

Employee shareholder status: capital gains tax exemption

Who is likely to be affected?

Individuals who have taken up the 'employee shareholder' employment status and have capital gains.

General description of the measure

This measure exempts any capital gains made by individuals on the disposal of shares acquired through the adoption of the 'employee shareholder' employment status from capital gains tax (CGT).

Policy objective

This measure is part of a wider policy to introduce a new 'employee shareholder' employment status to reduce regulatory burdens on business. 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.

Background to the measure

On 8 October 2012 the Government announced its intention to introduce a new 'employee shareholder' employment status. Individuals adopting the status will receive between £2,000 and £50,000 of CGT-exempt shares.

The Department for Business, Innovation and Skills published a consultation on the implementation of the 'employee shareholder' status on 18 October 2012. The consultation closed on 8 November.

Detailed proposal

Operative date

The exemption will apply to shares received through the adoption of the new 'employee shareholder' status on or after 6 April 2013.

Current law

Section 3 of the Taxation of Chargeable Gains Act 1992 (TCGA) provides that individuals pay CGT only on their chargeable gains (net of allowable losses and all other reliefs) that exceed the annual exempt amount (currently £10,600) for the tax year. Shares are assets for the purposes of capital gains tax (section 21 TCGA 1992) and, in the absence of provisions to the contrary, gains on disposals of such assets are chargeable to capital gains tax.

Proposed revisions

Legislation will be introduced in Finance Bill 2013 to exempt any capital gains on the disposal of shares acquired through the adoption of the 'employee shareholder' employment status from CGT. Existing share pooling and identification rules will be amended as necessary.

Summary of impacts

Exchequer impact (£m)	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18
	-	nil	nil	negligible	-20	-80
	These figures are set out in Table 2.1 of the Autumn Statement and have been certified by the Office for Budget Responsibility. More details can be found in the policy costings document published alongside the Autumn Statement.					
Economic impact	The measure is not expected to have any significant economic impacts.					
Impact on individuals and households	As it is entirely new, predicting the take up of the new employment status is highly uncertain. It is broadly expected that 20,000 to 40,000 individuals a year may eventually benefit from the CGT exemption on disposal of the shares.					
Equalities impacts	<p>The gender split for CGT payers has been relatively stable over time, with men making up around 60 per cent of those filing a tax return that includes a capital gain and women making up around 40 per cent. Those aged 45-50 and 55-60 are most likely to file a return that includes a capital gain.</p> <p>The introduction of this CGT exemption is not expected to have a disproportionate impact on any protected group.</p>					
Impact on business including civil society organisations	<p>Most of the companies affected are likely to be those already awarding employee shares and reporting to HM Revenue & Customs. The requirement to notify the awards of shares associated with the new employee shareholder status is likely to involve minimal additional activity in form returns. There may be a small number of companies that are attracted by the measure and start awarding shares to employees. Overall no significant cost is expected, both in terms of one off implementation costs and ongoing administrative burdens.</p> <p>Overall, this measure is expected to have a negligible impact on businesses and civil society organisations.</p>					
Operational impact (£m) (HMRC or other)	The ongoing costs of operating the 'employee shareholder' employment status, including the provision of valuation services, form processing and compliance work, are estimated to be in the region of £1.6 million a year. These include operational costs relating to the wider policy, as well as the CGT exemption.					
Other impacts	<p><u>Small firms impact test:</u> the impact on small firms (with fewer than 20 employees) has been considered. This measure is a beneficial measure and excluding companies with fewer than 20 employees would not achieve the stated policy objective.</p> <p>Other impacts have been considered and none have been identified.</p>					

Monitoring and evaluation

This measure will be kept under review through communication with affected taxpayer groups.

Further advice

If you have any questions about this change, please contact Rob Clay (email: rob.clay@hmrc.gsi.gov.uk) or Edward Odell (email: edward.odell@hmtreasury.gsi.gov.uk).

1 Exemption for employee shareholder shares

- (1) After section 236A of the TCGA 1992 insert—

“Employee shareholders

236B Exemption for employee shareholder shares

- (1) A gain which accrues on the disposal of exempt employee shareholder shares is not a chargeable gain.
- (2) Shares are exempt employee shareholder shares if—
- (a) they are employee shareholder shares, and
 - (b) 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.
- (4) 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.

236C Only first £50,000 of shares under each agreement to be exempt

- (1) An employee shareholder share is exempt under section 236B only if, immediately after its issue or allotment in consideration of an employee shareholder agreement (“the relevant agreement”), the total value of qualifying shares which have been issued or allotted to the employee does not exceed £50,000.
- (2) “Qualifying share” means an employee shareholder share in—
- (a) the employer company in relation to the relevant agreement, or
 - (b) an associated company of that company,
- which is issued or allotted to the employee in consideration of an agreement within subsection (3).
- (3) The agreements are—
- (a) the relevant agreement,
 - (b) another employee shareholder agreement with the same employer company, and
 - (c) an employee shareholder agreement with an associated company of that company.
- (4) For the purposes of this section—
- (a) a company is an “associated company” of another if—
 - (i) one of the two has control of the other, or
 - (ii) both are under the control of the same person or persons, and

- (b) if a company controls another when an employee shareholder agreement is entered into with the employee, paragraph (a) applies as if that continued to be the case (in addition to any other circumstances) when any subsequent employee shareholder agreement is entered into with that employee.
- (5) But subsection (4)(b) does not apply as between two companies if –
- (a) one of the companies has been dissolved, and
 - (b) the period of two years beginning with the date of the dissolution has passed and the employee has not been engaged in any office or employment (including engagement under a contract for services) with any company which is an associated company of the dissolved company.
- (6) If a number of qualifying shares are issued or allotted to an employee on a day and –
- (a) before that day, the value of qualifying shares issued or allotted to the employee does not exceed £50,000, and
 - (b) at the end of that day, that value does exceed that sum,
- the appropriate proportion of the shares (rounded down, if necessary, to the nearest share) is to be treated for the purposes of subsection (1) as having been issued or allotted separately and before the others.
- (7) The “appropriate proportion” is the following –
- $$\frac{50000 - B}{T}$$
- where –
- B is the value of qualifying shares issued or allotted before the day;
 - T is the total value of qualifying shares issued or allotted on the day.
- (8) For the purposes of this section, the value of a share (at any time) is its unrestricted market value at the time when it was issued or allotted.
- (9) The unrestricted market value of a share when it is issued or allotted is what the market value of the share would be immediately after the issue or allotment, but for any restriction.
- For this purpose “restriction” has the meaning given by section 432(8) of ITEPA 2003 (restricted securities for the purposes of Chapter 2 of Part 7 of that Act).

236D Shares not exempt if shareholder or connected person has material interest in company

- (1) An employee shareholder share is not exempt if –
- (a) at the time the share is issued or allotted, the employee has a material interest in the employer company or its parent undertaking, or
 - (b) at any time in the period of 1 year ending with the date on which the share is issued or allotted, the employee had a material interest in the company or parent undertaking.
- (2) An employee shareholder share is not exempt if, at the time the share is issued or allotted, the employee is connected with an individual who

has a material interest in the employer company or its parent undertaking.

- (3) An individual (“A”) has a material interest in a company if at least 25% of the voting rights in the company are exercisable –
 - (a) by A,
 - (b) by persons connected with A, or
 - (c) by A and persons connected with A together.

236E Identification of exempt employee shareholder shares

- (1) Sections 104 (share pooling), 105 (disposal on or before acquisition) and 106A (identification of securities) do not apply to exempt employee shareholder shares.
- (2) Subsection (3) applies where –
 - (a) an employee holds shares of the same class in a company,
 - (b) some, but not all, of the shares are exempt employee shareholder shares, and
 - (c) the employee disposes of some, but not all, of the shares in that holding.
- (3) Where this subsection applies –
 - (a) the employee may determine what proportion of the shares disposed of are to be treated as exempt employee shareholder shares (up to the number of such shares which the employee holds), and
 - (b) the consideration received for the shares disposed of is to be apportioned accordingly.
- (4) For the purposes of this section shares in a company are not to be treated as being of the same class unless they are so treated by the practice of a recognised stock exchange or would be so treated if dealt with on a recognised stock exchange.

236F Reorganisation of share capital involving employee shareholder shares

- (1) Section 127 (equation of original shares and new holding on reorganisation) does not apply to exempt employee shareholder shares.
- (2) The reference in subsection (1) to section 127 includes that section as applied by sections 135 and 136 (other company reconstructions).

236G Relinquishment of employment rights is not disposal of an asset or consideration for shares

- (1) This section applies, for the purposes of this Act, where an employee has the rights mentioned in section 205A(2) of the Employment Rights Act 2006 (rights which an employee shareholder does not have) before entering into an employee shareholder agreement.
- (2) The employee is not to be regarded as disposing of an asset by entering into the agreement.
- (3) The consideration for the acquisition of the employee shareholder shares is to be treated as being nil.”

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- (2) In section 58(2) of that Act (spouses and civil partners: disposals excepted from the usual rule) –
 - (a) omit “or” at the end of paragraph (a), and
 - (b) after paragraph (b) insert “, or
 - (c) if the disposal is of exempt employee shareholder shares (see sections 236B to 236D),”.
 - (3) This section comes into force in accordance with provision made by the Treasury by order made by statutory instrument.

EXPLANATORY NOTE

EXEMPTION FROM CGT FOR EMPLOYEE SHAREHOLDER SHARES

SUMMARY

1. This clause provides for gains on disposals of ‘employee shareholder shares’ which were worth up to £50,000 on receipt, to be exempt from capital gains tax (CGT). ‘Employee shareholder shares’ are shares received by a person in return for agreeing to accept the new employee shareholder employment status.

DETAILS OF THE CLAUSE

2. Subparagraph 1 introduces six new sections into Part 7 of the Taxation of Chargeable Gains Act 1992 (TCGA). These new sections provide for the exemption and impose an upper limit on the value of the shares to which the exemption applies.
3. New section 236B states that gains on exempt employee shareholder shares are not chargeable gains and defines exempt employee shareholder shares as employee shareholder shares which meet the further requirements in new sections 236C to 236D.
4. Subsection (3) states that an exempt employee shareholder share ceases to be exempt when its owner disposes of it, by selling it or otherwise.
5. Subsection (4) defines ‘employee shareholder share’ and other terms used in the clause.
6. New section 236C sets limits on the value of shares that can be exempt.
7. Subsection (1) provides that an employee shareholder share is exempt if, when it is received, the total value of the shares received under the relevant employee shareholder agreement does not exceed £50,000.
8. Subsections (2) and (3) provide that, for the purpose of applying the £50,000 limit, employee shareholder shares received in connection with previous employment agreements with the same company or with associated companies, are taken into account.
9. Subsection (4)(a) defines two companies as associated if either one has control of the other or both are under the control of the same person or persons.

10. Subsection (4)(b) provides that where one company controls another at the time an employee shareholder agreement is made with an individual, that control is treated as persisting when any subsequent employee shareholder agreement is entered into with that individual.
11. Subsection (5) states that subsection (4)(b) does not apply where one of the two companies has been dissolved and two years have passed between the dissolution and the subsequent employee shareholder agreement, during which time the individual has not been employed by a company associated with the dissolved company.
12. Subsections (6) and (7) provide a means of determining which employee shareholder shares are treated as exempt where the number of shares issued or allotted on a day takes the recipient over the £50,000 limit. The shares are deemed to be issued or allotted in two tranches, one of which consists of the maximum number which may be received without breaching the £50,000 limit.
13. Subsections (8) and (9) define ‘unrestricted market value’ as the value the share would have were it not for any restrictions which apply to it (that is to say, any provision relating to the shares made by any contract, agreement, arrangement or condition).
14. New section 236D prevents an employee shareholder share received by an individual from being an exempt share in certain circumstances.
15. Subsection (1) applies where, when the share is issued or allotted, the employee has a material interest in either the employer company or its parent company, or has had such an interest in the year preceding the issue or allotment. In these cases, the share will not be an exempt employee shareholder share.
16. Subsection (2) applies where, when the share is issued or allotted, a person connected with the employee has a material interest in the employer company. In these cases also, the share will not be an exempt employee shareholder share.
17. Subsection (3) defines a material interest by providing that an individual has a material interest in a company if at least 25% of the voting rights in the company are exercisable by that individual, by persons connected with that individual, or by the individual and persons connected with him or her together.
18. New section 236E disapplies the special share pooling and share identification rules in the TCGA which would normally apply both to exempt employee shareholder shares and to non-exempt employee shareholder shares taken together.

19. Subsections (2) and (3) permit a person who holds both exempt and non-exempt employee shareholder shares of the same class in a company and who disposes of shares of that class to specify how many exempt shares he or she has sold (up to number they held).
20. Subsection (4) defines what is meant by shares in a company being 'of the same class'.
21. New section 236F prevents the special rules at section 127 TCGA (which apply to shares which are involved in reorganisations of share capital, or schemes of reconstruction, or in share exchanges) from applying to exempt employee shareholder shares.
22. New section 236G ensures that for capital gains tax purposes where an individual ceases to have certain employment rights by virtue of becoming an employee shareholder, this is not to be treated as the disposal of an asset for chargeable gains purposes, and for the same purposes no consideration is deemed to have been given to acquire the employee shareholder shares.

BACKGROUND

23. A new employment status, known as 'employee owner status' is being created by the Growth and Infrastructure Bill. As an incentive to employees to agree to this new status, employers will be required to give employee owners shares worth at least £2,000. As a further incentive, capital gains on those shares will not be subject to capital gains tax, whenever the shares are disposed of. There will be limits on the shares which qualify for this exemption, imposed by reference to the value of employee shareholder shares at the time they are received.
24. If you have any questions about this change, or comments on the legislation, please contact Rob Clay on 03000 570649 (email: rob.clay@hmrc.gsi.gov.uk).