COVINGTON

COVINGTON & BURLING LLP

E-ALERT | UK Employment Deregulation: Employee-Owners

November 21, 2012

UK GOVERNMENT PROPOSAL TO INTRODUCE EMPLOYEE OWNERSHIP

The Government is proposing to amend the Employment Rights Act 1996 to create a new type of employee, the employee-owner. The aim is to lighten the burden of UK employment regulation by allowing employers to offer employees tax-favoured shares in the employer company in return for surrendering a number of their employment rights.

The shares should be worth between £2,000 and £50,000, valued according to their unrestricted market value at the time that they are awarded. The award of employee-owner shares will be subject to income tax and National Insurance Contributions as usual. However, employee-owners will not have to pay Capital Gains Tax ("CGT") on gains in the value of the shares. Employers may also include a clause in contracts requiring the employee-owner to sell back the shares when he/she leaves employment.

WHAT IS THE EFFECT ON THE EMPLOYEE?

For existing employees, assumption of employee-owner status will be optional. However, employers may choose to offer only employee-owner positions to new recruits. Those accepting the offer will:

- not have the right to claim unfair dismissal (except where the dismissal is automatically unfair or discriminatory);
- lose their rights to statutory redundancy pay;
- be required to give 16 weeks' notice (rather than eight) of their intention to return early from maternity/parental leave;
- only have the right to request flexible working when they return from the statutory 18 weeks' unpaid parental leave per child derived from EU law; and
- lose the statutory right to time off for training.

Large employers may consider that this new employment category provides a good opportunity to limit legal risk and so reduce costs. With respect to small and start-up companies, the hope is clearly that employee ownership will provide a useful incentive, enabling employee-owners to take full advantage of potentially significant share value growth. A nil rate of CGT is an improvement on both the standard rate (18% or 28%, depending on taxable income) and the 10% rate available under Entrepreneurs Relief. However, share price growth will have to be significant for employee-owners to exceed the current CGT annual exemption of £10,600.

HISTORY

In January 2012, the Government appointed Graeme Nuttall to review its proposals in relation to employee ownership. His report was published in July this year, and the Department for Business, Innovation & Skills (BIS) issued its response in October. The response accepts almost all of the Nuttall review's recommendations and contains various action points. In particular, the Government will:

- set up a minister-led implementation group to oversee the next steps and evaluate the viability of an employee ownership institute, as well as working with a number of other bodies, such as HM Revenue and Customs and the John Lewis Partnership (the largest employee-owned business in the UK) in order to raise awareness of employee ownership;
- consult on ways to deregulate share buybacks (by, for example, allowing companies to authorise off-market share buybacks by ordinary resolution, rather than special resolution, and by permitting the payment of consideration in instalments);
- work with professional bodies to produce template documents for employee ownership; and
- produce a voluntary toolkit to enable employees to request employee ownership.

The Government subsequently consulted on the proposed new arrangements, and responses have been published this month by the Chartered Institute of Taxation, the Law Society and others. Many respondents have expressed concern that this will prove an expensive and time-consuming arrangement to implement - particularly with respect to obtaining share valuations. Others question whether the mischief that the Government is seeking to address - perceived over-regulation of the UK employment market and its dampening effect on the job market - is over-stated. Employers are already protected from unfair dismissal claims for the first two years of employment, and numerous other economic and political factors might more adequately explain current sluggishness in the market.

Legislation is expected later this year so that employers can recruit their first employee-owners from April 2013.

If you're interested in a more detailed discussion concerning the content of this client alert should contact any of the following member of the Global Mobility Team:

Christopher Walter	+44.(0)20.7067.2061	cwalter@cov.com
Christopher Bracebridge	+44.(0)20.7067.2063	cbracebridge@cov.com
Guy Dingley	+44.(0)20.7067.2026	gdingley@cov.com
Helena Milner-Smith	+44.(0)20.7067.2070	hmilner-smith@cov.com
Robin Wolfenden	+44.(0)20.7067.2117	rwolfenden@cov.com