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Government's proposed 'employee-shareholder' scheme – who does it really benefit?

The Government is seeking to introduce a new "employee-shareholder" status under section 27 of the Growth and Infrastructure Act (the "Act"). Initially due to take effect from 6 April 2013, this scheme is currently due to come into force on 1 September 2013. The scheme is intended to provide small to medium businesses with more flexibility and also to reduce the likelihood of employment claims being brought against employers in the Employment Tribunal. Whether it will have these effects is, however, highly debatable.

Under the Act, an employer and an employee may agree that the employee will be engaged by the employer as an "employee-shareholder". In return for agreeing to become an employee-shareholder, the employee is entitled to receive fully paid up shares in the employer company (or its parent company) provided they have a value of not less than £2,000 on the date of issue or allotment. Any profits on the eventual sale of these shares will be exempt from Capital Gains Tax ("CGT"). While there is no upper limit on the value of shares that may be issued, the CGT exemption will only apply to the first £50,000 worth of shares. In addition, it was announced in the March 2013 budget that the first £2,000 worth of shares will be exempt from income tax and NICs.

In return for the shares, the employee-shareholder will be required to give up a number of the statutory employment rights that they would otherwise have, namely the right to:

- make a claim for unfair dismissal (other than for automatic unfair or discrimination-based dismissal);
- claim statutory redundancy payments;
- request time off for training; and
- request flexible working hours.

In addition, employee-shareholders will be required to provide 16 weeks' notice or a firm date of return from maternity, paternity or adoption leave (as opposed to the usual 8 weeks' notice in respect of maternity leave or adoption leave and 6 weeks' notice in respect of paternity leave).

Acceptance of an offer to become an employee-shareholder is not mandatory and the legislation specifically provides that an employee shall not be subjected to any detriment or dismissal as a result of their refusal to become an employee-shareholder. Nonetheless, employers may make acceptance of the new employee-shareholder status a condition of accepting a position with the employer. This could lead to prospective employees feeling pressurised into accepting an offer pursuant to which they are required to give up a significant level of employee rights compared to "normal" employees.

It is questionable whether the employee-shareholder scheme offers any real advantages to small or medium-sized businesses. Firstly, for many smaller businesses the minimum threshold of £2,000 of shares would be too high. In addition, unlisted companies will have to conduct a share valuation in order to accurately value the shares being offered, which is likely to be prohibitively costly.

The legislation does provide that regulations may be introduced in the future which would govern the terms of any share buy-back agreement between the employer and employee-shareholder on termination of the employee-shareholder's appointment. However, the legislation is otherwise silent on the question of what will happen to an employee's shares when they leave and there is nothing on the face of the legislation preventing employers putting various restrictions on the shares. As a company is not obliged to buy the shares back (and there may well be no effective market for the shares) it may also prove to be very difficult for an ex-employee to realise any value.

There are also serious questions as to whether a small business would want to dilute its ownership in such a way. It is anticipated that the employee-shareholder status will not be widely adopted but may offer some advantages to employers if implemented carefully.

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