Response of The Esop Centre to the HM Treasury Call for Evidence on Non-Discretionary Tax Advantaged Share Schemes.

What follows supplements the evidence and points made in a meeting with officials on 12th July 2023.

1. **If you are a business owner or manager, what is your business activity, when was your company created, where is it based and how many employees do you have?**

[Not applicable]

2. **If you are responding on behalf of a representative body or think tank, please briefly describe the body, its objectives, and its members.**

The Employee Share Ownership (Esop) Centre is a non-profit subscription-based organisation which draws from over 35 years of experience to inform, research and promote direct employee share ownership in the interest of developing all forms of broad-based employee share ownership plans in the UK and Europe. Its membership includes accountants, administrators, bankers, brokers, consultants, lawyers, registrars, remuneration advisers, and trustees, alongside the companies that issue share plans to their employees.

3. **Does your company offer an employee share scheme? If so, which one?**

[Not applicable]

4. **To what extent do you agree/disagree that SAYE and SIP are fulfilling their policy objectives?**

Both SIPs and SAYE share option schemes successfully fulfil the policy of encouraging, enabling and incentivising employees to acquire shares and thereby benefit from growth in value to which they contribute by their labour. They would achieve that objective rather more effectively if the changes mentioned below were made to the governing legislation and if the government took steps to publicise their existence and advantages and enable and encourage their establishment by companies not presently eligible.

SAYE share options have been attractive on the basis that, at least when interest rates on savings have been competitive, the arrangement is “heads I win, tails I do not lose”. That has not been the case for so long as bonus rates have been zero.

5. **If you offer SAYE or SIP to your employees, why did you choose to do so? If you are responding as a representative body, please specify your members’ main reasons for offering SAYE or SIP to their employees.**

In the case of SAYE in particular, as a way of enabling employees to save and to engender a sense of having a stake in the company - people have to have money to put into these schemes but, nevertheless, they are a good way for perhaps more junior employees, to participate and have the benefit of share participation that they wouldn't otherwise have. There have been many surveys that have shown that for some employees, the only savings they make will be under an SAYE or SIP and, equally, that starting to save under an SAYE or SIP takes an individual who hasn't previously had any habit of saving into the idea of saving and creates that ethos of saving and just generally has a more beneficial effect and impact on that individual and their family.

In the case of SIP, the ongoing tax shelter for so long as a participant remains an employee is attractive.

In our experience, members are typically supportive of, and willing to give effect to, the objective of promoting direct employee share ownership and allowing employees to benefit from the growth in value to which they contribute by their labour.

The benefit of a closely-defined and readily-adoptable scheme with a clear path to securing tax-advantages, and no uncertainty as to the tax treatment, is that it allows companies to achieve that objective at a relatively lower cost and with greater certainty, and therefore lower risk, than if they were to establish some form of bespoke employee share scheme, even assuming the company could do so in a tax-advantageous manner. SAYE schemes and SIPs are perceived as providing a "well-trodden path" which companies may follow with a high degree of confidence and low risk.

6**. If you have chosen to offer only SIP or SAYE, what were the deciding factors of choosing one over the other? What do you see as the advantages of one over the other?**

SAYE options are for a fixed period and, in the case of a private company, consideration has to be given to enabling participants to be able to realise the value of the shares acquired, either immediately at the end of that option period or after holding them as an investment for a further period. Under a SIP, participants may simply allow their plan shares to remain held by the trustee for so long as the employment lasts (although similar consideration must be given at the outset to how shares will be recovered from leavers).

Although a SIP may be operated in a manner similar to an SAYE option, by having a one-year accumulation period for savings, the annual limits are lower.

The (relatively high) costs of engaging a savings carrier mean that SAYE options are in practice of attraction to only the larger employers. Familiarity with SAYE savings contracts, and the perceived ease of administration (it being outsourced to the savings carrier) also mean that large eligible employers appear to favour SAYE options. All things being equal, smaller and private companies tend to favour a SIP, or would do so but for the complexities mentioned below and the fact that companies under the control of private-equity are ineligible – see below.

7. **The number of companies using SAYE and SIP has not increased in recent years. In your view, what barriers exist that may impact a company's decision to offer an employee share scheme? These could be barriers related to specific schemes or wider concerns.**

The principal reasons are (i) the fact that companies under the control of private-equity funds are ineligible to adopt such a tax-advantaged scheme and (ii) the perceived complexity, and therefore also the cost of establishment and administration.

The harsh accounting treatment (IFRS2 reporting) has put off some companies from adopting SAYE option schemes.

8. **The number of employees using SAYE or SIP has declined in recent years, what do you think has caused that decline? Do you have evidence to support this?**

See 7 above. The substantial rise in the proportion of British companies now controlled by private-equity (or venture capital funds, private offices, etc.) inevitably restricts access to such schemes.

In terms of hard evidence and by way of example, Xtrac Limited, a world-leader in motor sports engineering, attributes much of its success to the fact that, when it was independently owned, all employees benefitted from participation in all forms of tax-advantaged schemes (SIPs, SAYE, CSOPs and EMI). Although such employees have continued to benefit from a SIP since the company came under the control of private equity in 2017 (as securities acquired by participants in exchange for plan shares have remained held by the plan trustee sheltered from CGT), that company has since been unable to make awards under a SIP or grant SAYE options. This has been a cause of dissatisfaction on the part of employees as the workforce now comprises "those who benefitted" and "those who could not".

9. **What proportion of employees participate in the share scheme(s) your company offers?**

Not applicable, but in the example cited above, all qualifying employees participated in the schemes when they were available.

10. **In your view, what are the reasons your employees give for choosing to participate in the scheme? If you are responding as a representative body, please specify what you think are the main reasons employees choose to participate in a share scheme.**

The opportunity to benefit financially from the growth in value of the business to which employees contribute by their labours. Once it becomes apparent to those who choose not to participate when a scheme is first established that those who did participate benefit financially, there is typically a "snowballing effect" in that others then choose to participate in later awards/option grants.

An SAYE contract, or SIP accumulation of partnership share money, is a way of saving. It offers a sense of having a stake in the company - people have to have money to put into these schemes but, nevertheless, they are a good way for perhaps more junior employees, to participate and have the benefit of share participation that they wouldn't otherwise have and there have been many surveys that have shown that for some employees, the only savings they make will be under an SAYE or SIP and, equally, that starting to save under an SAYE or SIP takes an individual who hasn't previously had any habit of saving into the idea of saving and creates that ethos of saving and just generally has a more beneficial effect and impact on that individual and their family.

The ongoing tax shelter for so long as a participant in a SIP remains an employee is attractive.

Lack of money is typically cited as the reason why employees choose not to take up SAYE option offers. Consideration should be given to allowing participation in future growth in value by those too impecunious to be able to "pay to play".

SIP awards of Free Shares, even if subject to forfeiture if an employee leaves (or is a "bad" leaver) and subject also, in the case of an unquoted company, to provisions in the company's articles whereby the shares can be recovered from "good" leavers, are seen by employees of independent unquoted companies as an attractive risk-free, and cost-free (at least to the employees), means of participating and benefitting as shareholders. Awards of Free (and invitations to acquire Partnership) shares in a start-up company with modest value at the early stage of a new venture are seen by early-stage employees as potentially highly valuable – and highly tax-advantageous - if the company grows in value.

11**. What changes, if any, would increase participation amongst employees or change the way your company uses or offers the schemes?**

Simplification: removing the 3-year/5-year differential in tax treatment of the withdrawal (etc) of SIP award shares. This would align the period for which the shares must be held in the SIP, to secure tax relief on withdrawal/sale, with the minimum holding period for free and matching shares.

Increasing the accumulation period for SIP awards of partnership shares from one to three years.

Increasing the annual limits on participation in a SIP and the limit on monthly SAYE savings.

Allowing savings contributions to an SAYE share option-linked savings contract (if made by deduction from earnings) to be made out of pre-tax earnings (as are savings accumulated to acquire partnership shares under a SIP).

Treating a participant who resigns voluntarily at any time as a "good leaver" so as to allow access to savings on a tax-free basis.

Enabling a company to cap the initial value of shares awarded to long-serving employees under a SIP so that invitations may be made to new joiners without thereby increasing participation by existing employees who have already been awarded shares up to a specified limit.

12. **In your view, is awareness of the benefits of SAYE and SIP low? How could the government and other groups raise awareness?**

Reduce complexity:

The perceived complexity of SIPs in particular means there is a reluctance on the part of (smaller or less experienced) advisers of small and private companies to educate themselves and their clients of the benefits. Those who do have found the promotion of SIPs in particular to generate good business for themselves as well as advantages for their clients. The fact that a SIP can be operated by offering awards of shares on the basis that if a participant leaves for any reason, he or she must forfeit free shares and offer back for sale to the SIP, the company, other employees or an employees' trust or other shareholder on a "no gain" basis means that significant benefits, in the form of tax free profit upon a sale of the company, can be offered at no effective cost to existing proprietors. This is a scenario which should be more effectively communicated to advisers.

Publish model company documentation:

The precedent documentation published by HMRC covers only half the picture: a private company establishing a SIP or SAYE scheme needs to give thought to amending its articles of association (and possibly also any shareholders' agreement) to take account of the acquisition of shares by employees. It would be helpful if HMRC, or the Dept. for Business & Trade, would publish model documentation which could be used as a starting point for smaller companies thereby reducing the costs and avoiding such companies falling into "traps" because of having adopted a scheme without due consideration of how employees who acquire shares can in due course realise the value of those shares.

13. **In your view, how easy or difficult is it to operate or administer SAYE and SIP? Please explain your answer and specify any ways in which the schemes could be simplified.**

SAYE options

The cost of engaging a savings carrier, and the limited choice of providers, makes administration relatively expensive and therefore of little or no attraction to smaller companies. Larger, listed, companies find SAYE schemes easier to administer, perhaps because much of the burden is outsourced to the independent savings carrier/administrator.

There needs to be greater leaver flexibility within an SAYE share option scheme. Companies should have the flexibility to designate an employee who resigns as a 'good leaver'. At the moment it is absolutely clear that an employee who resigns is classed as a bad leaver. Extending the category of "good leavers" allows such participants to benefit to the extent that they have accumulated savings. This would encourage a greater rate of take-up.

SIPs

As above, larger companies will outsource administration to an administrator. Despite the need for a trust, the apparent complexity of the SIP Code and of the published precedents of rules, the experience of smaller companies which have established a SIP suggests that they can be easily administered "in-house" and at relatively low cost. Private companies will generally make awards only on an annual or occasional basis, or possibly a "one-off" basis, rather than on a continuous basis (with regular monthly share acquisitions). The need for time and attention typically arises in relation to annual HMRC reporting, leavers and to administering the buy-back of shares, rather than to the up-front award of shares.

The administrative burden could be reduced by removing the requirement that the maximum annual value of partnership shares must be restricted to 10% of salary if less than £1,800. It is difficult to see what practical safeguard is afforded by this requirement which is difficult to monitor on a continuing basis.

14. **Do you feel SAYE and SIP offer enough flexibility to adapt to individual companies' circumstances? If not, please state why.**

As mentioned above, the fact that companies under the control of another body corporate are ineligible typically counts out those companies now owned by private-equity.

See also the points made at 11 above.

Neither scheme allows for participation by "gig economy" workers, which excludes a substantial proportion of those who contribute to growth by the provision of personal services. Extending participation to such workers would necessarily require also changes to company laws to extend the definition of an "employees' share scheme" to include individuals who provide personal services otherwise than as an employee.

It would make it easier for companies to ensure compliance with company law requirements, and reflect widespread practice of non-executive directors excluding themselves from participation, if eligibility to be granted SAYE options excluded directors who are not employees. This would ensure consistency with eligibility to participate in SIPs.

Is there any policy reason not to remove the requirement in para 22, Sch 3 ITEPA that shares under SAYE options must be either employee-control shares or "open market" shares – in the same way that the equivalent restriction on CSOP options has now been removed?

15. **Does your company make use of the current flexibility within the scheme rules? Do they vary the terms on which the employees participate? If so, in what ways?**

Member companies typically do take advantage of such flexibilities by, for example, restricting SIP awards to below the statutory limits. However, we are not aware of any company which has chosen to make performance-related awards of free shares as the rules governing such awards are perceived as too complex.

Typically, companies offering matching shares do so on a basis which is more restrictive than the statutory limit of 2 for 1.

Private companies variously offer free, and/or partnership shares (with or without matching shares) on either a single occasion, or on an ad hoc basis, rather than, as larger companies do, offering on a continuous (rolling) or an annual basis.

SAYE options tend to be offered to qualifying employees each year on a more consistent basis, although limits are from time to time imposed upon the maximum amount of monthly savings (so as to restrict the aggregate number of shares which may be acquired).

Many companies choose not to set the option exercise price at the full 20% discount permitted.

16. **Does participation in SAYE or SIP amongst employees vary according to remuneration? If so, in what ways?**

Yes, in the sense that higher paid employees will tend to recognise the potential financial benefits of participation and be more able to afford to participate.

Currently, employees with less money have to wait longer (5 years under a SIP) for the tax advantage than executives with EMI or CSOP options. Reducing the time employees have to hold shares in a SIP in order to qualify for tax breaks from five to three years, would boost take up. Three years is the norm in other schemes.

SIP awards of free shares are commonly made on a basis which differentiates according to length of service/hours worked/level of basic salary as this is perceived as "fair". A cap on levels of participation in partnership shares may also be imposed if otherwise the benefits would be too much in favour of senior staff.

17. **In your view, does employee motivation or the reasons for participating in a share scheme vary according to different levels of remuneration? If so, in what ways?**

Participation is principally a factor of communication. Effective communication leads to higher take-up.

18. **If you are a company or a scheme user, does your company currently make use of the flexibility of the rules and vary the terms on which your employees participate according to remuneration?**

Our understanding of the practices of member companies and issuers is that they do.

19. **In your view, are SAYE and SIP appropriately targeted towards lower- and middle-income earners?**

Yes, but…many lower paid or less affluent employees are unable to afford to participate in the acquisition of partnership shares or by way of putting aside monthly savings out of earnings.

Lower-paid employees (i.e. those earning a basic salary of less than a specified amount) could be supported by amending the SIP rules to allow companies to make to such employees (only) an annual or single "stand-alone" award of free shares, up to a statutory limit of, say, £3,600, which may be withdrawn from the SIP after only one year and will not be forfeited (and may remain in the SIP and sheltered from CGT and with no income tax) if the employee leaves for any reason after a qualifying (post-award) period of, say, 3 months.

20. **In your view, what barriers exist that might prevent lower income earners from participating in an employee share scheme?**

See the response to 19 above.

It is difficult to see a policy reason why companies are prevented from offering payment of a (taxed) cash bonus as an alternative to participation in an award of free shares under a SIP.

SAYE share option schemes enable an independent company to offer to all its qualifying employees the opportunity to acquire shares on favourable terms by the exercise of options. Option gains are free of income tax ***but are not free of capital gains tax***. Nevertheless, as the average gains realised by employee participants has typically been below the annual CGT exempt amount (£11,800 in the period of 5 years to 2021 according to published HMRC statistics), the fact that such gains are within the charge to CGT has been of little consequence.

The substantial reduction in the annual CGT amount, to £6,000 for the current tax year and to £3,000 for the next tax year (2024/25), will mean that a great many SAYE share option scheme participants will become liable to pay CGT on gains on the sale of SAYE option shares.

Further, many such employees, particularly those who are lower-paid and unfamiliar with the responsibilities of accounting for tax on non-PAYE earnings and gains, will now be required to submit a self-assessment tax return, or otherwise report gains via HMRC's 'real time' service, by reason only of having exercised an SAYE share option and sold the shares acquired.

We envisage that many such employees will be at risk of penalties for failure to report or submit a return because they will not appreciate the need to do so by reason only of the sale of shares acquired on exercise of an SAYE share option. The cost of obtaining professional advice on reporting or completing a tax return will also impose a disproportionate financial burden on such employees.

Inclusion in the next Finance Bill of a provision which exempts from CGT any amount of gain (or an amount of gain up to, say, £12,000 per year) realised upon the disposal of shares acquired pursuant to a SAYE share option, would go a long way to restoring the former attractiveness of SAYE share options, for lower-paid employees in particular, and avoid what could become a significant compliance issue as a consequence of the need for employees to report chargeable gains on SAYE option share disposals.

A further potential barrier to take-up is the recent reduction in the tax-free allowance for dividend income, which will drop from £2,000 last year to £500 in 2024-25, meaning many relatively low earners paid dividends through a SIP could be required to fill out a self-assessment tax return for the first time or contact HMRC to have their PAYE tax code adjusted.

This will be a trap for many and we anticipate a large number of penalties being unwittingly incurred for failure to do so. This administrative burden (for HMRC as much as for individuals) could be relieved by:

- exempting from CGT gains of up to, say, £12,000 realised by the sale of shares acquired pursuant to the exercise of SAYE share options; and

- providing that cash dividends on SIP shares are exempt from income tax (so as to put the taxation of SIP share dividends on the same basis as shares held in an ISA).

21. **What other performance incentives does your company offer? How do these compare to SAYE and SIP?**

Not applicable – although most, if not all, companies known to us to operate SAYE and/or SIPs will, if eligible to do so, also grant (preferably) EMI, or CSOP, share options to selected key employees.

22. **In your view, how are SAYE and SIP valued by employees compared to other forms of remuneration or incentive?**

If appropriately communicated to eligible employees, and if the company is financially successful, they are highly valued – at least, once the initial cohort of participants have realised significant gains in consequence of exercising options and selling shares, or possibly in consequence of a corporate transaction allowing an opportunity for early exercise or for cashing in their SIP shares.

A substantial benefit of a SIP in a private company lies in the fact that there exists a substantial margin for a ***fall*** in the market value of the company as a whole without participating employees losing out having acquired partnership shares. The fact that partnership shares are acquired out of pre-tax salary, coupled with HMRC's practice of accepting that the market value of a small holding in a private company may be set at up to 75-80% less than the pro rata value of the shares, means that, in effect, partnership shares may be acquired at a very substantial discount. If the company is later sold, and participants receive a consideration for their SIP shares equal to the pro rata value, the uplift is entirely free of tax. Properly understood and communicated, this is a highly attractive feature of SIP awards for private companies.

23. **Would your company have granted options or awards to employees outside of SAYE or SIP in the absence of those schemes?**

Not applicable – but…as the taxation of unapproved share option gains is so unattractive when compared with that of tax-advantaged share options and with the tax treatment afforded to other individual investors, it is reasonable to infer that the tax advantages of SIPs (in particular) and SAYE share options are a principal reason why companies, particularly private companies, choose to establish them.

The award of shares and grant of options under a SIP or SAYE scheme allows companies to agree share values with HMRC, and a SIP enables the operation of an internal market with the certainty as to tax values which this gives.

24. **Is there any other information you would like to share with us in relation to these schemes?**

We would summarise the principal points as follows:

(a) Private-equity owned companies should be eligible to establish a SIP. There are many companies which have had a SIP but can no longer operate a SIP having come under the control of private equity – see the example above.

(b) There should be a single (3-year) period governing relief from IT, rather than the 3/5 year periods, which serve only to obfuscate and confuse all parties.

(c) There is a need for a better suite of pro forma documentation, including extracts from articles of a private company, to assist smaller companies to establish a SIP (compare the model documentation for companies with employee shareholders issued by Dept. for Business in 2013).

(d) Companies should be able to offer a cash alternative to participation in SIP free share awards. What is the policy objection to this?

(e) Eligibility should be extended to gig economy workers i.e. all those who provide personal services to the company/group, with liaison with other Departments to ensure that regulatory hurdles are overcome.

Other points (including those made in the course of the stakeholder meeting with officials on 12th July 2023):

Re SIPs:

- Few, if any companies take advantage of the ability to make performance-related free share awards – could that be simplified/removed?
- The reduction in the number of companies operating a SIP can be partly explained by the trend for Private Equity to take control of UK PLC.
- Any complexity in a SIP is more perceived than real as standard form documentation can be used and, in principle, a SIP for up to, say, 50 employees can be administered on a spreadsheet.
- Small companies use individuals as trustees (despite the risks of unlimited personal liability).
- The ongoing tax shelter afforded by a SIP for a participant's plan shares for so long as the participant remains an employee is attractive.

- For those companies which have woken up to the benefits of a SIP, it has proved its worth – perhaps because of the margin for failure of share price growth in the case of unlisted companies for which a 75%+ discount on MV, coupled with the funds being out of pre-tax earnings, make it very attractive, particularly if the company is sold as a whole.

- The fact that private company articles of association can provide for forfeiture of free shares if an employee leaves at any time for any reason, and for partnership shares to be offered back for sale on a no-gain basis if the participant leaves, means there is "no skin off the nose of the proprietors" in offering free and/or partnership shares under a SIP where the intention is for the shares to be held until the company is sold.

- Allow good leavers to leave their SIP award shares in the custody of the plan trustee for a period of up to, say, 3 years during which time they remain sheltered from CGT. This allows for an orderly and planned disposal over time in circumstances in which, for reasons outside the control of the participant, the value of the shares may have temporarily fallen. This would enhance the attraction of SIPs as a vehicle for employee investment and participation.

Re SAYE options:

- These are of interest to larger listed company employers only.
- The costs of a savings provider make them unattractive to other employers.
- There is a limited number of savings providers now that Yorkshire Building Society has withdrawn (apparently there are none in the Republic of Ireland, hence there being no new Irish SAYE schemes under their legislation).
- To address the tendency towards shorter-term employments, allow voluntary resignation to be treated as if the participant is a "good leaver" enabling access to a tax-free sum.
- Alternatively, enable a 1-year savings contract linked to a one-year share option – on the basis that 3 or 5 years is too long given the tendency towards shorter-term employments.
- Demergers: para 28(3), Sch 3 should be amended to allow appropriate adjustments to options to be made unilaterally in the event of a demerger (and see further below).
- Internal reorganisations by the interposition of a new holding company: allow an automatic exchange of equivalent share options without the need for agreement to be obtained from optionholders (as presently required by para 38, Sch 3).

Re SAYE and SIPs

- Takeovers: there is a need to revisit the rules allowing exemption from income tax on a takeover if participants are only entitled to receive cash and no other form of consideration for their SIP shares. Difficulties arise if, for example, the consideration is on a deferred or "earn-out" basis, or if the terms of the transaction are such that, regardless of the concerns for the tax treatment of the target company SIP and SAYE participants, the acquiring company allows participants (along with all other shareholders) to elect to take cash or shares/loan notes or other securities. Participants can be penalised through no fault or choice of themselves or their employer or plan company. This is unfair.

- Demergers: the rules governing when demerged companies cease to be "associated" should be simplified so that for the purposes (only) of a SIP or SAYE scheme, listed and AIM companies are treated as ceasing to be associated upon completion of a demerger and not at such later time as when they cease to be under common control (a point in time which it is difficult, if not impossible, for listed/AIM companies to monitor and identify).

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The Esop Centre 24th August 2023