, compared to eight weeks' notice for other employees.



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Equity share in the business in which they work

BIS initially stated in its consultation that employers who decide to implement the employee shareholder status would be able to offer their employees fully paid-up shares ranging from a minimum value of £2,000 to a maximum value of £50,000. The Government has since taken steps to remove the upper limit of the value of employee shareholder shares, but £50,000 will be retained as an upper limit on the value of shares (as at the time of acquisition) qualifying for CGT relief in respect of future gains.

BIS intends for all classes of shares to be eligible for use under this arrangement: the shares may carry rights to dividends, voting or a share in the company's assets if the company is wound up. Shares will be valued according to their "unrestricted market value" at the time that they are awarded.

Non-UK registered companies will also be able to benefit from the status and companies will be allowed to issue shares from their parent company, to enable subsidiaries with little value in themselves to issue shares in a more valuable parent company.

Three's a crowd?

Aligning employees' interests with those of their employer by offering employees shares in the business in which they work is not a novel idea; many large companies already have equity incentive plans in place. Employers can take comfort in the fact that the Government will allow for employers to apply restrictions on the shares they issue under the employee shareholder arrangement, as is common place in equity incentive plan arrangements, in order for employers to protect their companies. For example, employers would be able to include a clause in their contracts requiring the employee shareholder to surrender their shares upon leaving the company in certain circumstances (sometimes defined

as Bad Leaver circumstances). However, the Government will require that, if shares are surrendered, employers buy back the employee's shares "at a reasonable value."

The consultation revealed, however, that employers are concerned that having two different types of employment contract applicable to different groups of employees would be a possible source of disharmony within the workplace. Additionally, employers already find the laws surrounding the *current* categories of employment status complex. A third status may create additional confusion for an employer, and the time and cost of implementing and maintaining an appropriate employee shareholder scheme may be unappealing, particularly to small businesses.

Another concern for employers is the possible increase in discrimination claims as a consequence of employees having given up the right to bring an unfair dismissal claim. Already it is seen as a common tactic for some claimants to bring discrimination claims alongside an unfair dismissal claim; removing the option of an unfair dismissal claim could result in increased focus on such alternative claims.

Employee considerations

Whether the new employee shareholder status will be welcomed by employees poses a more difficult question: will employees be prepared to exchange some of their critical UK statutory employment rights in order to receive equity in the business in which they work? Presumably whether the scheme is suitable or an attractive option for an employee will depend on their circumstances.

Employee shareholders would only be required to exchange certain *statutory* employment rights in exchange for shares: the Government's response to the consultation makes it clear that the Government expects that 'companies using the new status would continue to negotiate contractual terms over and above the

statutory minimum as is currently the case'. An offer of shares may therefore appeal to employees who are able to rely on, for example, contractual redundancy pay.

An offer of shares might also appeal to employees of small, fast-growing companies where there is potential for high share growth. On the other hand, as the news seemingly demonstrates daily, an individual will have little comfort if their employer is struggling and they have given up their only redundancy payment rights for some shares which drop in value.

It may be that the new status will appeal to senior executives as, whilst many senior executives already receive shares in the business that they work for as part of their remuneration package, the CGT exemption which the new status offers is likely to be attractive, whereas the statutory rights they would be giving up may be seen as less valuable in the context of their overall package.

Guidance required

Whilst the technical side of implementing an employee shareholder scheme may be relatively straightforward (though possibly expensive) for employers, it is the practical aspects that require additional guidance from the Government.

A major concern is that individuals will feel pressured to elect to reduce their employment rights. It is tempting in this regard to draw parallels with the maximum 48-hour working week opt-out. Whilst it is unlawful to dismiss a worker or otherwise victimise them for refusing to sign an opt-out or for opting back in, there is currently no prohibition on refusing to employ someone unless they opt out. Consequently, and particularly in the current job market, an individual may feel pressured to agree to an offer of employment which contains an opt-out, or, as the case may be, reduced employment rights in return for £2,000 worth of shares in their new employer.

There is also concern regarding the valuation of shares. Unless this is absolutely clear, there may be a rise in pre-hearing reviews to determine whether an individual did in fact receive £2,000 worth of shares and is therefore barred from bringing a particular claim. Expert evidence as to share valuation methods may be required, creating additional expense for all involved.

Conclusion

The new employment status could take effect from 6 April 2013, the beginning of the first tax year in which the related CGT exemption is expected to be available. However, the Growth and Infrastructure Bill must first progress through the House of Lords, and the Government has yet to indicate a likely commencement date.

The proposal of a new type of employment status is a bold move from the UK Government and demonstrates its continuing focus on employment legislation. However, whilst the majority of the Government's employment reforms can be seen to align with its desire to "cut red tape", the new employee shareholder status may result in more red tape than bargained for by the Government.

It remains to be seen whether the Government is able to address issues such as the valuation of shares, taxation and the ease of implementing and maintaining such share schemes, and whether, even then, the new status will be popular enough with employers to be offered to employees.