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10 October 2014

Dear Sirs,

### **HM Treasury – New Employee Shareholding Vehicle**

#### ***Introduction***

We are the Quoted Companies Alliance, the independent membership organisation that champions the interests of small to mid-size quoted companies. Their individual market capitalisations tend to be below £500m.

The Quoted Companies Alliance is a founder member of European **Issuers**, which represents over 9,000 quoted companies in fourteen European countries.

The Quoted Companies Alliance Share Schemes Expert Group has examined your proposals and advised on this response. A list of members of the Expert Group is at Appendix A.

#### ***Response***

We welcome the opportunity to respond to this consultation.

Overall, we support in principle the idea of a simplified employee shareholding vehicle for use by employers as part of the operation and implementation of employee share plans. The main complexities of using and operating an EBT do relate to the tax issues raised in the consultation document and, in order to be attractive for employers, the vehicle must provide reliefs from most or all of the taxes identified. We consider that the vehicle could be legislated to ensure that it will not be abused and that the vehicle can provide the intended simplicity without creating risk to the exchequer.

However, we are concerned that the commercial restrictions may mean that the arrangements are not attractive to our members (or indeed companies generally) notwithstanding the tax benefits. In our view the vehicle should be made more attractive to be likely to achieve its aims. We are of the view that it may be simpler and more effective to deal with the underlying tax issues relating to EBTs in general rather than creating a new vehicle.

We have specifically addressed the questions in the consultation document as follows.

The Quoted Companies Alliance is the independent membership organisation that champions the interests of small to mid-size quoted companies.

- 1. Which of the issues identified by the OTS create the greatest complexity and administrative cost for companies? Please give practical examples if possible, including any behaviour that specific examples encourage, such as establishing offshore EBTs.**

A number of the complexities relating to the tax treatment of EBTs apply to close companies. The majority of our members – small and mid-size quoted companies – are not close companies and therefore these tax issues have limited impact on them.

The most common tax issue for our members is the risk of capital gains tax being payable by the EBT trustee. Whilst this is not necessarily the most complex tax issue, it does result in companies establishing EBTs with offshore trustees. A large number of our members with EBTs will have offshore trustees. There is a great deal of trustee expertise outside of the UK such that there are good non-tax reasons for appointing non-UK trustees but it should not be the case that UK EBTs are disadvantaged by being subject to UK capital gains tax in comparison to offshore EBTs.

The disguised remuneration provisions are long and complex and therefore companies do require a significant amount of advice on whether they fall within the exemptions for seemingly straightforward arrangements that are clearly intended to be caught by the exemptions and therefore these have a significant administrative cost.

The stamp duty implications and the impact on access to tax advantaged share schemes can create cost and complexity but, the overall implication of these provisions on our members is less than the capital gains and disguised remuneration impacts.

- 2. What would be the effect of providing simpler access to existing inheritance tax exemptions through this vehicle?**

The majority of our members are not close companies such that the inheritance tax implications do not create significant issues for our members.

However, EBT trust deeds for non-close companies as well as close companies are often drafted to address the inheritance tax risks and this creates a level of complexity that in most cases is not necessary. Even for close companies, it is very rare that shareholders are using EBTs to provide 'bounty' to employees.

Therefore, to provide the exemptions would avoid the need to address the complex inheritance tax provisions and would simplify the position for employers. Providing the exemptions should not give rise to abuse.

- 3. Which conditions of s239ZA TCGA are most onerous for onshore EBTs to meet, and why? What would be the effect of relaxing the conditions for capital gains tax relief under s239ZA to the new vehicle?**

One of the conditions required to be satisfied to obtain relief under section 239ZA(2)(c) TCGA is that *"no actual consideration (as opposed to consideration deemed to be given by any enactment relating to the taxation of chargeable gains) is given directly or indirectly to trustees or the asset"*.

As a result, this section will only provide relief where the employee pays no consideration for the underlying shares (e.g. on the exercise of a nil-cost option or on the vesting of a conditional allocation).

However, where an employee makes any payment for the shares underlying their award, such as on the exercise of a market value option or on the exercise of an option with an aggregate £1 exercise price, it means that the transfer of the shares will not meet the applicable conditions under section 239ZA(2)(c) TCGA and as a result a double tax charge may arise.

The condition in section 239ZA(2)(a) TCGA also states the following:

*“an amount that is equal to or exceeds the market value of the asset is chargeable to income tax as employment income...”*

Where an employee pays for shares either on the exercise of an option or an acquisition of shares for consideration, this condition will not be met since the taxable amount will be the amount of the undervalue on acquisition which will be less than the value of the asset.

Where the assets may be subject to a risk of double tax, companies are likely to establish the vehicle off-shore. It may not be possible to rely on Section 144ZA TCGA to avoid the “market value” rule applying if the option was granted by the company and the EBT has agreed to satisfy the option. This specific application of Section 144ZA TCGA may be addressed through an update to HMRCs manual.

As is stated above, it should not be the case that UK EBTs are disadvantaged by being subject to UK capital gains tax in comparison to offshore EBTs and there should be a level playing field between the two. The examples above highlight that UK EBTs can lose flexibility by the need to ensure that their steps fall within section 239ZA TCGA. Allowing this flexibility would not in our opinion present an opportunity to use the EBT abusively.

**4. What would be the effect of continuing to apply s455 CTA 2010 to any new vehicle? How often, given the considerations above, do circumstances arise where its application is an issue for companies?**

The majority of our members are not close companies such that s455 CTA 2010 does not apply to the majority of our members.

For close companies, the risk of a Section 455 CTA charge can prevent those companies from operating an EBT or require them to consider alternative funding arrangements such as third party financing. An exemption from the effects of a Section 455 charge arising would, for close companies, make the vehicle far more attractive and create a level playing field for close and non-close companies.

**5. What would be the effect of continuing to apply the transaction in securities rules to any new vehicle? Is there an alternative approach, such as guidance, that could address the issue identified by the OTS and provide companies with confidence about its use of the vehicle without providing an exemption from the rules?**

The transactions in securities rules apply to transactions involving close companies and the majority of our members are not close companies.

However, for employers where the transactions in securities rules apply, some guidance to provide comfort that the HMRC would not raise a counteraction notice for transactions involving the employee shareholding vehicle would simplify the process of some share acquisitions by these vehicles.

**6. Would a new vehicle be at a tax disadvantage compared to other EBTs if there is no exemption from stamp duty/stamp duty reserve tax on transfers of qualifying securities between the vehicle and the beneficiaries?**

The new vehicle would not be at a disadvantage as compared to EBTs, should the vehicle not benefit from an exemption from a double stamp duty/SDRT liability for the vehicle, on the basis that EBTs do not currently benefit from any double stamp duty/SDRT exemption. However, it would certainly make the vehicle a more attractive proposition if the vehicle is able to purchase shares in the market and then transfer them to beneficiaries for value without a double stamp duty liability arising.

The current stamp duty position creates an artificial bias in favour of companies issuing new shares to satisfy share awards instead of providing the shares through an employee trust.

**7. How important would this change be for the proposed new vehicle? In what circumstances and how often would companies be likely to place a controlling shareholding in the hands of a corporate trustee of a potential new vehicle, particularly given the introduction of employee ownership trusts?**

It is not fully clear whether control by an EBT constitutes control by a company to prevent the implementation of the various statutory qualifying share schemes and our members have experienced different guidance from HMRC in different specific but similar circumstances.

In practice it is not common for companies to be controlled by EBTs and it is highly unlikely that our members would be in this position. Where ownership of a controlling stake by an EBT does prevent the operation of such statutory schemes, this has a significant impact on the company and the change to the provisions of such schemes would make the new vehicle extremely attractive for such companies.

**8. What would be the effect of continuing to apply Part 7A to a new vehicle? Is there an alternative approach, such as guidance, that could address the issue identified by the OTS and provide companies with confidence about its use of the vehicle without providing a carve out from the rules?**

There are exemptions within Part 7A to deal with employee share schemes but these are complex so for a company or trustee to be sure that an exemption applies can be costly and time consuming. This complexity means that there are inherent risks with operating incentives which are designed to fall within tightly drafted exemptions; if incentives fall outside of the exemptions it is likely to expose the employees to an immediate tax charge (as noted in section 1 above).

If Part 7A is to apply to the new vehicle, the risks highlighted above will continue to apply and companies will require advice on these provisions. Clear guidance as to how Part 7A would apply to transactions within the vehicle would be very welcome, but most companies and advisors would prefer a blanket exemption from Part 7A as this would make the vehicle a lot more attractive to companies that are looking to administer it in-house.

**9. More generally, do you agree with the OTS that if the government is unable to address all (or most) of the tax issues identified by the OTS then the vehicle would not be an attractive proposition for those seeking a simpler vehicle for companies wishing to establish employee share schemes? Please explain why.**

The main complexities of operating an employee benefit trust do relate to the tax issues raised in the consultation document and in order to be attractive for employers, the vehicle must provide reliefs from most or all of the taxes.

**10. Do you agree that further exemptions are unnecessary to make the potential vehicle a viable and attractive proposition? Please explain why.**

The list of exemptions that have been discussed should prove sufficient to make the new vehicle an attractive proposition for companies looking to set-up and administer the vehicle themselves. The key is to keep the vehicle and any exemptions as clear and as simple as possible.

**11. Do you agree that these safeguards would provide sufficient protection for the Exchequer? What, if any, opportunities would be open to those wishing to engage in tax avoidance and how could these be prevented?**

The safeguards should be sufficient.

**12. Would companies choose to establish the vehicle onshore if it could not be legislated for that vehicle and its trustees should be UK resident?**

The principal reason why any EBT is established offshore is to avoid tax-leakage. If the new vehicle had to be established on-shore, then in the absence of an exemption from UK CGT (and UK income tax on non-UK source income) it would make the vehicle less attractive than an offshore trust for the reasons outlined above.

As a result, the location in which a company would establish a vehicle would depend upon whether they would expect any CGT liabilities to arise in the vehicle which could reduce the number of companies that would be prepared to establish such a vehicle. By exempting the vehicle from UK capital gains tax (and UK income tax on non-UK source income), the vehicle should not be placed at a disadvantage, as compared to offshore EBTs, by establishing and operating the vehicle on-shore.

**13. What would be the effect of limiting the beneficiaries to current employees? What time limit would be appropriate for former employees to redeem shares or incur charges?**

We do not consider it necessary that former employees should be excluded from benefit. In practice, the interaction of an EBT with former employees would tend to reflect the commercial terms of incentive schemes and arrangements and therefore the ability for former employees to benefit would not in our view represent an opportunity for the vehicle to be used abusively or in a way that is not consistent with the principles of effective employee share schemes. In particular, the vast majority of employee share schemes have to deal with leavers and the cessation of employment cannot always be anticipated such that all benefit from the vehicle has been concluded prior to the cessation of the employment. We would find it strange that a sick employee, for example, who has to leave employment suddenly cannot then benefit. On the death of the employee, the personal representatives must be able to benefit from the vehicle.

To limit the period over which former employees can be beneficiaries of the vehicle runs the risk of conflicting with stated good practice which can encourage longer term retention of shares and holding requirements and clawback even after individuals have ceased employment.

If it is considered necessary to limit the benefit of former employees, we would suggest that the better way to address this is to limit their benefit to options, awards or other arrangements that have been entered into whilst the individual was an employee. Therefore the commercial terms of a share scheme can be allowed to play out whilst there are no new arrangements entered into. If a time limit was seen as necessary, we would suggest 5 years.

**14. What would be the effect of excluding those who have a significant influence over the management and direction of the company? What level of restriction would be appropriate?**

Limiting the beneficiaries to current and former employees of the company that do not hold in excess of a 5% interest in the company may be acceptable. However, excluding executive directors may be problematic, as it may mean that the company has to operate two vehicles, one for employees and an EBT which would only be used for directors as well as creating a two-tier system. As this would result in a duplication of costs and administration, it is likely that companies would elect to simply establish an EBT which could be used to benefit all current and former employees of the company (including executive directors).

**15. What would be the effect of establishing these criteria to define “qualifying purposes” for property held within the vehicle? Should any others be considered?**

Generally, the “qualifying purposes” outlined in the consultation would appear to cover most of the transactions that such a vehicle would be required for.

Sometime the arrangements between an EBT and the employing company are such that the company would fund the EBT but that the EBT trustees would make awards net of employer’s national insurance and use its assets to satisfy the employer’s national insurance. This is an effective way of companies being able to hedge the employer’s national insurance cost. The vehicle could also have its own stamp duty or tax liabilities depending on what exemptions are available. In addition, the EBT may be funded by way of a loan from the sponsoring company or a third party and the trustee would need to repay these loans.

A qualifying purpose should include a general satisfaction of contractual or fiscal obligations so that the trustee could be comfortable that the other qualifying purposes would not prevent it from making these types of payment.

**16. What would be the effect of allowing the vehicle to deal only in the “qualifying securities” recommended by the OTS? Please explain why. The breach of any of these conditions would mean the exemptions would no longer apply and which could, potentially, be backdated for several years unless the breach is proven to be trivial or accidental.**

We generally agree with the definition of qualifying securities and the purpose of including the restriction to avoid the vehicle being used in ways that are not intended. This should not generally restrict the attractiveness of the vehicle to our members.

There are some situations where companies (although probably not our members) could undertake transactions which could result in ordinary shares held by the vehicle being exchanged for non-ordinary or redeemable shares. We would suggest that a provision should be incorporated to address

this situation without the immediate loss of the exemptions. For example, if non-qualifying securities are acquired in exchange for qualifying securities, the vehicle only would lose its status if it continues to hold the non-qualifying securities 6 months following their acquisition.

**17. What would be the effect of introducing safeguards that would ensure the exemptions would no longer apply and allowing this to be backdated several years if the vehicle is purposely abused by a company?**

The intention behind safeguarding the vehicle against tax avoidance is of key importance to HMRC and we support the principle of protecting against any abusive use of the vehicle.

However, we are concerned that the retrospective removal of reliefs for ‘abuse’ could create uncertainties that would reduce the attractiveness of the vehicle. The term “abuse” is very broad and could be applied in almost any circumstance where HMRC do not like what a company has used a vehicle for (even if it falls within the legislation in force at the time). Therefore, it is important that any ability to retrospectively remove exemptions will need to be carefully considered and drafted to ensure that the test is objective and not subjective. If the position can be clearly set out so that employers are very clear what is abusive and what is not, we are not opposed to the principle of backdating the removal of exemptions.

**18. What would be the effect of potentially introducing maximum and minimum holding periods for employees? What periods would be appropriate to prevent avoidance risks?**

The Government should not consider introducing any form of minimum or maximum holding period as the acquisition and holding of shares is an individual investment decision for the employee.

Companies should be free to set the terms on which employees acquire and hold shares in their company via the Company’s articles of association. Introducing arbitrary rules which seek to override a Company’s articles of association would cause uncertainty and additional legal expense and may effectively make the proposed vehicle unworkable as it would potentially negate the key facets of the vehicle – a warehouse for shares that can be administered by companies with minimal complexity.

**19. What would be the effect of potentially restricting the vehicle from borrowing cash to loan to beneficiaries, or to set up sub-funds?**

In practice, most loans to employees are now made by the employing company due to part 7A ITEPA so there would not be a material impact on the effectiveness of the trust by restricting loans to employees. We do consider that the vehicle could be more effective if the trustee could make loans to employees specifically for the purpose of acquiring shares from the vehicle or to fund income tax or stamp duty charges on the acquisition of shares from the vehicle. Loans such as this can give rise to effective share plans and do not reflect the abusive use of EBTs referred to in the consultation document. This would need to be alongside a relief from part 7A ITEPA or such loans would give rise to income tax charges in any event so would be unattractive.

**20. What would be the effect of restricting the ability of the trustees to waive voting and dividend rights?**

Whether shares held in the vehicle should have voting and dividend rights is a commercial decision for the sponsoring company when the vehicle’s constitutional documentation is established.

If a trustee is not permitted to waive dividends paid on shares may cause significant cash to become trapped in the vehicle where its purpose is to allow shares to be acquired directly by employees rather than accumulate cash.

Also, corporate trustees may not be comfortable voting the shares without clear directions from underlying beneficiaries (which may not be possible) and could be criticised by beneficiaries if the corporate trustee has a vote and did not exercise it. Therefore, the default position is generally that corporate trustees do not vote shares held within a discretionary trust.

We do not consider that the waiver of votes and dividends whilst shares are held within the vehicle would reduce the overall purpose of the vehicle and therefore do not support this restriction.

If you would like to discuss our response in more detail, we would be happy to attend a meeting.

Yours faithfully,

A handwritten signature in blue ink, appearing to be 'TW', written over a light blue rectangular background.

Tim Ward  
Chief Executive

### Quoted Companies Alliance Share Schemes Expert Group

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