Employment-related Securities

HM Revenue and Customs Research Report 372

BMRB

TNS

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Contents

Glossary

Articles of Association	The Articles of Association is a document that contains the purpose of the company as well as the duties and responsibilities of its members defined and recorded clearly. They set the rules that company officers must follow when running their companies.
Capital Gains Tax (CGT)	Capital Gains Tax is a tax on the profit, over the annual tax-free allowance, when an asset that has increased in value is sold, or disposed of. The rates are currently 18% and 28%, depending on the size of the gains and whether the taxpayer is a basic rate or higher or additional rate taxpayer.
Corporation Tax (CT)	Corporation tax is a corporate tax levied in the United Kingdom on the profits made by companies and on the profits of permanent establishments of non-UK resident companies and associations that trade in the European Union.
Employee Benefit Consultant (EBC)	Employment benefit consultants design schemes that can help a business to attract, retain and motivate the best staff.
Employee Benefit Trust (EBT)	EBTs are a form of trust used to facilitate employee share ownership. They can perform various functions, including acting as in internal market through which employees can buy and sell shares in their employer; and acting as a “warehouse” which holds legal title to shares on behalf of employees until the shares are fully vested.
Employee Shareholder Status (ESS)	Employee shareholder is an employment status. An employee shareholder is someone who works under an employee shareholder employment contract. The employing company must give, or the employee shareholder must receive, shares in the employer’s company or employer’s parent company. These shares must have a minimum value of £2,000 on receipt. There is no set upper value.
Enterprise Management Incentives (EMI)	The Enterprise Management Incentive (EMI) is a tax-advantaged share option scheme designed for smaller companies. A company may grant options to selected employees to allow them to acquire its shares over a prescribed period and provided that certain qualifying conditions are met.
Entrepreneur’s Relief (ER)	Entrepreneurs’ Relief was created to incentivise people to set up and grow businesses by providing a reduced level of Capital Gains Tax on business disposals. It is available to individuals. It would typically apply to a business person – either a sole trader, member of a business partnership, or a limited company shareholder in a trading business.
Flowering shares	Include a requirement that the company reaches an agreed level of future growth (known as the “hurdle”). Shares are issued at day one value. Once the hurdle has been met, the shares will have an agreed value. This amount can either be variable (based on a suitable percentage) or a fixed and hardwired amount.

Growth shares	Growth shares are a special class of share that offer potential rewards to employees through capital growth. They are tax-efficient structures giving employees the ability to invest in the employing company in a cost-efficient manner with access to capital gains tax treatment.
Income tax	A tax on income; most people in the UK get a Personal Allowance of tax-free income. This is the amount of income a person can have before they pay tax. The amount of tax they pay can also be reduced by tax reliefs if they qualify for them. Income tax rates are 20% for basic rate taxpayers, 40% for higher rate and 45% for additional rate taxpayers.
Initial Public Offering (IPO)	An initial public offering, or IPO, is the first sale of stock by a company to the public. A company can raise money by issuing either debt or equity. If the company has never issued equity to the public, it's known as an IPO.
Joint Share Ownership Plans (JSOPs)	Arrangements under which employees own shares jointly with a trust. The interest in the shares held by the trust entitles it to the whole of the current value of the shares, while the interest held by the employee entitles them to all or most of any growth in the value of the shares.
National Insurance Contributions (NICs)	National insurance is a scheme where people in work make payments towards benefits. Certain benefits are only payable if a person meets the national insurance contribution conditions.
Ratchets	Arrangements under which employees receive shares on the basis that if the company meets certain targets, other investors will cancel some of their shares. The effect is that if the targets are met, an employee's shares will increase in value as they will account for a higher proportion of total shareholding.
Tax-advantaged Share Schemes (TASS)	Employee share schemes allow employees of quoted and private companies to share in the success of that company. The most widely used scheme is Save as You Earn (SAYE) – also known as Sharesave or Savings Related Share Option Schemes. It provides generous tax breaks to encourage employees to take a direct stake in their company. There are other types of share schemes: Share Incentive Plans (SIPs), through which employees buy shares from their gross salary and give a 40 per cent discount for higher-rate taxpayers. The other TASS are Company Share Option Plans (CSOP) and Enterprise Management Incentives (EMI). Non-tax advantaged share plans also exist in various forms and are widely used.

Key Findings

Employment-related securities are any type of share or security given to an employee as part of their pay and benefits package. The focus of this research is on ‘growth shares’ that can exceed the growth available to an external investor.

The qualitative research comprised hour-long in-depth telephone interviews with advisers (accountants and lawyers), employee benefit consultants and employers. The sample of twenty-four respondents is not representative of the overall population of the parties involved with growth shares – rather the research provides an overview of the range of views and experiences held by a diverse range of individuals.

Firms interested in growth share schemes can often be those with ambitious growth plans and clear exit strategies in the short to medium term (3-10 years) as well as private equity firms and management buy-outs. While not sector-specific, advisers taking part in the research felt that growth share were of most value and appropriate to the hi-tech, communications and media sectors.

The research with advisers and employers suggests that the appeal of growth shares for employees lies in the opportunity to see their income increase in relation to the effort, skill and time they put into the business, plus favourable tax treatment. The drawback is that tax and National Insurance Contributions (NICs) are paid up front.

The benefits for employers, identified in this research, are: they help company owners to recruit, retain and incentivise employees and encourage attitudes and behaviours that will bring about high levels of growth; until and unless such growth is achieved equity in the business remains intact; and there can be a tax advantage for employers in some cases as there are no NIC costs to the employer. The key drawback, given by respondents, is there is usually no deduction for Corporation Tax purposes.

Advisers said that growth shares are complex and can be fairly costly to implement because they are always bespoke, require changes to the Articles of Association and the shares need complex valuation at issue. They tend to require a great deal of explanation to employers and employees alike. These complexities, it is suggested, are why in practice only a small proportion of enquiries about growth shares result in implementation.

Advisers were most familiar with ratchet growth shares whereby the value of an employees’ shareholding increases as certain growth targets are met. By delivering the benefits over the course of the agreed period of growth, ratchets still provide a financial benefit even if the ultimate goal is not reached.

The preferred alternative to growth shares by advisers are Enterprise Management Incentives (EMI). This is because: they grant an option which an employee can choose to take, or not and so costs nothing up front either to the employer or the employee. EMIs are inexpensive to implement; more tax efficient because the employee does not have to pay tax up front and the employer is allowed to deduct from their Corporation Tax liability; and, for employees that leave the company, the EMI option can simply lapse, whereas with growth shares these have to be clawed back. However, EMI is not suitable for all companies.

Summary

Background and Methodology

Employment-related securities are any type of share or security given to an employee as part of their pay and benefits package. By using shares, employers can link key employees' or managers' rewards to individual or company performance; align their employee's interests with those of external investors; and in some cases require employees or managers to demonstrate commitment by investing their own funds.

The focus of this research is on employment-related securities that can exceed the growth available to an external investor. Such growth can be taxed as capital rather than income in certain circumstances, has tax advantages to the recipient of these arrangements, and can also have a tax advantage for the employer. These arrangements are sometimes known as 'growth shares' or 'growth securities' and are generally implemented with the assistance of tax or remuneration specialists.

Growth shares are a relatively un-researched area of employee remuneration. In order to enhance HMRC's understanding of how growth shares are used in the business community, exploratory research was commissioned to provide insight into the types of employment-related securities arrangements that are favoured and used by businesses.

The research was qualitative in nature and comprised hour-long in-depth telephone interviews conducted in February and March 2015 with twenty advisers (accountants and lawyers), two Employee Benefit Consultants and two employers. The research is not representative of the whole population; it provides an overview of the range of views held by the sample interviewed.

The Employer – Agent Relationship

Advisers/agents in this sample tend not to directly market growth shares to clients. Typically, clients come to them either via generalist advisers, or through recommendation and sometimes because of the adviser's reputation for specialist knowledge and experience in the sector.

Advisers said that when discussing growth shares, the primary focus was on employee remuneration and incentivisation; tax efficiencies were an important, but secondary consideration.

The bespoke and complex nature of growth shares means that employers and advisers develop a close relationship and one in which the employer looks to the adviser for advice as well as considerable hand-holding in navigating and understanding the complicated aspects of growth shares. On their part, the adviser requires an in-depth and detailed understanding of the client's business, their business goals and objectives, future plans for the sale of the business and the reasons for wanting to incentivise employees in this way.

This is because advisers strongly felt that growth shares should be implemented primarily for sound commercial reasons and not just because it's the current trend.

Growth Shares

Advisers and employers felt that the main motivation for using growth shares was to assist in growing the business from its present value to a higher value at a certain point in time. However, growth shares are a small part of the employee share schemes sector and used in a limited number of circumstances. In this research, advisers indicated that while not sector-specific, growth shares were of most value and appropriate to the hi-tech, communications and media sectors and those private companies looking for an exit plan in the short to medium-term, especially those backed by private equity investors. Overall, advisers thought that growth shares were best suited for short to medium-term growth strategies and not for the longer-term.

Implementation of growth shares may frequently involve the creation of a new class of shares which involves changes to the Articles of Association and the involvement of multi-disciplinary teams. They are viewed (mostly by advisers) as complicated to understand and explain both to employers and their employees and they are considered costly to implement.

The strength of appeal of growth shares for companies seeking significant (and rapid) growth is that they can be used to attract the 'right' type of risk-friendly key senior management staff whose skills and talents will drive the necessary growth. By offering equity in their business, employers demonstrate their confidence in the business and their seriousness and commitment to their employees.

On their part, employees demonstrate their own commitment and loyalty to the business by putting 'their skin in the game' by choosing to pay the necessary tax up-front. This works because in order to enjoy the favourable tax treatment of growth shares, employees must agree to be taxed on, or to pay, an amount equal to the full market value of their growth shares, determined as if there were no continuing employment conditions attached to them. Those conditions will generally mean that if the employee leaves their job, they lose the shares. Agreeing to be taxed as if the conditions were not attached to the shares runs the risk of paying tax on shares that they might ultimately lose.

Advisers thought that the main motivation for employees in using growth shares is to maximise their earning potential over a period of time, with the preferential tax advantages providing an additional financial bonus.

Both parties accept the inherent risks of growth shares and accommodate the potential drawbacks alongside the anticipated benefits (although acceptance does not always mean complete understanding of all the implications).

For employers, the main benefit of growth shares is that they lose none of their equity in the business until and unless the set hurdles have been reached; in addition the growth in value does not attract employer NICs. The main drawback for employers is that a company cannot normally claim a corporation tax deduction when employees make a gain.

The main financial benefit for employees is two-fold: the anticipated future reward; and the tax saving. On top of the financial benefits there is also the potential emotional benefit of the employee knowing they are a key member of staff by being given equity in the business. The main drawbacks are that the anticipated growth may not be realised and the tax they paid upfront may exacerbate any potential loss if growth does not occur as expected.

Advisers felt that although tax treatment is important it does not drive the growth shares agenda for employers – commercial needs are the most important.

The most significant alternative to growth shares – and one that advisers favour – is Enterprise Management Incentives (EMI). This is because EMI is seen as uncomplicated, tax efficient and many companies qualify for it. However, there are businesses that do not qualify, such as larger SMEs and firms in the private equity sector and for them growth shares are the alternative.

The Future

This research found that growth shares have a definite and important role to play in encouraging the growth of businesses. In the view of some advisers they help to power the wider economy – especially amongst high growth SMEs, with turnovers over £10m – as they are seen as the backbone of the UK economy, creating employment and wealth.

With an increasingly buoyant economy, most of the advisers involved in the research expected employers and employees to show increased interest in using growth shares.

1. Introduction

1.1. Background

Remuneration is an important factor in determining an individual's standard of living; salaries, benefits and other perks will govern decisions about how much individuals can save, spend or invest. Remuneration is also important to employers as it is one of the most significant costs to the business and is a major consideration in operating effectively. Different ways of rewarding employees can be used to incentivise workers and maximise their productivity (ranging from the provision of private health care and workplace pensions to share option, bonus and share equity schemes) and in turn can have considerable impacts on the flexible labour market, especially where employers compete on effective remuneration packages to attract the best employees.

Remuneration through shares and other forms of employment-related securities is a central part of many employee reward and incentive packages and has been shown to have an impact on a wide range of economic indicators, including: productivity; corporate performance; corporate growth; share price performance and organisational stability[1]. Employment-related securities are any type of share or security given to an employee as part of their pay and benefits package. By using shares, employers can link key employees' or managers' rewards to individual or company performance; align their employee's interests with those of external investors; and in some cases require employees or managers to demonstrate commitment by investing their own funds.

This research focuses on employment-related security arrangements which offer potential rewards through capital growth of shares or other securities that can exceed the growth which would be available to an external investor who is not an employee. Such growth can be taxed as capital rather than income in certain circumstances and so has tax advantages to the recipient of these arrangements. They can also have tax benefits for the employer. These arrangements are sometimes known as 'growth shares' or 'growth securities' and are generally implemented with the assistance of tax or remuneration specialists.

Growth shares are a relatively un-researched area of employee remuneration. In order to enhance HMRC's understanding of how growth shares are used in the business community exploratory research was commissioned to provide insight into the types of employment-related securities arrangements that are favoured and used by businesses as part of their remuneration package and growth agenda.

[1] http://www.davidcraddock.com/The-Economic-Basis-for-Employee-Share-Schemes.html

1.2. Aims of the research

The aims of the research were to explore:

- how employment-related securities are used as part of a remuneration package, and how these arrangements may vary across size of business, industry and level of seniority of staff;
- the decision-making process for using employment-related securities to encourage growth and the type of remuneration package used;
- the types of employment-related securities that employers use, and whether these are bespoke or ‘off-the-shelf’ packages;
- the role of tax treatments in the use of employment-related securities;
- alternatives that had been considered, or may be considered if ‘growth shares’ were no longer viable or available;
- the potential impact on business growth if ’growth shares’ were no longer an option.

1.3. Research methods

The research was qualitative in approach, using a series of telephone depth interviews with lawyers, accountants, employee benefit consultants and employers to explore the role of growth shares in employee remuneration packages. As the experiences of the participants in the research were widely varying this approach provided the necessary flexibility to explore in detail their views and experiences of setting up and using growth shares. The sample of participants comprised:

- twenty advisers (nine specialist lawyers, six specialist accountants, three non-specialist lawyers and two non-specialist accountants. The definition of specialist was based on how the participant defined their professional role at the recruitment stage). A profile of participants may be found in Appendix A;

- two employment benefit consultants that had implemented growth share schemes for clients;

- two employers that were using growth shares as part of the remuneration package.

As there are no commercially available lists of accountants and lawyers that specialise in growth shares, or of employers that have used them we adopted a free-find approach to recruitment, using a recruitment screen to help structure the sample (Appendix B). This proved to be a difficult task and so in addition to free-finding we also adopted a networking approach with recruited participants where they were willing to assist in the process. Not everyone that had relevant experience was able to participate. In most of the instances this was due to a lack of time or impending holidays; for a minority it was an unwillingness to discuss what they saw as commercially sensitive issues.

The sample of respondents is not representative of the overall population of the parties involved with growth shares – legal and financial specialists and employers – and this research cannot provide numerical estimates of the views expressed. Rather the research provides an overview of the range of views and experiences held by a diverse range of individuals for whom growth shares have been relevant.

Telephone interviews were conducted during February and March 2015. Interviews lasting around an hour were structured using a topic guide (see Appendix B).

1.4. Report outline

Following this introductory chapter, the report comprises a further four chapters:

- **Chapter 2 –** an overview of the advisers and employers taking part in the research, how growth shares are used and an insight into the employer – adviser relationship;
- **Chapter 3** – remuneration Packages and an overview of growth shares;
- **Chapter 4** – the different types of growth shares used by employers;
- **Chapter 5** – conclusion and advisers' views about the future use of growth shares.

Throughout the report quotations are used to illustrate some of the points made and attributed according to the type of respondent.

2. An overview of the advisers and employers

This chapter provides an overview of the twenty advisers, two Employee Benefit Consultants (EBC) and two employers that took part in the research in terms of how growth shares are marketed, the industry sectors where growth shares are used and the role they play in a firm's business approach. The chapter also looks at the relationship between agents and employers.

2.1. Advisers

For advisers in this research, growth shares mainly represent a relatively small proportion of their workload which they tend to regard as niche products. Whilst, typically, for the specialist chartered accountants they may represent 10% to 40% of their work, for a long-established London-based law firm they are less than 1% of the company's work, and for two Employee Benefit Consultants (EBCs) the proportion of work dealing with growth shares ranged from 2% to 10%. Overall, accountants appeared to play a greater role in growth shares compared to lawyers.

Advisers concurred that in their experience growth shares are not industry-specific. However, dependent on the type of core clients that any one adviser may have (determined by their own commercial strategies) their experience may be skewed more towards certain sectors than others. So, for example, specialist tax agents appeared to deal with the broadest spectrum of businesses including finance, manufacturing, technology, commercial properties, retail and oil and gas. One firm of chartered accountants aligned themselves with dynamic organisations that are growing and often with specific exit strategies, such as start-ups in the pharmaceutical and bio-tech industries. As a consequence they considered that they have more growth share-related conversations with clients than others whose core client base is different, such as a small London-based law firm whose clients are mainly from the creative sector.

Overall, therefore, growth shares do not seem to be industry specific, but tend to reflect the industry portfolio of the adviser. However, they do appear to be more relevant to clients who have high-growth business plans regardless of sector.

> *"Our growth share clients tend to be small entrepreneurial companies often in technology."*
> (London-based law firm)

Furthermore, growth shares were seen by advisers as a short to medium-term strategy. Private equity-backed companies and those in management buy-out scenarios where investors are looking for ambitious growth plans to maximise a company's value after sale were typical users of growth shares.

2.1.1. Marketing Growth Shares

Overall, advisers said that they did not actively market growth shares. Typically, enquiries about growth shares tended to come from their existing clients or referrals from more generalist advisers that employers may initially turn to for information.

Referrals also occur between law firms and accountants with accountants referring to lawyers on the legal implications regarding growth share structuring and Articles of Association and from law firms to accountants, where law firms are in a position to talk about the pros and cons of different plans, but are unable to give financial advice. Some of the advisers in the research were multi-disciplinary and included accountants and tax lawyers and in these cases were able to provide a complete in-house service.

Many advisers included in the study also relied on their own industry reputation to attract clients, often building upon this reputation through lecturing, delivering conference papers, professional networking and through information made available on their website.

Across all the different advisers it appeared that conversations with existing clients about growth shares usually come from employers wishing to discuss remuneration in general, or about potential ways to incentivise key staff and retain them in the business, rather than growth shares per se.

> *"Ninety-nine per cent of clients come to us…sometimes it's small companies who at first are more likely to use their own lawyers or accountants because they tend to see paying specialist advisers as expensive but are then referred to us because we're more specialised; clients also come from our own Corporate Department often start-ups, or established companies aiming for exit strategy and who need to keep key staff."*
> (Accountant, Manchester)

Advisers said that when attracting new clients their marketing initiatives tend to focus on promoting the best ways for their clients to achieve strategic objectives while at the same time increasing tax efficiency. Growth shares are rarely the focus of their marketing material.

Consequently, the way the conversation about growth shares develops differs according to where the conversation starts. When the direction of conversation is:

- employer to adviser, it is all about remuneration and incentivisation;
- adviser to employer, the conversation is typically as part of the company's broader business needs e.g. quarterly, annual reviews, or ad hoc reviews and it tends to be in the context of business objectives and tax efficiencies.

2.1.2. Bespoke, or off-the shelf products?

Advisers unanimously describe growth shares as bespoke products, with only one of the two Employee Benefit Consultants referring to them as off-the-shelf products.

Although some advisers hypothesise that there may be some off-the-shelf elements, in reality no interviewee was able to detail any such standardised features.

Their overwhelming view was:

> *"..any attempt to standardise growth shares [by advisers] is misguided..."* (Birmingham-based law firm).

This rationale was based on the principle that all matters relating to remuneration must reflect a company's/employer's individual commercial and strategic needs and therefore growth shares **must be bespoke** and the conversation with a client will always start with the question: **'What are you trying to achieve?'**.

> *"Growth shares may have features that are standard [Nb. none were given], but many elements have to be specific, plus the actual drafting has to be meshed with a company's existing Articles; also the threshold needs to be specific to the company and it depends on what hurdles they want to put in place and what terms they want to achieve before individuals can partake in that uplift – by their very nature they are very bespoke."* (Law firm, London)

From a legal perspective there was said to be no standard way of adding growth shares to a company's Articles of Association and so again by definition, they were deemed to be bespoke products.

> *"It depends entirely on how a company wants to frame the growth shares."* (Law firm, Bristol)

2.1.3. Growth shares and the company business model

Asked whether growth shares formed part of the company's business model, advisers and employers said that this was not the case. Rather, the business model was more likely to be a high growth plan with a short to medium-term exit strategy. Growth shares were one tool to help achieve the desired growth, but were not part of the business plan per se.

> *"It depends on what a company wants the journey to be as it's about achieving commercial needs not about which shares are used...growth shares are a tool to achieve a company's wider commercial aims...broadly it would come under encouraging senior management to want to instigate growth."* (London-based equity management specialist law firm)

Drawing on their knowledge of the industry, advisers thought that the only types of businesses where growth shares were part of the stated business model were private equity firms and some start-ups where there is a very specific growth agenda and exit strategy.

"Private Equity backed companies have investors who aren't happy to see a company just ticking along, they're less patient and want performance quite quickly."
(Accountant, Specialist Tax Agent, London)

"We get most interest from start-ups where they have great plans, but don't have the money [to pay big salaries up front]."
(Chartered Accountant, Manchester)

2.2. Employers

The employers in the study thought that although the concept of employee share schemes was appealing they found the *'nuts and* bolts' of growth shares complicated and looked to their advisers to recommend an approach that best met their specific business needs:

- One employer runs a company which has put growth shares at the heart of their employee remuneration plan. This is with the overall aim to recruit and retain the 'right', like-minded, 'risk-receptive' individuals in order 'to make a lot of money quickly'. This employer also mentioned that potential employees looking to work for fast growth companies will often attend recruitment fairs and specifically ask for equity in the company.

  "We really have to spoil our staff – they have massive pensions and entertainments too. They work 80 hours a week so we need to keep them happy with goodies."
  (Employer, London)

- The second employer – a business looking to expand in the UK and Europe – had already discussed growth shares with their regular solicitor, but found them difficult to understand. They remain unsure whether they are the appropriate for the company.

  "It's not my forte, but I want to feel in control. It's still my baby and I want to fully understand the implications of any decision I might make…I sit with my lawyer and he says a lot of things that go over my head so I just go 'ok' and then I go and do a lot of research afterwards."
  (Employer, London)

  In this case, the reason for looking to growth shares was the loss of a key member of staff who felt unchallenged. The employer was concerned that remaining key staff may too be feeling unmotivated which would undermine the plans to develop the business.

From these employers' perspectives growth shares were primarily a staff recruitment and retention tool to achieve their companies' objectives of fast growth.

The view of one employer that had already implemented growth shares was that certain types of employees are aware of, and will ask for, growth shares. For example, those employees that come from software backgrounds and those with experience of start-up companies were said to be especially aware of growth shares.

> *"At recruitment fairs all the people wanted growth shares. Lots of them came from software backgrounds and seemed aware of what start-ups offer and they said they would not have joined had we not offered them; it's essential really."*
> (Employer, London)

3. Growth Shares – An overview

3.1. Overview - prevalence and popularity of growth shares

Advisers considered that growth shares, as a part of employee share schemes, continue to be popular, especially during this time of perceived economic upturn.

This because:

- employers are now more optimistic about the potential growth of their businesses, especially among private equity firms and start-ups, regardless of sector;

  "In times of growth people are more upbeat and looking for big returns, whereas in a recession they're happy to keep their heads above water [employers] *and to keep their jobs* [employees]*, so now highly paid employees do ask for [growth share] schemes though by and large they don't really understand them."*
  (London-based Lawyer)

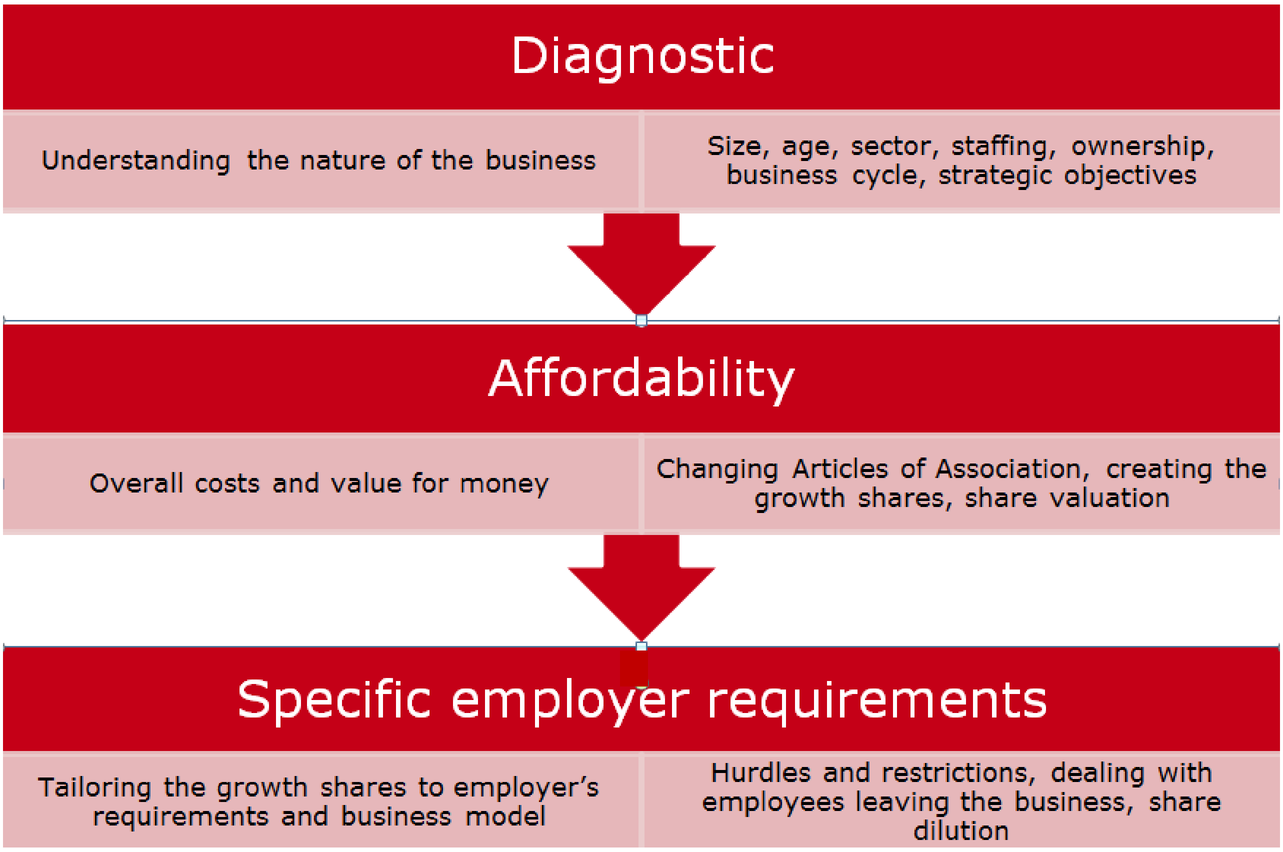
- growth shares can help to deliver the short-term growth (3-7 years) sought for companies backed by private equity investors;

  "Private equity investors aren't happy to see a business just ticking along they want to see it growing and so are less patient, they want performance quite quickly and so for companies in that situation growth shares are a good tool".
  (Specialist Tax Agent, London)

- Advisers commented that the John Lewis Partnership principle of employees having a vested interest in the business (albeit a different model) provides a spring-board for discussion about aligning the interests of shareholders with those of executives. This in turn leads to discussion about business objectives and the means to achieve these, with growth shares being one of the tools discussed.

3.2. Key influences in designing a growth share package

Advisers indicated that there are a wide range of factors that have to be taken into account when designing a growth shares package and though these will differ from sector to sector and business to business they also tend to loosely fall into three broad steps, as follows.



Step 1 - Diagnostic – an adviser typically aims to take a holistic view of a business, focusing on present and future aims and objectives. For example, this would include where in the life-cycle of a company the business currently sits, whether it faces any specific problems/issues and what it wants to achieve in the short, medium and longer term.

Considerations that will be taken on board during this phase may include:

- the age, maturity, value and nature of the business (single ownership / joint venture / private equity backed). Advisers said that reasons for not using growth shares included: Start-ups that have no value may use ordinary shares which have a low face value; and joint ventures because of complications that can arise when applying for Entrepreneur's Relief in cases of more than one owner;
- business size and turnover – those with fewer than 250 staff and less than £10m per year turnover may find an approved scheme like EMI to be more appropriate and less costly to set up;
- whether the business is in a growth sector of the economy and it has the potential for growth. Typically, an adviser would look for potential growth in the region of 15% to 20% per annum (rather than 5% to 6% as might be the case with 'ordinary growth' companies);
- the business cycle – such as start-ups in the media and technology sectors looking for key people to develop products and then exit within five years; established high growth companies that may be looking for an exit plan; expanding companies that want to reward key staff and further incentivise growth;

- the business' commercial and strategic objectives – to ensure that any package places these at the heart of the growth plans;
- the business staffing issues – how many and which employees the business seeks to incentivise / reward (whether growth shares will be used to recruit new staff, or incentivise existing staff and also that a business is not just looking for an alternative to properly remunerating employees);
- whether the business will remain in private ownership – for example, if not an Initial Public Offering (IPO) or buy-out, who will fund the disposal of shares when these are sold back to the business.

> *"Growth shares are all about offering hope and driving growth where the employee can realise the value, but in the right way."*
> (Accountancy firm, Cambridge)

Step 2 - Affordability and value for money – once diagnostic questions have been answered, advisers consider (and communicate) the cost of setting up growth shares to the client company. Such costs relate to legal fees and the time that will be involved, for example, in changing the Articles of Association. Clients are asked to consider whether the significant work and considerable cost will in fact deliver against their desired objectives and whether the benefits will justify the investment.

None of the interviewees were able to give even a ballpark cost for setting up and implementing growth shares, with costs varying from company to company and on their particular and individual circumstances. However, growth shares would be more costly than setting up ordinary shares, with additional costs relating to changing the Articles of Association which is necessary to create a new class of growth shares and other costs may be involved such as for specialist valuation of the shares.

> *"With ordinary shares you value the company which is relatively simple. When valuing growth shares there is a lot more to it, you also have to value the growth prospects which is a difficult thing to do. The valuation has to be dovetailed with the documentation, the Articles [of Association] which is also not straightforward."*
> (Accountancy Firm, Reading)

Similarly the time involved in implementing growth shares was also said to vary according to the complexity of each company's individual structure, as well as the experience of the firm that is setting up the growth shares.

> *"It might be as short as a few days or it can take months to negotiate as part of a transaction. We do them a lot, but for some companies it can take much, much longer."*
> (US-owned International Law Firm, London)

“Because growth shares are expensive to implement, it’s important clients understand it’s not a five minute job. First you have to value the business then change articles and much more.”
(Lawyer, Bristol)

“A lot of firms like the idea, but when they hear what’s involved they don’t go ahead with it.”
(Accountant, London)

Step 3 - The ‘specifics’ – if the employer understands all that is involved and wishes to continue the new class of shares has to then be structured according to their wants and needs. This involves discussion between the employer, accountant and lawyer before decisions can be taken around a number of key elements:

- restrictions and hurdles – for example, when would the employer want their employee(s) to receive the shares, at the start or the end of the period (it can be either);
- what happens when an employee leaves early? How will the shares be bought back – by employer or a third party?
- how does the employer want to deal with shareholder dilution?

3.3. Employer motivations, benefits and drawbacks

When discussing motivations, benefits and drawbacks of growth shares, issues that were raised spontaneously were initially discussed. This was then followed by a menu of specific motivations, benefits and drawbacks that were prompted and designed to further expand the discussion. The latter responses are detailed in section 3.5.
Advisers in this research believed that employers will have often heard of growth shares from industry peers, their bankers, accountants, or the media. Employers may be attracted to the concept of growth shares, especially if their business strategy is for rapid growth and an exit plan. However, advisers thought that in reality employers know very little of what is involved, or of how they and their employees may benefit from growth shares beyond the goal of achieving growth.

This perception is supported by the two employers in the sample who were drawn to growth shares by the idea of offering some of their staff an incentive aimed either at achieving significant growth, or in order to retain some valuable members of staff. These two employers displayed no more than an awareness of tax treatment which one employer referred to as the *‘minor details’.*

3.3.1. Employer motivations

The key motivation for an employer to turn to growth shares was said by advisers to be ***to grow the business from today’s value to a higher value at a certain point in time***.

There may also be a whole raft of other reasons that can trigger an employer to explore the viability of growth shares, including:

- attracting the 'right' people with the relevant talent, skills and a risk-friendly attitude who will help grow the company – especially for companies looking to recruit in a global recruitment market ;
- retaining key staff, especially if they appear unchallenged or unmotivated to grow the company;
- incentivising employees to work harder, or put in more effort to grow the company;
- rewarding employees for 'pulling out the stops' and working harder to grow the company.

Advisers said other circumstances that also motivated employers (and in some cases shareholders too), these were:

- when an entrepreneur wishes to either move on to another venture, or step back and wants a key senior employee to continue and drive the business on;
- when management and shareholders wish to ring-fence the accrued value of shares;

  "I've grown the business and don't see why I should give this new person a dividend, or equity in what I've already grown."
  (Accountant quoting Employer client, London)

- to attract external investors as this sends a strong signal of the company's seriousness to grow and therefore provide a good return on their investment.

3.3.2. Employer benefits

As discussed earlier, the purpose of using growth shares is to encourage a high level of growth. The benefit of using growth shares to achieve this is that the employer **provides equity without eating into the company's cash reserves and without diluting their current equity.** In reality what businesses are giving is 'hope equity' for short to medium-term growth that keeps their current equity intact. In this respect, advisers often mentioned that growth shares were a form of 'protected incentivisation.'

> *"Until growth shares flower and grow, or until they achieve the hurdle they will never come into life and so the company hasn't actually lost anything."*
> (Accountant, London)

The benefits of growth shares to the business include:

- attracting and retaining staff – especially very senior employees such as directors that businesses either cannot afford to lose, or who are not easily replaceable.

Advisers gave no indication as to the balance between retaining and attracting employees as based on their personal experiences both are seen as benefits of using growth shares;

- alignment of key employees with shareholders who will appreciate 'ownership' as well as the friendly tax treatment;
- brand loyalty – from staff and investors; the vested interest that employees acquire (via growth shares) can elevate a company from being 'just another employer' to the level and status of a brand in which they become emotionally engaged and can identify with. Investors who see this type of loyalty and emotional commitment are also likely to find the company a more attractive investment proposition;
- securing outside investment – the seriousness of their growth plans can bring in the 'right' outside investors;
- cash-saving, especially for start-ups that often cannot afford the highest salaries and so prefer to offer 'hope incentive';
- equity without interference - typically growth shares have no voting rights and therefore employees who are given them cannot 'dabble in' or interfere with the strategic running of the business.

3.3.3. Employer drawbacks

The one key drawback for employers, noted by advisers in this research, is that growth shares may not be treated as deductible when calculating Corporation Tax.

> *"Most of potential future gain will not be deductible for Corporation Tax."*
> (Accountant, London)

Often also seen as 'drawbacks' of growth shares are aspects that mostly stem from the complexity and expense of implementation and as such tend to be seen (by advisers) as a one-off drawback at the beginning of the process. Once these are ironed out at the structuring stage they are no longer perceived a drawback, but can be seen as an initial disincentive for employers to proceed with implementation. Costs arise from the following:

- Growth shares are bespoke with considerable up-front work and consultation taking place before they are implemented. For example, decisions need to be made about: coping with leavers and newcomers; making 'good' and 'bad' leaver provisions such as if an employee leaves the business the value they sell the shares back for will depend on whether they are a 'good' leaver (redundancy, retirement, death) in which case the shares will attract a higher value than in the case of a 'bad' leaver (termination, dismissal, resignation) where the shares may attract no value;
- changing Articles of Association with associated high legal fees;
- explaining growth shares to employees – most advisers indicated that even highly experienced employers and employees struggle with understanding the complex

detail.

"It's very difficult for anyone not a legal person, even highly intelligent people, to understand what Articles say."
(Accountant, in specialist multi-disciplinary law firm, Birmingham)

Other perceived disincentives of growth shares (in the view of advisers) were:

- poorly implemented growth shares where targets are set too high – if targets are unrealistic and employees find them unachievable then growth shares can become an employee disincentive;
- Growth shares may become a matter of public record[2] – the fact that employees may be able to see what others are entitled to may be something employers would rather not share for fear it might create disharmony and dissatisfaction; the opposite of what they wish to achieve.

3.4. Employee motivations, benefits and drawbacks

It was typically reported that employees do not ask for growth shares and know very little about them, unless they have come from a company that had already implemented them. As one employer indicated, potential employees 'in the know' will ask about these for example at professional recruitment fairs. Those who are more likely to ask for growth shares are very senior managers, director-level staff, and people with very specialised skills and experience in particular sectors, such as software and media companies.

3.4.1. Employee motivations

From the perspective of advisers and employers (note that employees were not part of the sample) those employees who are either aware of growth shares, or who have had growth shares properly explained will be motivated by ***the opportunity to maximise their earning potential over a set period of time***. This happens when an employee can see the potential in the business to grow substantially and consequently for the share price to grow significantly in a short period of time.

Growth shares present an opportunity for employees to 'buy' into a company in a financially more affordable way, usually because all they have to pay upfront is tax, usually on the lowest possible share value that the employer and their advisers are able to achieve at issue.

Affordability becomes even more motivating due to the subsequent tax treatment that growth shares receive (Capital Gains Tax at 28% when shares are sold which with Entrepreneur's Relief can bring it down to 10% instead of Income Tax at 45%).

Advisers have known of cases of employers giving employees a cash bonus with the express intention of using this to pay the due tax up front.

[2] In 2013, the Prime Minister stated an intention to create a Central Registry of Company Beneficial Ownership, but this has yet to be enacted.

"These are often high earning Directors who value not just the challenge, but also the chance to earn as much as they can before moving on to the next big challenge and opportunity."
(Lawyer, London)

3.4.2. Employee benefits

Employees can look to three main groups of benefits: financial; emotional; and motivational.

The financial benefit is twofold (i) the potential reward if targets are met and (ii) the tax advantage – high earners value tax efficient ways of remuneration.

"It's something tangible, they can actually see that their effort puts money in their pocket...it's a great financial incentive for employees that they can see."
(Accountant, Reading)

The emotional benefits stem from the elevated status that is bestowed on an employee, not just of a valued employee, but of a 'key' person in the business.

"It can be incredibly empowering to be told that you are important enough for someone to want you to have a stake in the business."
(Employer, London)

Advisers also thought that growth shares were in themselves motivational. Although the type of employee likely to attract growth shares was likely to be highly motivated anyway, the provision of growth shares was thought to enhance their motivation to grow the business.

"They [growth shares] are clearly motivating, not withstanding they are going to be highly motivated people anyway, but they add the additional sparkle, shall we say."
(Accountant, London)

3.4.3. Employee drawbacks

Drawbacks of growth shares were primarily around where the anticipated potential for growth fails to be realised, or if the employee chooses to leave the company and relinquish shares under the terms set out in the 'bad' leaver provision.

The employee may find themselves disadvantaged if:

- Growth fails to hit the target, in which case the return may be smaller, or none at all;
- Having already paid tax at issue the employee will also have made a non-recoverable expenditure.

3.5. The benefits and drawbacks of specific aspects of growth shares

Of the list of characteristics of growth shares used as prompts during the interviews these were the perceived benefits and drawbacks associated with them by participating employers and advisers:

- ***When they are acquired, income tax and any National Insurance Contributions (NICs) are charged on a low value***

  i) **Employee benefit:** where the employee elects to pay tax and NICs up front, which most employees are said to choose to do, it is the more affordable way of buying equity in the business. However, it was also an issue which employees could see as a drawback given that they are having to pay income tax and national insurance contributions up front for shares that may yield a low return, or may even be worthless if the company fails to grow as expected.

  ii) **Employer benefits:**

  1) it minimises employer NICs;

  2) *if* an employee were to elect **not** to pay tax up front the employer's Corporation Tax contribution would normally be lower, although this is unlikely to happen because the tax benefit to the employee would then effectively be negated;

  3) the tax and NICs employees can elect to pay up front is what some advisers and the employers described as *'employees having skin in the game'*, that is, employees committing their own money to show that they really are on board with the growth agenda.

- ***The shares are held from the date the shares are issued***

  The **employee advantages are:**

  - they have a stake in the period of growth from the beginning of the growth agenda;
  - it demonstrates the employer's firm commitment to them as employees which they are likely to then match with their own appropriate increased effort and commitment;
  - a greater sense of employee ownership, especially if their involvement can be further enhanced by allowing them to attend general meetings even though such attendance is symbolic, because growth shares tend to have no voting rights.

  This feature can also pose a disadvantage to the employer:

  - the company has given equity away before the member of staff proves themselves; and

- by giving shares from the date of issue (as opposed to at the end of the period), the business runs the risk of ending up with a lot of small shareholders whose shares they would have to claw back in the event of their departure.

- ***The employee only receives a significant sum in relation to the shares if the value of the company grows after he/she has held his/her shares***

  For employees this poses advantages and disadvantages. The **advantage** is the direct correlation between the employee's efforts and the value that their shares are accruing; the **disadvantage** is that if growth does not materialise the shares may be limited in value, or even worthless.

  The advantages for employers are: the business only loses some of its equity if the value grows successfully; and the value of the growth does not attract employer NICs.

- ***The gain on the shares is subject to capital gains tax (CGT)***

  This is seen as a clear **advantage to employees** as tax is paid at the CGT rate of 28% instead of Income Tax which for high income earners would be 45%. If growth shares are structured correctly the employee will additionally be able to claim Entrepreneur's Relief (ER) bringing their tax liability down to 10%. Some advisers prefer to structure growth shares in conjunction with Employee Shareholder Status (ESS) instead of ER because they deem it less attractive than ESS.

  There are no advantages or disadvantages to employers.

- ***The gain on the shares cannot be treated as deductible in calculating the corporation tax of the employing company***

  This is generally seen as the main **drawback to employers**. However, one of the accountants in the study indicated that whether this is a drawback depends on how the scheme is structured and it may be possible for the value of shares to be deducted and to attain Corporation Tax relief, thus minimising this particular disadvantage to employers.

3.6. Tax treatment

Advisers noted that while growth shares are treated favourably in terms of tax treatment, the key driver of their use by employers is in attaining their growth strategy.

> *"Tax does not drive the agenda, it underpins business strategy. Sometimes it is not the most tax efficient offering that companies need, but what can help them commercially, so the tax consequences flow from the commercial ones, not the other way round."*
> (Accountant, Cambridge)

From the perspective of the employing company advisers indicated that growth shares must first and foremost make commercial sense, but tax treatment is a key incentive to attract and reward employees. Tax treatment is the next important issue that is usually considered after *'Do we need growth shares and is it a good idea?'* when employers and advisers discuss the potential role of growth shares in their company.

> *"Preferable tax treatment continues to make growth shares popular and if current tax treatment was withdrawn growth shares popularity would drop…or consultants and tax experts would beaver away to produce something else that is tax efficient even if 'sailing close to the wind.'"*
> (Accountant, London)

Advisers report that preferential tax treatment can also be a somewhat tainted vehicle for some employers, an issue that goes back to various tax scandals of the past and makes companies wary of being associated with schemes that could potentially tarnish their brand. Taxation can be complex and sensitive and employers who often feel inadequately informed are wary of schemes that may even inadvertently, or through ignorance place them foul of the law.

> *"So now it's more about what the business wants to achieve and what is the best fit for them than about going for products that enable companies to save 'x' amount of tax if the business is structured in 'y' way."*
> (Lawyer, London)

Advisers thought that preferential tax treatment options were very limited and included:

- Enterprise Management Incentives (EMI)
- Growth shares
- Employee Shareholder Status (ESS) – in conjunction with growth shares that permits tax-free status on share gains
- Entrepreneur's Relief – together with CGT can bring tax liability down to 10%
- Tax-Advantaged Share Schemes, referred to by advisers as Tax Advantage Share Option Plans
- Joint Share Ownership Plans

EMI was overwhelmingly considered to be the most efficient and beneficial approach in terms of tax advantages.

Growth shares were also seen as highly tax advantageous but depended on:

- specialised initial valuation;
- a structure that enables all the growth to fall within CGT allowances; and
- fulfils the right criteria that could additionally make either Employee Shareholder Status (ESS) or Entrepreneur's Relief (ER) available to employees and can reduce their tax liability further, although ER would not necessarily be available to everyone.

3.7. Low valuation at issue

Achieving low valuation at issue is of foremost importance as it (i) makes growth shares attractive and affordable to employees and (ii) separates what went before, from the period of growth that employers and employees enter into.

> *"The aim is to create a share with low value and with variable hurdles that will be dependent on the size of the award given to employees."*
> (Accountant, Reading)

How this low value is achieved is something advisers found difficult to explain saying that without an accountancy background it is fairly hard for a layperson to understand. However, their view is that it involves valuing the business as a whole – less difficult in the case of start-ups, but infinitely more complicated in the case of established companies.

> *"This is very difficult to explain and it's really the remit of specialist valuers…there is no single way of doing it."*
> (Accountant, London)

One or two aspects are however easier to detail. One reason that makes it possible to achieve low valuation is because in reality only a small number of shares will be issued and so as minority shares (those shares that cannot control the direction of the company), by definition will not be worth very much.

Furthermore, as growth shares cannot be sold in the market place as they only represent 'hope value' they have no actual market value. Restrictions such as 'no voting' and 'no dividend' as well as various other bespoke hurdles also suppress the valuation.

> *"You suppress a value by how achievable it is – you can put a hurdle in so the shares only have 'hope' value and it's to do with the basis at which the threshold is set and the hurdle at which the value must be achieved."*
> (Accountant, London)

One adviser said that it is not uncommon for the employing company to require a certain level of growth first, before an employee is able to participate, though the impact of this on low valuation was difficult for the adviser to explain suggesting that it would still be possible to achieve a lower level of valuation at issue.

3.8. Restrictions

Restrictions were generally understood by advisers to refer to the often time-vested 'conditions', which are frequently also described as 'hurdles' and have to be defined when growth shares are structured.

Restrictions were said to be completely bespoke and although in the view of advisers in the sample companies generally do not to want to appear to be aggressive by imposing ‘harsh’ restrictions, they do nonetheless want to lock *the ‘right’ behaviours* into their employees as well as to ensure their continued employment.

Restrictions are set up from the start and come into play at the time the shares are sold, or upon departure of the employee. They will vary from company to company but will remain valid for the duration of a period of time up to the specified ‘exit event’ which can typically be up to five years, or more, although it is also said that time-frames are not usually specified as rigidly as a precise number of years.

They are primarily seen as conditions intended to impact on staff retention, rather than as drivers of growth per se. However, in some cases the restriction, or hurdle itself can also be a more direct driver of growth, such as where the condition stipulates that an employee will receive no benefit if the desired growth target or exit event is not achieved.

> *“An employer will not give away growth shares with no conditions when the whole point is to encourage staff to stay until exit.”*
> (Lawyer, Birmingham)

Our analysis has identified three groups of restrictions given by respondents.

The **first** is those that impact primarily, though not exclusively, on **staff retention** and are:

- Length of employment conditions whereby an employee is ‘locked in’ to the company for a certain number of years with one year being the usual minimum;
- The time in which the employee can sell back their growth shares – the exit event.

The **second** type of restriction impacts more on **value growth**. Typically employers would not impose conditions such as a specific percentage of growth per year, but are more likely to be around a specific anticipated value at the exit event. For example:

- Growth shares receive value only if the business is sold for ‘x’ amount;
- An employee can sell their growth shares only if the majority of other shares are sold at the exit event;
- One adviser also noted that it is also not uncommon for a company to set a requirement that the business has to achieve a certain level of growth before an employee can even participate in growth shares.

Third, there are typical **leaving restrictions** that define the circumstances under which employees will be able to leave prior to the ‘exit event’ and specifies what will happen to their shares in the case of such departure, who will buy them and even what would happen in the event of liquidation:

- Defining ‘good’ leavers – redundancy, retirement, death; and ‘bad’ leavers – dismissal, termination, resignation;
- Whether shares will be relinquished altogether, or under certain conditions will be bought at their initial nominal value;

- Whether the company itself, or a trust fund will buy them, for example an employee trust fund;
- That on sale, or liquidation of the company the value of the business will be assessed and employees will share only in a percentage of value above a particular hurdle.

4. Different types of growth shares

A prevailing view existed among many advisers in the sample that 'different types' of growth shares do not really exist. In their view 'growth shares are growth shares' and what makes them different are the different 'hurdles' that are structured as part of the conditions that will prevail around aspects such as continuous employment, entry thresholds, exit event values and circumstances of departure.

They were however presented with a list of descriptors and their feedback suggests that when certain hurdles are applied, growth shares can then be described either as ratchets, or as flowering shares – both very similar and most closely thought of as growth shares. Joint Share Ownership Plans (JSOPs) were not thought of as growth shares per se and debt-based gearing was something that some advisers had not come across.

4.1. Ratchets

Ratchets were seen by advisers as mainly relevant to only the most senior executives of a company and are typically used as a one-off arrangement between a private equity house, or the founders of the company and their senior management. They are tailored very closely to the *success* of a company with the value of shareholding increasing as certain targets are met. For example, a management team may start with X number of shares and upon collectively meeting a certain target their shareholding will increase so they get X + Y shares. They provide a geared incentive to achieve successful growth.

By virtue of delivering incremental value by 'ratcheting up' the share value under certain circumstances they are able to deliver smaller amounts of benefit over the course of a period so that even if the ultimate hurdle is not achieved they provide a safety net along the way that make them an attractive growth share to employees.

Ratchets were said to be very tax efficient. Some of the advisers said that if 'done properly' to fit in with the 2003 Joint Memorandum, agreed between the Inland Revenue and the British Venture Capital Association (BVCA), the certainty of a tax advantage for employees can provide a powerful incentive to drive growth.

4.2. Flowering shares

Although the term 'flowering shares' was recognised by advisers, they were not seen by advisers as a distinct type of growth share as there was a lack of clarity as to when a growth share becomes a flowering share. Some advisers saw them as growth shares with conditions while others described them as 'more like ordinary shares with restrictions'. They were also described by some advisers as 'similar to Joint Share Ownership Plans (JSOP's), described below, and also as a 'hurdle share'.

Overall, however, flowering shares were generally characterised as a share that only has value when a particular set of growth conditions are met; unlike ratchets they do not have any incremental value and so are an 'all or nothing' share.

> *"A flowering share is like a hurdle share because they will start to accrue value only if the value of a business reaches a certain amount."*

(Accountant, London)

Flowering shares are believed by some advisers to be more likely to be used in existing businesses (than in start-ups) and like ratchets are thought to provide greater certainty over tax treatment.

> *"Because returns of these schemes are usually written in the Articles of Association"*.
> (Lawyer, London)

4.3. Joint Share Ownership Plans (JSOP)

Advisers interviewed felt that JSOPs tend not to be seen as growth shares primarily because they do not involve the creation of a new class of share. An oversimplification of what occurs for the creation of JSOPs is that an ordinary share is taken and split into two, with one part representing the existing value of the share and owned by a Trust (the company) and the other part representing future growth and owned by the employee(s).

JSOPs were divisive in their appeal among the advisers in the study. Some saw clear advantages and regarded them as novel, conceptually different to growth shares and reflected 'out-of-the-box thinking'. They are simpler to administer because they do not involve creating a new class of shares and therefore do not necessitate changes to the Articles of Association.

Other advisers, however, saw them as complicated to explain to employees as well as costly because by necessity they involve the creation of an offshore (Employee Share) Trust.

Some advisers felt that they are not favourably looked upon by HMRC and that some bad media publicity around them over tax avoidance has created an atmosphere of fear that HMRC might challenge employers going down this route, or might even clamp down on them altogether.

Even those advisers who thought of them as unpopular acknowledged that they had **advantages** over growth shares. These were:

- not having to create a new class of share, so easier to implement as there is no need to change the company's Articles of Association;
- administratively easier, especially if making multiple awards to multiple employees over the years as shares can be easily recycled for use by future participants;
- described by some interviewees as *"surprisingly tax effective"* and capable of delivering a CGT advantage even though they do not qualify for Employee Shareholder Status (ESS) and Entrepreneur's Relief (ER), although they are also seen as less tax efficient than ratchets and flowering shares.

JSOPs are seen as being more appropriate for fully listed companies:

"Their one, perhaps only, advantage is if the right type of shares can't be created in the company - if for example it's a listed company with ordinary shares that employees can't afford - then a JSOP can be used."
(Law firm, London)

A disadvantage of JSOPs for the employer is thought to be over the forfeiture of shares when an employee departs. The shares tend to go back to the Trust rather than the company, so the employer can end up with a pool of residual value shares that are stuck in an Employee Benefit Trust.

4.4. Debt-based gearing

Debt-based gearing was seen as commercially quite different from growth shares mainly because through a formula debt is turned into shares. However, this is perceived as risky, particularly for employees because what is classified as debt can be interpreted in different ways, for example, debt/equity, long term debt/equity, and total liabilities/equity.

"I would not advise them to my clients as they're too risky, though if they go well you can make a lot of money, but if they don't you can lose a lot."
(Accountant, London)

Most advisers in the research had very little to say about debt-based gearing because none of them in the study had experience of dealing with them; many could not see the logic of advising companies to deliberately create debt to generate an incentive.

4.5. Alternatives to growth shares

The most significant alternative to growth shares were considered by advisers to be Enterprise Management Incentives (EMI). EMI was said to be the first port of call even before growth shares are considered and were generally the scheme favoured by almost all the advisers taking part in the research.

Under an EMI scheme the employee is granted an option to buy a certain percentage of shares in the company at a given point in time at today's price. If the shares increase over time the employee is rewarded for their effort in helping to achieve the growth.

"In my view it's the best form of share plan available as it has an agreed tax regime with the revenue which is attractive to employees and employers."
(Accountant, London)

The main advantages of EMI were believed to be:

- uncomplicated to set up; because it affords an option which does not necessitate a new class of shares - it can be for existing ordinary shares; it does not involve complicated provision for leavers – under EMI the option lapses whereas with growth shares they have to be clawed back;
- highly tax efficient – employees pay no tax up front; no NICs; they qualify for Capital Gains Tax; and for employers they are deductible for Corporation Tax;
- many companies will qualify for EMI.

There are two disadvantages that were identified:

- Not all private companies are eligible, such as larger SMEs with more than 250 employees and gross assets of more than £30m; and

- EMI is not suitable for the Private Equity Sector – this is due to a condition of the scheme that a company operating EMI must be independent and not controlled by another corporate body. We were told by advisers that the shares in private equity backed companies will be held by a number of other investors and it can be difficult to prove that the shares are not being held by another corporate body, although this may not be the case in reality.

There were very limited alternatives suggested to growth shares, primarily because they cannot be used in a bespoke way. Consequently, while advisers mentioned Employee Shareholder Status (ESS), Structured/Systematic Investment Products (SIPS), Save As You Earn (SAYE) and Company Share Option Plans (CSOPs) as potential vehicles to attract and retain staff, the inability to tailor these and their limited tax advantages gave them limited appeal.

5. Conclusions and perceptions of the future of growth shares

This research found that firms interested in growth share schemes can often be those with ambitious growth plans and clear exit strategies in the short to medium term (3-10 years) as well as private equity firms and management buy-outs. While not sector-specific, advisers taking part in the research felt that growth share were of most value and appropriate to the hi-tech, communications and media sectors.

Advisers taking part in the research noted that growth shares (particularly ratchets and flowering shares) are complex and can be fairly costly to implement because they are always bespoke, need changes to the Articles of Association, and require complex valuation of the shares at issue. Their complexity also means they require a great deal of explanation to employers and employees alike. These associated complexities are said to be the reason why in practice only a small proportion of enquiries result in implementation.

The preferred alternative to growth shares by advisers taking part in this research is Enterprise Management Incentive (EMI). This is because: EMI grants an option which an employee can choose to take, or not and so costs nothing up front either to the employer or the employee; it is inexpensive to implement; it is tax efficient because the employee does not have to pay tax up front and the employer is allowed to deduct from their Corporation Tax liability; for employees the EMI option can simply lapse, whereas with growth shares, these have to be clawed back. However, EMI is not suitable for all companies.

Predicting future trends is difficult and the feeling amongst advisers was that share-based incentives will continue to grow in popularity, albeit retaining their niche within the employee remuneration landscape. Growth shares are certainly expected to continue to be relevant to larger SMEs as well as for the many private equity-backed businesses neither of which qualify for EMI. For these and other private companies that are looking for fast growth and a short-medium term exit plan, advisers consider that growth shares will continue to have a role, especially in the recruitment and retention of key senior staff. Growth shares are not thought to be as appropriate, however, for those companies with longer-term strategies, or with those employers and employees that are risk-averse and look towards slower levels of growth.

In thinking about the future of business growth, advisers saw:

- growth shares as continuing to have a valuable role to play in developing companies that they saw as ‘engines of the economy’ - larger SMEs (£10m+ turnover). Advisers said that these are the backbone of the UK economy and are companies that have the greatest potential to grow, will create new jobs, will generate wealth to drive the economy forward and are good candidates for the use of growth shares

> *"It's an important part of the economy as you're talking about larger SMEs and above with potential to achieve growth and drive the economy…they create lots of jobs and so these are firms that generate serious growth in the economy."* (Specialist Tax Agent, London)

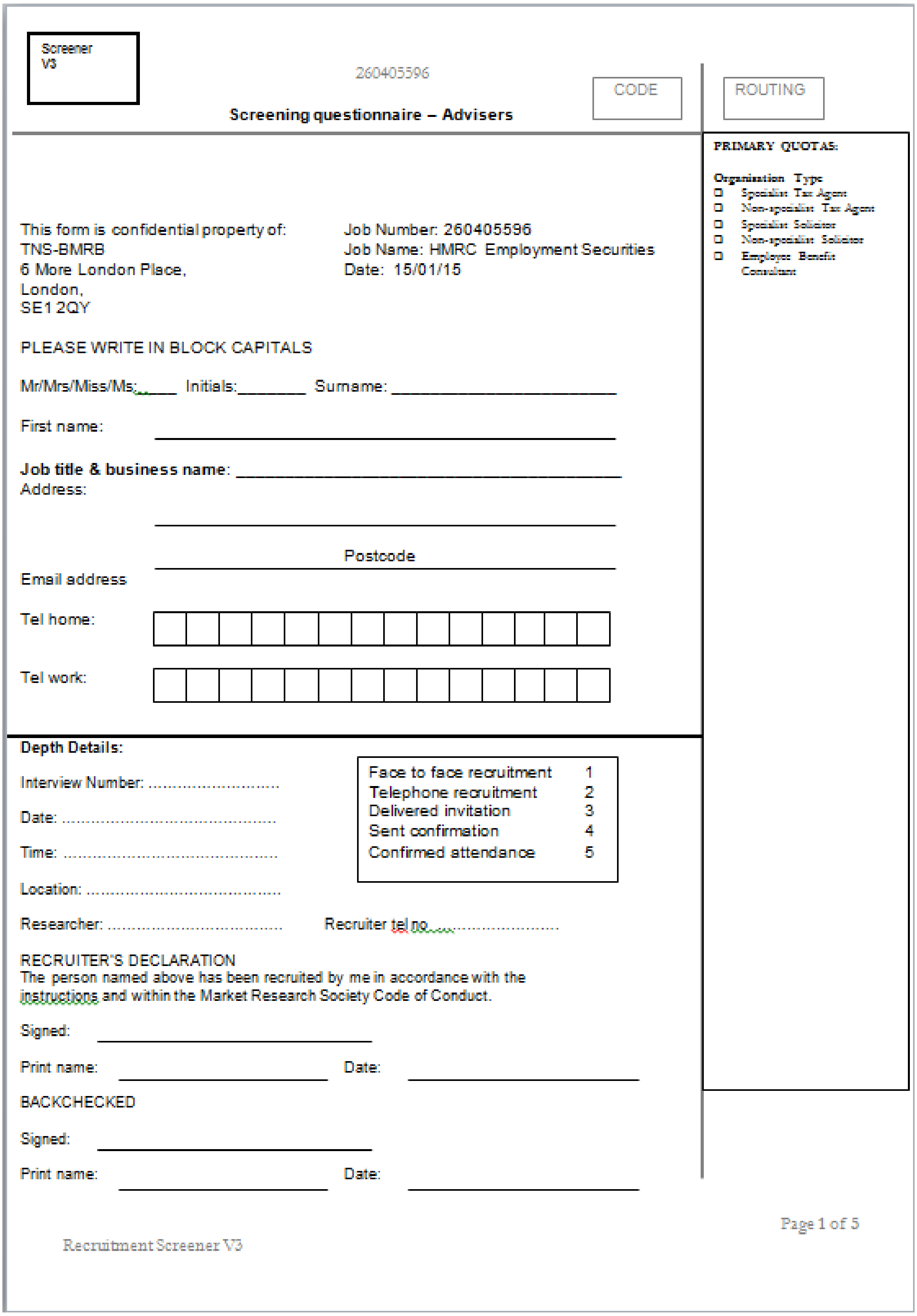
- an increasing trend and a commercial appetite among employers for employees increasingly taking some risk and being really enfranchised in the business by investing their own money in the business;
- longer time periods over which a growth payout is made; and
- possibly more emphasis on individual employee performance conditions rather than simply on company growth objectives.

Appendix A – Profile of advisers and EBCs

ID	Type of adviser	Specialist / non specialist	Specialism
1	Solicitor	Non specialist	
2	Accountant	Non specialist	
3	Law Firm	Specialist	Equity Management Buy-out
4	Multi-disciplinary Law Firm	Specialist	Specialist Tax Accountant
5	Law firm	Specialist	Private equity
6	Firm of Accountants	Specialist	Remuneration & tax planning
7	Law Firm	Specialist	Partner, Tax Department
8	Solicitor	Specialist	Head of Employee Incentives & Benefits
9	Law Firm	Specialist	Partner, Pensions & Employee Benefits Practice
10	Solicitor	Specialist	Head of Employee Share & Incentives
11	Law firm	Specialist	Solicitor Partner heading up Employee Incentives Practice
12	Law firm	Specialist	Head of Employee Incentives and Tax
13	Global Chartered Accountants	Specialist	Tax Director
14	Firm of Accountants	Specialist	Taxation
15	Law firm	Non-specialist	Tax Department
16	Firm of Accountants	Specialist	Wealth Management
17	Firm of Solicitors	Specialist	Senior Associate Employee Incentives & Employee Tax Department
18	Firm of Accountants	Specialist	Tax Department Employer Solutions
19	Law firm	Non-specialist	
20	Law firm	Non specialist	
21	EBC		Specialist in Taxation, Financial Planning, wealth Management and
22	EBC		Specialist in Employee Share Schemes and Executive Compensation

Appendix B – Research materials

Screening questionnaires (Advisers)



Screener V3

260405596

Screening questionnaire – Advisers

CODE

ROUTING

PRIMARY QUOTAS:

Organisation Type
- Specialist Tax Agent
- Non-specialist Tax Agent
- Specialist Solicitor
- Non-specialist Solicitor
- Employee Benefit Consultant

This form is confidential property of:
TNS-BMRB
6 More London Place,
London,
SE1 2QY

Job Number: 260405596
Job Name: HMRC Employment Securities
Date: 15/01/15

PLEASE WRITE IN BLOCK CAPITALS

Mr/Mrs/Miss/Ms:____ Initials:_______ Surname: ________________________

First name: ________________________________

Job title & business name: _______________________________________
Address:

Postcode

Email address

Tel home:

Tel work:

Depth Details:

Interview Number: ....

Date: ....

Time: ....

Location: ....

Researcher: ....

Recruiter tel no ....

Face to face recruitment	1
Telephone recruitment	2
Delivered invitation	3
Sent confirmation	4
Confirmed attendance	5

RECRUITER'S DECLARATION
The person named above has been recruited by me in accordance with the instructions and within the Market Research Society Code of Conduct.

Signed: ________________________

Print name: __________________ Date: ____________________

BACKCHECKED

Signed: ________________________

Print name: __________________ Date: ____________________

Page 1 of 5

Recruitment Screener V3

CODE	ROUTING

INTRO:

Good morning/afternoon, my name is….and I'm from TNS BMRB, an independent research organisation working on behalf of HM Revenue and Customs. HM Revenue and Customs have asked us to carry out research with organisations advising companies on their employee remuneration packages to understand more about their experiences.

The research is completely anonymous. Any of the information you share with TNS-BMRB will be kept completely confidential, and your personal details will not be passed on to HMRC. TNS-BMRB are totally independent of HMRC.

May I ask you a few questions please?"

Recruiter information - If respondents have any concerns or want more information about the study, please give them Andrew's phone number and s/he will call them back.

Andrew Thomas
Tel: 0207 656 5776

Please contact Tanya Ennis (0207 656 5252) if there are any other questions.

Explain to everybody:

The nature of the methodology – 60 minute telephone interview

Confidentiality and anonymity of respondents

That depths will be recorded

About TNS-BMRB

Note: If respondent does not want to participate could you ask them to please provide a reason as to why and record their answer below:

____

____

	CODE	ROUTING

1. Do you have any experience of advising companies on their employee remuneration packages (e.g. private healthcare schemes, pensions, bonuses, share options, share award schemes and so on)

	CODE	ROUTING
Yes	1	Continue
No	2	Close

2. Do you have experience of advising companies on shares, share options and securities specifically?

	CODE	ROUTING
Yes	1	Continue
No	2	Close

3. I'm going to read out a list of employment-related securities. Can you tell me which of the following you have advised companies on within the last year?

	CODE	ROUTING
All-employee tax-advantaged schemes – Share Incentive Plans (SIP), Save As You Earn Option Schemes (SAYE)	1	
Discretionary tax-advantaged schemes - Enterprise Management Incentive Schemes (EMI), Company Share Option Plans (CSOP)	2	
Growth Shares (These might be called 'Ratchets', 'Flowering shares', Joint Ownership Plans', 'Debt-based Gearing')	**3**	Continue
Other share option arrangements	4	
Other share award arrangements – with restrictions/forfeiture',	5	
Other share/award arrangements – without any restrictions/forfeiture'	6	

RESPONDENT MUST BE CODED 3 AT Q3. TO CONTINUE.

Note: If respondent has not advised any businesses on growth shares ask them to provide a reason why and record their answer below (then thank and close)

____

____

260405596

	CODE	ROUTING

4. **Which of the following statements best describes the nature of your organisation?**

	CODE	ROUTING
We are tax agents/advisers and employee remuneration is one of our key specialisms	1	Recruit to quota
We are tax agents/advisers but employee remuneration is not one of our key specialisms	2	
We are solicitors and employee remuneration is one of our key specialisms	3	
We are solicitors but employee remuneration is not one of our key specialisms	4	
We are Employee Benefit Consultants	5	

5. **Which of the following business sizes do you have experience of advising?** (Tick all that apply)

	CODE	ROUTING
Micro businesses (0-9)	1	Ensure spread of business sizes
Small businesses (10-49)	2	
Medium businesses (50-249)	3	
Large businesses (250+)	4	

6. **Which industry sectors do you mainly offer remuneration advice to?**

	CODE	ROUTING
Agriculture, Forestry and Fishing	1	Ensure spread of industry sectors
Mining and Quarrying	2	
Manufacturing	3	
Electricvity, gas, Steam and Air	4	
Water, Sewage and Waste	5	
Construction	6	
Wholesale, Retail Trade, repair of motor vehicles and motor cycles	7	
Transport and Storage	8	
Accomodation and Food	9	
Information and Communciation	10	
Financial and Insurance	11	
Real Estate	12	
Professional, Scientific and Technical	13	
Admin and sSupport Services	14	
Health and Social Work	15	
Arts, Entertainment and Recreation	16	
Other service activities	17	

Page 4 of 5

Recruitment Screener V3

260405596

CODE	ROUTING

We would like to invite you to take part in an interview to talk about your experiences of advising companies on their employee remuneration schemes. This would be 60 minutes long. There is a gift of £60 (EXPLAIN: this is in the form of a charitable donation to a charity of their choice) payable to all those who take part, as a thank you for your time.

Would you be willing to take part?

Yes	1	Get contact details and provide interview details
No	2	Thank and close

If No, please give reason...

The interview will be held on:

........./........./.......... (date), at (time) ....

(place) ....

....

Note to recruiter: please remind respondents that we will be audio recording the interviews, but this is STRICTLY CONFIDENTIAL. TNS BMRB adheres to the Data Protection Act and operates under the MRS Code of Conduct.

Contact details (e.g. best time of day/number to ring/office to visit) ....

....

THANK AND CLOSE

Page 5 of 5

Recruitment Screener V3

Screening questionnaires (Employers)

Screener
V3

260405596

Screening questionnaire - Employers

CODE

ROUTING

PRIMARY QUOTAS:

Organisation Size
- Micro (0-9)
- Small (10-49)
- Medium (50-249)
- Large (250+)

Organisation Sector
- Agriculture, Forestry and Fishing
- Mining and Quarrying
- Manufacturing
- Electricity, gas, Steam and Air
- Water, Sewage and Waste
- Construction
- Wholesale, Retail Trade, repair of motor vehicles and motor cycles
- Transport and Storage
- Accommodation and Food
- Information and Communication
- Financial and Insurance
- Real Estate
- Professional, Scientific and Technical
- Admin and Support Services
- Health and Social Work
- Arts, Entertainment and Recreation
- Other service activities

This form is confidential property of:
TNS-BMRB
6 More London Place,
London,
SE1 2QY

Job Number: 260405596
Job Name: HMRC Employment Securities
Date: 15/01/15

PLEASE WRITE IN BLOCK CAPITALS

Mr/Mrs/Miss/Ms:____ Initials:________ Surname: ______________________

First name: ______________________

Job title & business name: ______________________
Address:
____

Postcode ______________________

Email address

Tel home:

Tel work:

Depth Details:

Interview Number: ....

Date: ....

Time: ....

Location: ....

Researcher: ....

Face to face recruitment	1
Telephone recruitment	2
Delivered invitation	3
Sent confirmation	4
Confirmed attendance	5

Recruiter tel no..........................

RECRUITER'S DECLARATION
The person named above has been recruited by me in accordance with the instructions and within the Market Research Society Code of Conduct.

Signed: ______________________

Print name: ______________ Date: ______________

BACKCHECKED

Signed: ______________________

Print name: ______________ Date: ______________

Page 1 of 5

Recruitment Screener V3

INTRO:

Good morning/afternoon, my name is….and I'm from TNS BMRB, an independent research organisation working on behalf of HM Revenue and Customs. HM Revenue and Customs have asked us to carry out research with organisations to understand their experiences of structuring employee remuneration packages.

The research is completely anonymous. Any of the information you share with TNS-BMRB will be kept completely confidential, and your personal details will not be passed on to HMRC. TNS-BMRB are totally independent of HMRC.

May I ask you a few questions please?"

Recruiter information - If respondents have any concerns or want more information about the study, please give them Andrew's phone number and s/he will call them back.

Andrew Thomas
Tel: 0207 656 5776

Please contact Tanya Ennis (0207 656 5252) if there are any other questions.

Explain to everybody:

The nature of the methodology – 60 minute telephone interview

Confidentiality and anonymity of respondents

That depths will be recorded

About TNS-BMRB

Note: If respondent does not want to participate could you ask them to please provide a reason as to why and record their answer below:

____

____

260405596

	CODE	ROUTING

1. **Do you have any employee remuneration packages in place (e.g. private healthcare schemes, pensions, bonuses, share options, share award schemes and so on)**

Yes	1	Continue
No	2	Close

2. **Within these remuneration packages are any of your employees offered shares, share options or securities specifically?**

Yes	1	Continue
No	2	Close

3. **I'm going to read out a list of employment-related securities. Can you tell me which, if any, of the following are included in your employee remuneration packages?**

All-employee tax-advantaged schemes – Share Incentive Plans (SIP), Save As You Earn Option Schemes (SAYE Share Incentive Plans (SIPS)	1	
Discretionary tax-advantaged schemes - Enterprise Management Incentive Schemes (EMI), Company Share Option Plans (CSOP)	2	
Growth Shares (These might be called 'Ratchets', 'Flowering shares', Joint Ownership Plans', 'Debt-based Gearing')	3	Continue
Other share option arrangements	4	
Other share award arrangements with restrictions/forfeiture'	5	
Other share/award arrangements – without any restrictions/forfeiture'	6	

RESPONDENT MUST BE CODED 3 AT Q3. TO CONTINUE. — Continue

Note: If respondent's business does not include growth shares in remuneration packages ask them to please provide a reason why and record their answer below (then thank and close)

____

____

4. **Did you approach an adviser, or were you approached by an adviser regarding employee remuneration packages?**

I approached an adviser with regards to employee remuneration packages	1	If 1 go to Q5
I was approached by an advisor with regards to employee remuneration packages	2	If 2 go to Q6

Page 3 of 5

Recruitment Screener V3

260405596

	CODE	ROUTING

5. **Who did you approach for advice in structuring your employee remuneration packages?**

My regular tax agent/adviser who deals with all my financial affairs	1	Ensure spread of advisers Go to Q7
A tax agent/adviser who specialises in employee remuneration	2	
My regular solicitor who deals with all my financial affairs	3	
A solicitor specialising in employee remuneration	4	
An Employee Benefit Consultant	5	

6. **Who were you approached by in regard to structuring your employee remuneration packages?**

My regular tax agent/adviser who deals with all my financial affairs	1	Ensure spread of advisers Go to Q7
A tax agent/adviser who specialises in employee remuneration	2	
My regular solicitor who deals with all my financial affairs	3	
A solicitor specialising in employee remuneration	4	
An Employee Benefit Consultant	5	

7. **Which of the following best describes how *involved* you were in determining the structure of the remuneration packages on offer to employees?**

Very involved – I/we wanted a bespoke package structured to suit our needs and I/we worked very closely with the adviser to achieve this	1	Continue
Quite involved – I/we were happy with a bespoke or off the shelf package to suit our needs and I/we worked closely with the adviser to achieve this	2	Continue
Uninvolved – I/we were happy with an off the shelf package and trusted the adviser to structure this for us	3	Close

8. **How many people does your business employ?**

Micro business (0-9)	1	Recruit to quota
Small business (10-49)	2	
Medium business (50-249)	3	
Large business (250+)	4	

Page 4 of 5

Recruitment Screener V3

260405596

	CODE	ROUTING

9. Which industry sector would you classify yourself as being in?

Agriculture, Forestry and Fishing	1	Recruit to quota
Mining and Quarrying	2	
Manufacturing	3	
Electricvity, gas, Steam and Air	4	
Water, Sewage and Waste	5	
Construction	6	
Wholesale, Retail Trade, repair of motor vehicles and motor cycles	7	
Transport and Storage	8	
Accomodation and Food	9	
Information and Communciation	10	
Financial and Insurance	11	
Real Estate	12	
Professional, Scientific and Technical	13	
Admin and sSupport Services	14	
Health and Social Work	15	
Arts, Entertainment and Recreation	16	
Other service activities	17	

We would like to invite you to take part in an interview to talk about your experiences in structuring employee remuneration schemes. This would be 60 minutes long. There is a gift of £60 (EXPLAIN: this is in the form of a charitable donation to a charity of their choice) payable to all those who take part, as a thank you for your time.

Would you be willing to take part?

Yes	1	Get contact details and provide interview details
No	2	Thank and close

If No, please give reason...

The interview will be held on:

........./........./.......... (date), at (time) ....

(place) ....

....

Note to recruiter: please remind respondents that we will be audio recording the interviews, but this is STRICTLY CONFIDENTIAL. TNS BMRB adheres to the Data Protection Act and operates under the MRS Code of Conduct.

Contact details (e.g. best time of day/number to ring/office to visit) ....

....

THANK AND CLOSE

Page 5 of 5

Recruitment Screener V3

Topic guide (Advisers)

260405596 HMRC Employment Related Securities – Adviser Topic Guide V2

The key aims of this study are set out below but these aims will be housed in a broader discussion about advising businesses on their employee remuneration structures and employment-related securities.

Please be aware that any form of remuneration package, especially if it is designed to be tax efficient, is a sensitive subject, and agents may consider it to be a potential conflict of interest in discussing such issues. This needs to be carefully handled during the interview.

The specific aims of the interviews are to understand:

- Key **influences on the design** of different remuneration approaches;
- How **prevalent** the use of growth shares / securities are within remuneration packages and **how this varies** by business and employee type;
- The **decision-making process** for using growth shares / securities as part of a remuneration package and how this has **changed over time;**
- The **types** of growth share remuneration packages used (e.g. Ratchets, Flowering Shares, Joint Share Ownership Plans or Joint Owned Equity, Debt-based Gearing) and whether these are bespoke or 'off-the-shelf' packages – see Appendix for definitions;
- **Key factors motivating** the use of growth shares amongst businesses and the alternatives considered;
- The **role of tax treatments** in the use of employment related securities;
- **Alternatives** that may be considered if employment related securities were no longer viable or available in future;

1. Introduction and Company Background

- Introduce yourself and TNS BMRB (an independent research agency working on behalf of HMRC)
- Explain purpose of the session – a discussion about advising businesses on their employee remuneration structures with a particular focus on growth shares
- Explain recordings and confidentiality
- Length: Approximately 60 minutes
- Reminder of £60 incentive

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TNS

1

TNS January 2015
JN 260405596

2. Company background (5 minutes)

Note to researcher – in this section we want to get a brief overview of the company the respondent works for and their views and experiences of advising on growth shares as a form of employee remuneration

- Could you start by telling me a little bit about (company name)
    - What is your role? Tell me your 'elevator speech' (i.e. how you would describe your role in 10 seconds)
    - How long has (company name) been established?
    - What are the company's specialisms / specialist areas?
        - Proportion of work dealing with growth shares / securities
    - Who are your core clients for growth shares / securities? PROBE around size of businesses / sectors

3. Employer – Agent relationship (10 minutes)

- How does the process of marketing growth shares / securities work?
    - PROBE:
        - The agent actively markets growth shares to existing clients
        - The agent actively markets growth shares to new clients
        - Employers come to them
    - Where does the balance between these lie (i.e. are employers proactively interested in growth shares or is it the fact that agents are actively marketing them?)
    - Do you think businesses tend to seek out specialist advisers on remuneration or use their 'regular' tax agent or solicitor?
    - Does this differ according to size of business / sector? Does it differ within businesses for different types/seniority of employees? How might their experiences differ?

4. Remuneration Packages - Growth Shares (40 minutes)

Note to researcher – this pivotal section focuses solely on the growth share.

***Explain** – I now want to focus solely on employment related shares / securities with a particular focus on growth shares*

USE Appendix to describe each type of growth share

- What would you say are the key influences in designing the share / security-based element of a remuneration package?
  - What are considered to be the key benefits of these? To the employer? And to the employee?
  - And the drawbacks? To the employer? And to the employee?
- What is your role in recommending a particular share / security arrangement?
- How prevalent are growth shares within the remuneration packages you structure?
  - Has it always been this way? Are they used more now / less now?
  - Would you say they are popular? Why?
- Why / when would you recommend a growth share / security? And in what instances would you not?
- What sorts of businesses use growth shares?
  - PROBE on different sizes, different sectors, start-ups / risky / established businesses / listed / unlisted
  - Who would you typically recommend growth shares to? Why?
  - What sorts of employees are they typically used for?
  - PROBE around, attracting / retaining specific types of staff, level of seniority, duration of employment, employment status, including whether self-employed (therefore no/self-employed NICs) or employed (therefore no employee & employer NICs)
  - Do employees ever ask for them? Types of employees (e.g. role, seniority, new to the business, etc.), sectors?
- What are the key motivations for using growth shares?

- What are all the benefits of growth shares? - PROBE on benefits to employee (tax implications) and benefits to company (attracting / retaining staff, tax driver, incentive to grow etc.)
- Do they have any disadvantages? E.g. risk to employees?

- Do businesses using growth share arrangements typically seek out bespoke packages or more generally marketed / off-the-shelf arrangements? Why is this?
- Where growth shares have been recommended to an employer, have other share / security arrangements more commonly available to external investors been considered? What would these typically be? If not why not?
- Are growth shares / to what extent are growth shares, used in conjunction with other schemes and reliefs, e.g. Employee Shareholder Status, Entrepreneur's Relief
- Are growth shares linked to growth of the business / growth of shareholder value?
  - How is this achieved?
  - Are different types of growth share used; what?
- Are different types of growth shares linked to speed of growth?
  - In what way; which growth shares link to high speed growth?
  - Are these found in all industry sectors or specific sectors; which?
- I'm going to read out a number of characteristics of growth shares – can you tell me a bit more about these features and whether you think they are a benefit or a drawback to the employer / employee:
  - *When they are acquired low income tax and any NICs are charged on a low value*
    - *However, the employee can elect to pay income tax and NICs on the value of the shares upfront. Are there likely to be any instances where an employee would not elect to pay upfront?*
  - *The shares are held from the date the shares are issued*
  - *The employee only receives a significant sum in relation to the shares if the value of the company grows after he has held his shares*
  - *The gain on the shares is subject to capital gains tax (CGT)*
  - *The gain on the shares cannot be treated as deductible in calculating the corporation tax of the employing company*

- *Explore how growth shares may work in practice*
  - Shares have low valuation at issue; how is this achieved; are there different ways and what are they?
  - The employee only receives a sum in relation to the shares after certain restrictions lift
    - What are these restrictions?
    - What are the most common restrictions?
    - how common are restrictions around the sale of shares vs restrictions around leaving employment vs both;
    - how long do these restrictions tend to last;
    - what is the effect of the restrictions on the valuation of the shares at issue;
    - what role do these restrictions play in the retention of staff
    - what role do these restrictions have as a driver of growth)

- What are all the different sorts of growth shares that businesses use? Which sorts are favoured? Which are not? PROBE around the following if not raised spontaneously:
- *NOTE: Definitions in the Appendix*
  - Ratchets
  - Flowering shares
  - Joint ownership plans
  - Debt-based gearing
  - Other types of growth shares?

- What are the benefits / drawbacks of these different options?
- Do businesses understand the differences; how reliant are they on agent recommendation?
- What is your role in recommending a particular option? What would influence your decision to recommend one type of arrangement over another?

- PROBE on the influence of business size, business sector, start-ups / established businesses, seniority of staff, employment status of staff, any other factors

5. Tax Treatment (5 minutes)

***Explain** – I now want to briefly discuss tax treatment specifically*

- Thinking about the whole range of remuneration arrangements there are, what role does tax treatment play in deciding which to use?
- To what extent does the tax treatment of growth shares influence their use by employers
- Thinking about growth shares specifically, how do they rank order them in terms of tax efficiency?

6. Changes Over Time / The Future (5 minutes)

***Explain** – And finally…*

- Can you tell me about:
    - How you think share / security remuneration has changed over time? What were the reasons for this change?
    - How do you expect share / security remuneration to change in the future? What are the emerging trends?
- If current tax treatment of growth shares were not available anymore:
    -
    - Would growth shares still be used; IF NOT, what would be the alternative?
    - Would there be any impacts on recruitment, retention, growth etc.?

Thank and close

Appendix – growth Share definitions

Ratchets – Arrangements under which employees receive shares on the basis that if the company meets certain targets, other investors will cancel some of their shares. The effect is that if the targets are met, an employee's shares will increase in value as they will account for a higher proportion of total shareholding

Flowering Shares – Arrangements under which employees are awarded special shares, which pay out additional reward if certain targets are met

Joint Share Ownership Plans / Joint Owned Equity – Arrangements under which employees hold a small interest in shares that they own jointly with a trust, but any growth in the value of the shares accrues to the employees, not the trust

Debt-based Gearing –involves awarding shares in companies whose funding is provided to a very large extent via debt (or alternatively preference shares) with a fixed rate of return, so that any growth in value of the company above the rate of return on the debt / preference shares is enjoyed by the shares, some of which are held by the employees.

Topic guide (Employers)

260405596 HMRC Employment Related Securities – Employer Topic Guide V1

The key aims of this study are to understand how businesses use employment-related securities – growth shares – as a means of employee remuneration.

Please be aware that any form of remuneration package, especially if it is designed to be tax efficient, is a sensitive subject, and agents may consider it to be a potential conflict of interest in discussing such issues. This needs to be carefully handled during the interview.

The specific aims of the interviews are to understand:

- The **decision-making process** for using growth shares / securities as part of a remuneration package and how this has **changed over time**;
- The **types** of growth share remuneration packages used (e.g. Ratchets, Flowering Shares, Joint Share Ownership Plans or Joint Owned Equity, Debt-based Gearing) and whether these are bespoke or 'off-the-shelf' packages – see Appendix for definitions;
- **Key factors motivating** the use of growth shares amongst businesses and the alternatives considered;
- The **role of tax treatments** in the use of employment related securities;
- **Alternatives** that may be considered if employment related securities were no longer viable or available in future;

1. Introduction

- Introduce yourself and TNS BMRB (an independent research agency working on behalf of HMRC)
- Explain purpose of the session – a discussion about employee remuneration structures with a particular focus on growth shares
- Explain recordings and confidentiality
- Length: Approximately 60 minutes

2. Company background (5 minutes)

- Could you start by telling me a little bit about (company name)
    - What is your role?
    - Nature of the business
        - How long has (company name) been established?
        - What are the company's specialisms / specialist areas?
        - Growth over the past 5 years; prospects for future growth

3. Remuneration Packages - Growth Shares (40 minutes)

Note to researcher – this pivotal section focuses solely on the growth share.

***Explain** – I now want to focus solely on employment related shares / securities with a particular focus on growth shares*
USE Appendix to describe each type of growth share

- How are they currently using growth shares?
    - What type of staff?
    - How many staff?
    - Why these staff?
- What are the key motivations for using growth shares?
    - Business growth
    - Staff recruitment / retention
    - Other
- What type of growth shares are they using?
    - *NOTE: Definitions in the Appendix*
    - Ratchets
    - Flowering shares
    - Joint ownership plans
    - Debt-based gearing
    - Other types of growth shares?

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TNS
2
TNS January 2015
JN 260405596

- Reasons for using this type of growth shares
    - Extent to which these were recommended or whether they decided which to use
- Did they consider other share / security arrangements more commonly available to external investors been considered? What would these typically be? If not why not?
- For how long will they use growth shares?
- Are growth shares / to what extent are growth shares, used in conjunction with other schemes and reliefs, e.g. Employee Shareholder Status, Entrepreneur's Relief
- Are growth shares linked to growth of the business growth of shareholder value?
    - How is this achieved?
    - Are different types of growth share used; what?
- Are different types of growth shares linked to speed of growth?
    - In what way; which growth shares link to high speed growth?
    - Are these found in all industry sectors or specific sectors; which?

- I'm going to read out a number of characteristics of growth shares – can you tell me a bit more about these features and whether you think they are a benefit or a drawback to the employer / employee:
    - *When they are acquired low income tax and any NICs are charged on a low value*
        - *However, the employee can elect to pay income tax and NICs on the value of the shares upfront. Are there likely to be any instances where an employee would not elect to pay upfront?*
    - *The shares are held from the date the shares are issued*
    - *The employee only receives a significant sum in relation to the shares if the value of the company grows after he has held his shares*
    - *The gain on the shares is subject to capital gains tax (CGT)*
    - *The gain on the shares cannot be treated as deductible in calculating the corporation tax of the employing company*

- *Explore how growth shares may work in practice*

- Shares have low valuation at issue; how is this achieved; are there different ways and what are they?
- The employee only receives a sum in relation to the shares after certain restrictions lift
    - What are these restrictions?
    - What are the most common restrictions?
    - how common are restrictions around the sale of shares vs restrictions around leaving employment vs both;
    - how long do these restrictions tend to last;
    - what is the effect of the restrictions on the valuation of the shares at issue;
    - what role do these restrictions play in the retention of staff
    - what role do these restrictions have as a driver of growth)

4. Tax Treatment (5 minutes)

***Explain –** I now want to briefly discuss tax treatment specifically*

- Thinking about the whole range of remuneration arrangements there are, what role does tax treatment play in deciding which to use?
- To what extent does the tax treatment of growth shares influence your use?

5. Employer – Agent relationship (5 minutes)

- How did you decide to use growth shares?
    - Approached by an agent
    - Requested by staff
    - Knew about them already
- What type of help did you use to set up the growth shares (non-specialist, specialist in growth shares)

6. Changes Over Time / The Future (5 minutes)

And finally…

- How likely are you to (continue) to use growth shares?
    - Under what circumstances would you stop using them?
- If current tax treatment of growth shares were not available anymore:
    - Would company still use growth shares; IF NOT, what would be the alternative?
    - Would there be any impacts on recruitment, retention, growth etc.?

Thank and close

Appendix – growth Share definitions

Ratchets – Arrangements under which employees receive shares on the basis that if the company meets certain targets, other investors will cancel some of their shares. The effect is that if the targets are met, an employee's shares will increase in value as they will account for a higher proportion of total shareholding

Flowering Shares – Arrangements under which employees are awarded special shares, which pay out additional reward if certain targets are met

Joint Share Ownership Plans / Joint Owned Equity – Arrangements under which employees hold a small interest in shares that they own jointly with a trust, but any growth in the value of the shares accrues to the employees, not the trust

Debt-based Gearing –involves awarding shares in companies whose funding is provided to a very large extent via debt (or alternatively preference shares) with a fixed rate of return, so that any growth in value of the company above the rate of return on the debt / preference shares is enjoyed by the shares, some of which are held by the employees.

Definition of growth shares

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