

## Ask an expert

### Deferred payment arrangements for employee shares

**Q** Our client is a company which would like to allow employees to acquire shares to help them build up a stake in the company but does not want them to have to pay the full purchase price immediately. It has asked if it can give the shares to employees but defer payment. What are the tax issues?



**Karen Cooper**  
Partner, Osborne Clark  
Email: karen.cooper@osborneclarke.com  
Tel: 0117 917 3628

**A** Shares can be issued on a partly paid or nil paid basis or existing shares can be purchased on deferred payment terms. In both cases, the intention is that the full market value of the shares will be paid but not until such time as a specified event occurs (for example, an exit) or other performance conditions are satisfied. Typically, the shares offered to employees under these arrangements will be a separate class of shares with limited dividend and voting rights together with provisions for forfeiture on termination of employment.

The tax treatment will be governed by ITEPA 2003 Part 7 Chapter 3C on the basis that the shares are securities acquired for less than market value. This means:

- No tax on the value of the shares at acquisition as the liability to pay the acquisition price (market value) is simply deferred.
- There may be an annual tax charge on the outstanding acquisition price. Employees would be taxed as if they had received an interest free loan from the company equal to this amount (ITEPA 2003 s 446S). The annual tax charge is on the difference between any interest rate paid (which can be nil) and the 'official' interest rate (currently 4%). NIC would also be payable on this amount.
- However, the loan will be exempt from tax and NIC if the outstanding acquisition price is no more than £5,000 (assuming the employees have no other employee loans (ITEPA 2003 s 446S and s 180).
- Depending on the circumstances, employees may be able to claim tax relief on these amounts (ITA 2007 ss 392–395). The availability of relief will depend on whether the company is 'close' for tax purposes and it will be necessary to show that the individual works in the 'actual management or conduct' of the company – ie, involvement in the central management of the company, rather than just having responsibility for a particular area.
- If the loan is fully written off (for example, if there is no exit) or the shares are sold or forfeited before an exit event and before the loan is repaid, employees are charged to tax at

that point on the outstanding acquisition price (ITEPA 2003 s 446U).

- When the shares are sold following the payment of any outstanding purchased price, the growth in value is taxed as capital (provided the appropriate tax elections have been entered into). No income tax or NIC will be due.

However, following the introduction of the disguised remuneration legislation in ITEPA 2003 Part 7A with effect from 6 April 2011, care needs to be taken when structuring arrangements that offer employees the opportunity to purchase existing shares on deferred payment terms.

It was common for deferred shares to be provided from an employee benefit trust (EBT), particularly where shares had been warehoused. An EBT may also offer protection to employees if the company became insolvent.

The disguised remuneration legislation applies where a 'relevant third party', such as an EBT, takes a 'relevant step' which can include the payment of a sum, the making of a loan, or the transfer of an asset. Its effect is to impose an immediate income tax and NIC charge on the value of that relevant step, even if the employee is not yet entitled to the full benefit of the asset.

There are a number of statutory exemptions to the Part 7A charges in the context of employees' share schemes. One such exemption in ITEPA 2003 s 554N7 applies where consideration is given to an EBT for the relevant step. However, although employees who acquire deferred shares from an EBT will ultimately pay consideration in the form of the full market value of those shares, the exemption only applies where the consideration is given 'at or about' the time the shares are transferred to the employees. HMRC has specifically stated that arrangements where an employee is allowed to pay for shares in instalments or otherwise defer payment will give rise to a Part 7A charge (see HMRC's *Finance (No. 3) Bill 2011: Disguised remuneration legislation – frequently asked questions* available via [www.lexisurl.com/PzvFV](http://www.lexisurl.com/PzvFV)).

A benefit provided directly to an employee by an employer or group company should not be within the scope of the rules, as long as there is no underlying tax avoidance.

Therefore, after 6 April 2011, employees should either receive a loan from a group company (not an EBT) to enable them to pay the full market value of shares upfront from a third party, or shares should be issued directly by a group company on a partly or nil paid basis. ■

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