EMPLOYEE SHAREHOLDER AGREEMENTS

Employee shareholder status is a relatively new type of employment status. The provisions came into effect from the 1st of September 2013 and the employment law provisions on employee shareholder status are in section 205A of the Employment Rights Act 1996 (ERA 1996).

An employee shareholder is someone who works under an employee shareholder employment contract or agreement.

This fact sheet summarises the statutory provisions mainly from an employment law perspective and it does not set out detailed tax or company law information or advice.

REQUIREMENTS FOR EMPLOYEE SHAREHOLDER STATUS

In order for an employee to be or become an employee shareholder, there are four basic requirements that must be met:

- The company and the individual must agree that the individual is to be an employee shareholder
- The company must issue or allot to the individual fully paid up shares in the company (or in its parent company) which have a market value of at least £2,000 on the day of issue or allotment
- The company must give the individual a written statement of the particulars of the status of employee shareholder and of the rights which attach to the shares
- The individual must give no consideration except entry into the employee shareholder agreement, this means they must not pay for the shares in any way
- If the individual or the company do not comply with these requirements, the individual will not be an employee shareholder

EXCLUDED STATUTORY EMPLOYMENT LAW RIGHTS

An employee who is an employee shareholder does not have the right to:

- Claim ordinary unfair dismissal (apart from automatically unfair dismissals, health and safety dismissals or dismissals amounting to unlawful discrimination)
- Claim a statutory redundancy payment
- Request flexible working (except if made within 14 days beginning with the day on which the employee shareholder returns to work from a period of parental leave)
- Make an application for time off to undertake study or training

Additionally, employee shareholders are required to provide 16 weeks' notice of an early date of return from maternity leave and adoption leave instead of the usual eight weeks, and 16 weeks' notice of an early date of return from additional paternity leave instead of the usual six weeks.

Employee shareholders are still employees. The employment law rights of an employee shareholder are exactly the same as those for an employee with the exception of the statutory rights listed above. This means employee shareholders can still make all other forms of claim like discrimination, automatically unfair dismissal and breach of contract claims.

If an employee shareholder sells their shares whilst still in the employee shareholder job, their employment status will not change. Their employment status can only change if both the employer and employee shareholder contractually agree to change it.

THE WRITTEN STATEMENT

As well as specifying the statutory employment law rights that the employee is giving up or does not have, the written statement must also set out precise details in relation to the shares.

The statement must:

- State whether any voting rights attach to the shares
- State whether the shares carry any rights to dividends
- State whether the shares would, if the company were wound up, confer any rights to participate in the distribution of any surplus assets
- If the company has more than one class of shares and any of the rights referred to above attach to the employee shares, explain how those rights differ from the equivalent rights that attach to the shares in the largest class (or next largest class if the class which includes the shares is the largest)
- State whether the employee shares are redeemable and, if they are, at whose option
- State whether there are any restrictions on the transferability of the shares and, if there are, what those restrictions are
- State whether any of the requirements of the Companies Act 2006 regarding existing shareholders' right of pre-emption are excluded in the case of the shares
- State whether the employee shares are subject to drag-along rights or tag-along rights and, if they are, explain the effect of the shares being so subject

Drag-along and tag-along rules relate to minority shareholders and whether they would have to sell their shares if majority shareholders have agreed to sell, or minority shareholders require the majority shareholders to procure the same offer to sell their shares if the majority are selling.

This written statement is in addition to the written statement of employment particulars already required to be given to employees within two months of the beginning of their employment by section 1 of ERA 1996.

INDEPENDENT ADVICE

An agreement that someone shall become an employee shareholder is invalid unless, having been given the written statement referred to above, the individual has received advice from a relevant independent adviser as to the terms and effect of the proposed employee shareholder agreement.

The people who are eligible as relevant independent advisers are:

- Qualified lawyers
- Officers, officials, employees or members of an independent trade union, provided that they have been certified in writing by the union as competent and authorised to give advice
- Employees or volunteer workers at advice centres giving free legal advice, provided that they have been certified in writing by the advice centre as competent and authorised to give advice
- Fellows of the Institute of Legal Executives employed by solicitors' practices

The employer also has to pay any reasonable costs incurred by the individual in obtaining that advice, regardless of whether they then choose to accept the offer of employee shareholder employment or not. There is no definition of what constitutes ‘reasonable’ so this will be a matter for agreement between the employer, the individual and the relevant adviser and it is recommended this be agreed in advance to avoid any subsequent dispute.

There is a seven calendar day ‘cooling off’ period, commencing on the day after the individual receives the independent advice, during which any acceptance of an employee shareholder agreement will not be binding. This means the individual must take seven days to consider the advice received and whether they wish to accept or refuse the employee shareholder job. If the individual or the company do not comply with these requirements, the individual will not be an employee shareholder.

The requirement on the employer to pay for the advice does not lead to an income tax benefit-in-kind charge on an individual considering becoming an employee shareholder. However, this is limited to advice about the terms and effect of the employee shareholder agreement and tax advice consisting only of an explanation of the tax implications of employee shareholder agreements generally.

As the employer needs to ensure that the employee shareholder has definitely received advice from a relevant independent adviser and that the cooling off period has expired, it should ask for a written confirmation of this from the relevant independent adviser which includes the status and signature of the adviser and the date that the advice was given.

PROTECTION FROM DETRIMENT AND DISMISSAL

Existing employees are protected from detriment or dismissal if they refuse to switch to an employee shareholder agreement. This means they do not have to change their contract of employment if they do not want to.

Under section 47G of ERA 1996, an employee has the right not to be subjected to a detriment (for example, being disciplined or having their pay cut) by any act, or deliberate failure to act, by the employer done on the ground that the employee refused to accept an offer to become an employee shareholder.

Under section 104G of ERA 1996, it is an automatically unfair dismissal (with no qualifying period of employment required) if the reason or principal reason for the employee's dismissal is that they refused to accept an offer to become an employee shareholder.

These provisions do not apply to job applicants and therefore a job offer can be made solely on the basis that it is made under the terms of an employee shareholder agreement. However, the individual does not have to accept an employee shareholder job if they do not wish to do so.

JOBSEEKERS' ALLOWANCE

Jobseekers will not forfeit their Jobseekers' Allowance if they do not want to accept an employee shareholder agreement and a jobseeker cannot be forced to apply for an employee shareholder job.

TAX POSITION AND FUTURE REFORM

Originally, it was the case that the first £2,000 of shares allocated on this basis benefited from certain tax exemptions. However, those exemptions were abolished for shareholder arrangements entered into since 1 December 2016 (or since 2 December 2016 if independent legal advice was received on 23 November 2016 before 1:30pm). The Government has announced that it is planning to abolish the employee shareholder status to new entrants under future legislation.

HMRC guidance on the tax treatment of employee shareholder status can be accessed here.

COMPANY LAW MATTERS

An employer can only offer an employee shareholder agreement if it is a company limited by shares and the shares must be granted in the employing company or its parent company. The shares must be fully paid up; therefore in the majority of cases they will have to be paid out of distributable reserves and the accounts will have to demonstrate that the company has paid for the shares in full.

The employer will need to check it has the right to issue and allot new shares – this means consulting the company's articles of association and any shareholders agreement, as well as any other relevant corporate documents. If necessary, changes may need to be made to the articles to allow for the employee shareholder status to be offered and shareholder authorisation to this, and to issue shares, will be required. Employers will also need to consider the impact of issuing new shares – a new allotment may dilute the current shareholding and therefore impact on current shareholders.

Where the company is unlisted, the employer will need to take expert advice on share valuation to ensure the shares are worth at least £2,000 when issued or allotted. The employer should explain to the employee shareholder how the valuation of the shares was reached.

The employer will also need to consider the position on trading the shares at the end of the employee shareholder's employment – can they be sold or gifted to others, will the employee shareholder be allowed to keep the shares or will the company want to ensure it can buy back the shares (and, if so, what will the purchase price be). The transfer of shares can be restricted by the company's articles of association or any shareholders agreement. If the shares are to be subject to buy-back provisions, the employer will need to value the shares again when the employee shareholder leaves employment.

CONSEQUENCES OF BREACH

If any of the above provisions are breached, the employee will not be an employee shareholder but will be an ordinary employee and the employer will lose out on the waiver of employment rights, meaning the employee will then be able to challenge their employment status in an employment tribunal in any subsequent claim for unfair dismissal or statutory redundancy pay.

However, the employee will then also lose out on the tax advantages of employee shareholder status and may face legal action by the employer to try and recover the shares.

GOVERNMENT GUIDANCE

The Government has published guidance on employee shareholders, available here.