



**HM Revenue
& Customs**

**Guidance on the Income Tax treatment
of Employee Shareholder shares**

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Introduction and summary

Changes to take effect from 1 December 2016

As of 1 December 2016, the tax benefits of Employee Shareholder Status (ESS) will not be available to new entrants. The government will legislate to close the status itself to new entrants at the next legislative opportunity. This offers a short window for outstanding agreements to be finalised, due to the requirement that 7 days must pass between an employee receiving relevant independent advice on the offer and the arrangement being finalised. The effective date is to be the 2 December 2016 where relevant independent advice is received on 23 November 2016 prior to 1.30pm.

Employee shareholder is a new employment status, available from 1 September 2013. Employee shareholders will have different employment rights to employees, and will be awarded at least £2,000 of shares in their employer or parent company.

Finance Act 2013 provides tax reliefs for employee shareholder shares, and these will be available from the launch of the new employment status on 1 September. In summary:

- Income Tax and NICS will usually not be chargeable on the first £2,000 of share value received by an employee shareholder.
- There will usually be CGT exemption for £50,000 of shares received by an employee shareholder.
- When an employer funds the costs of the independent legal advice received by a person considering an employee shareholder offer, this will not usually be a taxable benefit.

Businesses awarding employee shareholder shares may propose a share valuation to HMRC's Share and Assets Valuation team in advance of this award. Where possible, HMRC will agree this valuation for tax purposes, and this agreement will be effective for 60 days.

There is no requirement for businesses wishing to offer an employee shareholder contract to obtain HMRC approval or agreement before doing so.

Employers who have awarded employee shareholder shares should provide details on HMRC Form 42 (Employment-related securities). The form will be amended to include a new section relating to these share awards.

Who can be an employee shareholder?

Section 205A of the Employment Rights Act 1996 (ERA) provides that an individual is an employee shareholder if:

- the company and the individual agree that the individual is to be an employee shareholder,
- in consideration of that agreement, the company issues or allots to the individual fully paid up shares in the company, or procures the issue or allotment to the individual of fully paid up shares in its parent undertaking, which have a value, on the day of issue or allotment, of no less than £2,000,
- the company gives the individual a written statement of the particulars of the status of employee shareholder and of the rights which attach to the shares referred to in paragraph (b) (“the employee shares”) (see subsection (5)), and
- the individual gives no consideration other than by entering into the agreement.

Further details can be found in the Department of Business, Innovation & Skills guidance published on the [GOV.uk website](https://www.gov.uk).

Where any of the above conditions are not met, an individual is not an employee shareholder and the special rules set out in this guidance will not apply. In such cases, any shares received by the individual by reason of their employment will be subject to the normal tax rules.

Income tax and employee shareholder

The income tax treatment of the acquisition of employee shareholder (ES) shares is provided by Income Tax (Earnings and Pensions) Act 2003 (ITEPA) sections 226A to 226D (and various consequential amendments to existing income tax legislation), introduced by Schedule 23 Finance Act 2013.

In broad summary, the income tax treatment is that:

- the value of ES shares awarded, less the amount that the employee shareholder is treated as having paid for them, is treated as earnings of the employment;
- for income tax purposes, the employee shareholder is usually treated as having paid £2,000 for the shares;
- ES shares are employment-related securities and, subject to the specific income tax treatment described here, the normal rules of Part 7 of ITEPA will apply to them;

- the benefit of the employer funding certain kinds of independent advice in relation to ES agreements is not taxable in the hands of an employee;
- employee shareholders with a material interest in the employing company are not entitled to be treated as having paid £2,000 for the shares;
- the £2,000 deemed payment is usually only available once to an employee shareholder from the same employer or an associated company.

Detailed guidance on the special Capital Gains Tax treatment of ES shares will be available later in 2013.

Shares worth at least £2,000

The provisions of ITEPA S226A and S226B apply “if shares having a market value of no less than £2,000 are acquired by an employee in consideration of an employee shareholder agreement”.

Shares are “acquired” by the employee for the purposes of ITEPA S226A to S226D if and when the employee becomes beneficially entitled to them.

The “market value” of the shares is determined using the meaning that term has for capital gains tax purposes, in accordance with Part 8 of Taxation of Chargeable Gains Act 1992 (TCGA).

It may be that ES shares will be subject to various conditions which make them “restricted securities”, within the meaning of ITEPA S423 (See ERSM30310). This will be the case if the conditions fall within any of subsections (2) to (4) of ITEPA S423 and the market value of the shares is less than it would be but for those conditions.

So, an employee shareholder might be specifically prevented from selling her shares for a period of time following their award. This “restriction” might well reduce the market value of the shares and it is this actual (in this case, restricted) market value that needs to be at least £2,000 if an individual is to be an employee shareholder.

It follows that an award of shares that have an “unrestricted market value” of £2,000 and which are subject to certain restrictions that have the effect of reducing the actual market value of the shares to less than £2,000, will not meet the requirements of ITEPA S226A and will not therefore attract the £2,000 deemed payment provided for by ITEPA S226B (see below).

When shares are acquired by reason of an employment, the amount which counts as employment income is modified in certain circumstances by two specific provisions. The two provisions are ITEPA S431, in relation to the acquisition of restricted securities (see ERSM30450) and ITEPA S437 in relation to the acquisition

of convertible securities (see ERSM40050). When determining the market value on award of ES shares for the purposes of qualifying for the income tax treatment that goes with ES status, ITEPA S226A(7) stipulates that those two provisions are ignored.

This means that:

- elections to treat restricted securities as if they were not restricted for various tax purposes will not affect the value taken into account to determine whether the shares are worth £2,000 for ES purposes; and
- for the purposes of determining whether convertible securities are worth £2,000 for ES purposes, the value should include conversion rights.

It is important to remember that ITEPA S226A(7) requires that the two provisions (ITEPA S431 and ITEPA S437) are ignored only for the purposes of subsection (1) of ITEPA S226A and not for the rest of that section. So the amount that is to be treated as earnings will be determined taking account of elections under ITEPA S431 and the adjustment to the market value of convertible securities that is provided by ITEPA S437 (see below).

Amount treated as earnings

When ES shares are acquired, ITEPA S226A(2) provides that an amount calculated in accordance with the formula:

$$MV - P$$

is treated as earnings from the employment for the year in which they are acquired.

MV

MV is the market value of the shares determined in accordance with Part 8 of TCGA.

Where ES shares are subject to restrictions the value to be used for ITEPA S226A(3) will be the actual, restricted market value of the shares. Normally, the actual, "restricted" value of the shares, less the payment treated as made under S226B, will be treated as earnings.

However, this treatment is modified in certain situations:

- the exemption from an income tax charge in respect of the acquisition of certain restricted securities, which is provided by ITEPA S425 (see ERSM30370), also applies in respect of ES shares;

- elections that may be made under ITEPA S425(3) and ITEPA S431(1) and (2) will have effect for the purposes of “MV” for ITEPA S226A(3) (by virtue of ITEPA S431(3)(aa)).

Where convertible securities are acquired as ES shares, the value to be used for ITEPA S226A(3) will be the same as the amount that would constitute earnings on the acquisition of convertible securities which were not ES shares (ITEPA S437(1)(a)). So normally, the “MV” for ITEPA S226A(3), will be the market value of the convertible ES shares, determined as if they were not convertible. This is in contrast to the value of convertible shares for the purposes of ITEPA S226A(1), referred to above, where their value for the purposes of determining whether they have the £2,000 minimum value for ES purposes, takes into account the value of their conversion rights.

P

P is the payment of £2,000 that the employee is treated as making for the shares under ITEPA S226B. (As already mentioned, it is a condition of qualifying for ES status that the employee gives no actual consideration other than by entering into the agreement, and, for the purposes of ITEPA, the employee is to be treated as having given no consideration other than this deemed payment of £2,000)

Options

Where ES shares are acquired pursuant to an employment-related securities option ITEPA S226A(2), which provides that an amount is treated as earnings, is disapplied. Instead, the normal rules that apply to shares acquired pursuant to employment-related securities options apply equally for ES shares (ITEPA S226A(4)). (See ERSM110000 et seq)

ES shares are employment-related securities

ES shares are employment-related securities and will be subject to the rules of Part 7 of ITEPA.

For example, if the shares are restricted securities (see ERSM30310) they will be subject to Chapter 2 of Part 7 and the possibility of charges arising on “chargeable events” which might occur at some time after they have been acquired. (See ERSM30300 et seq, and particularly ERSM30390)

Similarly, if ES shares give the employee shareholder the right to convert them into shares of a different description (ie they are convertible - see ERSM40020), then they will be subject to Chapter 3 of Part 7. (See ERSM40010)

It should also be borne in mind that, if ES shares are disposed of for more than their market value, then a charge under Chapter 3D of Part 7 is likely to arise.

Deemed payment for ES shares

ITEPA S226B provides that, subject to various conditions, an employee shareholder is deemed to have made a payment of £2,000 for ES shares. For the purposes of determining the date on which this payment is deemed to have been made, ITEPA S226B(2) applies where all the ES shares are acquired on the same day and ITEPA S226B(3) applies where ES shares are acquired on more than one day.

The payment is deemed to have been made “for the purposes of this Act”, meaning ITEPA, which means that it will have effect in relation to any other ways in which employment income might arise from the acquisition of ES shares, as provided for in ITEPA. Below are examples of how the deemed payment will have effect in relation to ES shares subject to certain conditions.

Restricted securities

The deemed payment will be a “deductible amount” within ITEPA S428(7)(ba) (see ERSM30400), to be taken into account in computing any charge under Chapter 2 of Part 7 of ITEPA.

Convertible securities

The deemed payment will be “ACS” within ITEPA S442 and the treatment of ACS as set out in that section will apply in computing any charge under Chapter 3 of Part 7 of ITEPA. (See ERSM40070)

Securities options

Where ES shares are acquired pursuant to an employment-related securities option, the deemed payment will be consideration given for the shares acquired, to be deducted from the market value of the shares by virtue of ITEPA S479(3) and (3A). (See ERSM110510)

No other consideration treated as given

By virtue of ITEPA S226B(7), the employee is to be treated as having given no consideration other than the deemed payment of £2,000 provided for in ITEPA S226B for the ES shares.

ES shares acquired on the same day

Where all the ES shares are acquired on the same day, a payment of £2,000 is treated as having been made on that day.

ES shares acquired on more than one day

Where ES shares are acquired on more than one day, and shares with a market value of at least £2,000 are acquired on the first of those days, a payment of £2,000 is treated as having been made on that day, for the shares acquired then.

ES shares acquired with a market value of more than £2,000

Where the market value of ES shares acquired on the day that the employee is deemed to have paid for them is more than £2,000, the amount that the employee is treated as having paid for each share is equal to the “appropriate proportion” of the market value of the share.

The appropriate proportion is determined using the formula:

$$\frac{2000}{V}$$

V being the total market value of the ES shares acquired by the employee on that day.

Shares acquired with a market value of less than £2,000

Subsections (2) and (3) of ITEPA S226B mean that a payment of £2,000 will only be deemed to have been made if the employee acquires shares with a value of at least £2,000 on either the only day, or the first day, that shares are acquired in consideration of an employee shareholder agreement. If shares having a market value of less than £2,000 are acquired on the first or only day that shares are acquired in consideration of an employee shareholder agreement, then the payment of £2,000 will not be deemed to have been made.

Deemed payment: associated ES agreements

ITEPA S226C ensures that the deemed payment set out in new section 226B of ITEPA is only available to the employee shareholder on the first occasion on which they acquire ‘qualifying shares’ under an ES agreement. If further ES shares are acquired under another ES agreement with the same company or with an ES agreement with an associated company, no further deemed payment will be available.

Guidance on what is an “associated company” for the ES rules will be in the detailed guidance on the special Capital Gains Tax treatment of ES shares to be available later in 2013.

Deemed payment: employees with a material interest

ITEPA S226D prevents an employee shareholder benefiting from the deemed payment set out in new section 226B of ITEPA where they, or persons connected

with them, have a material interest in their employer or a parent of their employer; or have had such a material interest at any time in the 12 months prior to the acquisition of the employee shareholder shares. Subsections (1) and (2) set out this condition.

Subsections (4) and (5) define a material interest for the purposes of this condition. Subsection (4) provides that an individual has a material interest in a company if at least 25 per cent of the voting rights in that company are exercisable by that individual, by persons connected with that individual, or by the individual and persons connected with them together. Subsection (5) provides that in the case of a close company, an individual has a material interest if, in any circumstances, at least 25 per cent of the net assets of the company would be available for distribution to that individual, persons connected with that individual, or the individual and persons connected with them together.

Further guidance on the definition of “material interest” for the ES rules will be in the detailed guidance on the special Capital Gains Tax treatment of ES shares to be available later in 2013.

Dividend/distribution treatment on buy-back of ES shares

Consideration given to an ex-employee by a company for buy-back of ES shares, gains on which are exempt under the capital gains tax provisions of TCGA S236B to S236D, will not be charged as income under dividend or distribution rules.

Advice relating to proposed employee shareholder agreements

There is an employment income exemption which prevents the employee from being taxed on the independent advice about ES status and the general tax effects of entering into an ES agreement that the employer is required to fund.

Under the terms of the ERA new section 205A, a number of requirements are imposed on a company that offers ES status to either a current or prospective employee. These include the following:

- The employer must provide a written statement of the details of the offer to the prospective employee shareholder (a “statement of particulars”) before it can be accepted. The statement of particulars must set out the particulars of the status of employee shareholder and the rights which attach to the ES shares being offered.
- ES status can only take effect if, following receipt of the statement of particulars of the ES status and the rights that attach to the ES shares, the employee receives relevant advice (not including tax advice) from a relevant

independent adviser as to the terms and effect of the proposed ES agreement.

- Seven days must pass after the employee receives the advice mentioned above before the ES agreement can be entered into.
- A company must meet the reasonable costs of advice on the terms and effect of the proposed ES agreement, whether the cost is incurred by the company itself or by the individual who received the advice.

The matters covered by the advice that the company must fund

The advice that the company must fund relates to the subject matter of the written statement of particulars that is required under ERA S205A(1)(c).

This subsection requires that a company using the ES status must provide prospective employee shareholders with a written statement of particulars of the status of employee shareholder and of the rights that attach to the ES shares. ERA S205A(5) sets out in detail the points that must be covered in the statement of particulars. The written statement must include all the following information:

- the employment rights that an employee shareholder does not have (compared to that of an employee)
- that the employee shareholder must give a minimum of 16 weeks' notice of an early return from maternity, additional paternity, or adoption leave
- whether there are any voting rights attached to the shares
- whether the shares carry any rights to dividends
- whether the shares would, if the company were wound up, confer any rights to participate in the distribution of any surplus assets
- if the company has more than one class of shares, and any voting or dividend rights, explain how those rights differ from the equivalent rights that attach to the shares in the largest class. If the shares offered are already part of the largest class of shares, then the explanation should refer to the next largest class
- whether the shares are redeemable and if they are, at whose option
- whether there are any restrictions on the transferability of the shares and what those restrictions are
- whether any pre-emption rights are excluded in the case of the shares given to the employee shareholder

- are the shares subject to drag-along or tag-along rights, and if they are, explain what that means.

The statement must be provided before the individual becomes an employee shareholder, and is separate from existing requirements for particulars of employment to be provided to employees under the ERA.

ERA S205A(6) provides that an individual must receive advice from a relevant independent adviser as to the terms and effect of the proposed ES agreement before any such agreement can take effect. A company is then required to meet any reasonable costs incurred by the individual in obtaining that advice (whether or not the individual becomes an employee shareholder).

Under normal employment income principles, the employer's funding of this advice would be taxable as employment income. However, ITEPA S326B contains an exemption that prevents any liability to income tax from arising on:

- the provision of relevant advice by a relevant independent adviser, or
- the payment or reimbursement to the employee of any reasonable costs in obtaining relevant advice from a relevant independent adviser.

'Relevant advice' is defined in ITEPA S326B(2) as advice which is provided for the purposes of ERA S205A(6)(a) (i.e. advice as to the terms and effect of ES agreement). Tax advice is specifically excluded from the exemption unless it consists only of an explanation of the tax effects of employee shareholder agreements generally.

So, if the advice from the relevant independent adviser included some factual material, simply explaining the general tax rules relating to ES status, this could qualify for exemption, providing the other conditions were satisfied. But advice describing how an individual might use the tax provisions relating to ES status for tax planning purposes would not qualify for exemption.

'Relevant independent adviser' has the same meaning as in ERA S203(3)(c). So a 'relevant independent adviser' must fall into one of the following categories:

- a qualified lawyer;
- an officer, official, employee or member of an independent trade union who has been certified in writing by the trade union as competent to give advice and as authorised to do so on behalf of the trade union;
- an individual who works at an advice centre (whether as an employee or a volunteer) and has been certified in writing by the centre as competent to give advice and as authorised to do so on behalf of the centre; or

- any person authorised to give legal advice by the Secretary of State. (The Department for Business, Innovation & Skills guidance on about ES status [GOV.uk website](#) explains who has been authorised in this way)

Employee shareholders – Questions and Answers

1. *Do I need HMRC approval before offering or accepting an employee shareholder position?*

No. HMRC approval is not required before you offer or accept an employee shareholder agreement.

2. *Will income tax be chargeable on shares awarded to an employee shareholder?*

Usually, tax is chargeable when an individual receives shares because of their employment. This tax may be chargeable when the shares are received, or later – depending upon the type of shares involved. However, a special tax rule applies for shares awarded under an employee shareholder agreement. Whether or not income tax is chargeable depends upon the value of the shares received by the employee shareholder.

3. *What is the special tax rule for shares awarded to an employee shareholder?*

As long as they meet certain conditions, employee shareholders are treated as if they have paid £2,000 for their employee shareholder shares. This means if an employee shareholder receives £2,000 worth of shares under their employee shareholder agreement, no tax is chargeable at the time of the award. If they get more than £2,000 worth of shares, tax is only chargeable on the value received in excess of £2,000. The precise position depends upon the type of shares received.

This special tax rule applies only to the initial shares received when an individual first becomes an employee shareholder with a company. If the employer awards more shares later to the employee shareholder, tax will be chargeable on those shares in the normal way.

This special tax rule does not apply in certain cases. One example is where the employee shareholder and anyone connected to them have a 'material interest' in the company because they hold 25 per cent or more of the voting rights in that company. Where this is the case, tax is chargeable on the employee shareholder shares in the normal way.

4. *How do I know what share value to use for tax purposes?*

Businesses awarding shares under an employee shareholder agreement may propose a share valuation to HMRC's Share and Assets Valuation team in advance of this award. Where possible, HMRC will agree this valuation for tax purposes, and this agreement will usually be effective for 60 days.

5. *What are the types of shares that might typically be received by an employee shareholder?*

Some of the types of shares that might be received under an employee shareholder agreement are set out below:

- **Unrestricted shares** (see question 6) – These are shares awarded without any ongoing conditions, limitations or requirements that affect their market value. If you hold non-restricted shares, you are usually in the same position as an external investor in the company.
- **Restricted shares** (see question 7) – These are shares awarded with conditions, limitations or requirements attached that reduce their value. For example, you may

not be able to sell your shares for a certain period, or if you leave your company you may not be able to retain your shares - and your employer may buy them back from you.

- **Forfeitable shares** (see question 8) – These are restricted shares awarded on the basis that within five years you may have to forfeit them, and in return will receive less than their market value.

6. *What is the income tax position if there are no restrictions on the shares I receive?*

The general rule is that income tax is chargeable when unrestricted shares are awarded, on their value at that time. However, most employee shareholders will be treated as if they have paid £2,000 for their shares. This means if the unrestricted shares awarded to an employee shareholder are worth £2,000, no tax will usually be due. If the shares are worth, for example, £5,000, tax is usually only chargeable on the excess over £2,000 (i.e. £3,000). There is usually no further income tax to pay on unrestricted shares.

For further details see Example A.

7. *What is the income tax position if the shares restricted, but not forfeitable?*

The general rule is that income tax is chargeable when restricted shares are awarded, on their value at that time. However, most employee shareholders will be treated as if they have paid £2,000 for their shares. This means if the restricted shares awarded to an employee shareholder are worth £2,000, no tax will usually be due when they get the shares. If the shares are worth, for example, £5,000, tax is usually only chargeable on the excess over £2,000 (i.e. £3,000) when the employee shareholder gets the shares.

Tax may be chargeable later, for example when any restrictions fall away from the shares or if they are sold. The tax rules that apply to 'restricted securities', which includes restricted shares, mean that, normally, tax is only chargeable on a proportion of the value of the shares at that time. For further details see Example B.

As an alternative to the above, when the shares are awarded, the employee shareholder and employer may jointly elect to treat the shares as if they were not restricted. In such cases tax is chargeable on the amount the shares would be worth if any restrictions did not apply. Further details are set out below – see question 12.

8. *What is the income tax position if the restricted shares are forfeitable?*

Different rules apply if the restricted shares may be forfeited within five years, and in return the employee shareholder would receive less than the market value of the shares at that time. Generally, no tax is chargeable when these shares are received. However, tax may be chargeable later, for example when the forfeiture condition falls away, or if the shares are sold. Employee shareholders will usually be treated as if they have paid £2,000 for their shares and the tax rules that apply to 'restricted securities' (including forfeitable shares) mean that, normally, tax will only be chargeable on a proportion of the value of the shares at that time. For further details see Example C.

As an alternative to the above, when the shares are awarded, the employee shareholder and employer may jointly elect to treat the shares as if they were not restricted. In such cases tax is chargeable on the amount the shares would be worth if any restrictions did not apply. Further details are set out below – see question 12.

9. Does the income tax charge take into account employment rights given up to be an employee shareholder?

Eligible employee shareholders are treated for tax purposes as having paid £2,000 for their shares. The value of any rights given up in order to become an employee shareholder does not count as an additional payment for these shares. In addition, employee shareholders are not allowed to give any consideration for the shares, other than agreeing to be an employee shareholder.

10. How should any tax chargeable be paid?

This depends upon whether the shares are 'readily convertible assets' for tax purposes. Generally, shares are readily convertible assets if they can be sold or otherwise turned into cash. An example is shares that can be sold on the stock market.

If shares are readily convertible assets, an employer accounts for any income tax due under PAYE. If shares are not readily convertible assets, the employee shareholder pays any tax due through the Self Assessment system.

11. Will National Insurance Contributions be payable on the shares?

Again this depends upon whether the shares are readily convertible assets. If they are, National Insurance Contributions (NICs) are payable through the PAYE system. However, under the special tax rule for employee shareholders, NICs are usually not payable on the first £2,000 of share value received.

12. What is an election (see questions 7 and 8 above)?

If an employee shareholder gets restricted shares (including forfeitable shares), they may jointly elect with their employer to treat the shares as if they were not restricted for tax purposes. This means income tax (and NICs where appropriate) is chargeable on the amount the shares would be worth if any restrictions did not apply. In most cases, this removes the possibility of income tax and NICs charges arising at a later date, for example where restrictions fall away from the shares or if the shares cease to be forfeitable.

The special tax rule treating employee shareholders as if they have paid £2,000 for their shares still applies where an election is made.

13. My employer has promised to award more shares in the future - will this special treatment apply to those shares as well?

An employee shareholder is only treated as having paid £2,000 for the shares they receive at the time they become an employee shareholder. If employer awards more shares later, the employee shareholder will not be treated as having paid anything for those shares. Income tax (and NICs where appropriate) will be chargeable on those shares in the normal way.

14. Is tax due when an employer meets the cost of independent legal advice provided to an employee considering an employee shareholder offer?

No. However this does not apply in relation to any tax advice, other than a general explanation of the tax rules for shares awarded under an employee shareholder agreement.

15. What rate of tax is chargeable on shares received as an employee shareholder?

Any tax due will usually be chargeable at the same rate or rates as earnings of the employee shareholder from their employment.

16. Do companies need to make a report to HMRC of the shares awarded under an employee shareholder agreement?

Employers who have awarded employee shareholder shares should provide details on HMRC Form 42 (Employment-related securities) at the end of the relevant tax year. The form will be amended to include a new section relating to these share awards.

17. Can Treasury shares be awarded under an employee shareholder agreement?

Yes treasury shares can be used and if all of the conditions for employee shareholder status are met, or an agreement satisfies the conditions set out in Department for Business, Innovation & Skills guidance, HMRC do not anticipate challenging an individual's status as an employee shareholder for the purposes of the tax reliefs. The circumstances in which tax relief will not be available to a person who is an employee shareholder are those set out in the tax legislation. One example is where the material interest conditions at sections 226D ITEPA 2003 and 236D TCGA1992 are not satisfied.

18. Will the employee shareholder treatment be denied if the rights given up under an employee shareholder agreement were effectively reinstated as contractual rights in the individual's employment contract?

Contractual reinstatement of certain employment rights would not exclude an employee shareholder from the relevant tax reliefs relating to the shares awarded to an employee shareholder.

Employee Shareholder - Income tax and NICs examples

The following are general examples, and have been simplified for illustrative purposes. The tax treatment in each individual case is determined by its individual facts.

Example A – Shares that are unrestricted

(i) If £2,000 share value is received on becoming an employee shareholder

- In December 2013, Ms James receives £2,000 of unrestricted shares when she becomes an employee shareholder.
- No income tax or NICs are chargeable at that time because she is treated as having paid £2,000 for them.
- Generally, no income tax or NICs will be chargeable on these shares at any later date.

(ii) If more than £2,000 share value is received on becoming an employee shareholder

- In December 2013, Mr Green receives £5,000 of shares that are not restricted or forfeitable when he becomes an employee shareholder.
- Because he is treated as having paid £2,000 for the shares, no income tax or NICs are chargeable on the first £2,000 of value received by Mr Green. Income tax (and NICs where relevant) is therefore only chargeable on share value in excess of £2,000 ($£5,000 - £2,000 = £3,000$).
- Usually, no further income tax or NICs will be chargeable on these shares at any later date.
- If the shares are readily convertible assets, income tax and NICs are accounted for by Mr Green's employer under PAYE. Otherwise, Mr Green should account for income tax on his Self Assessment return for 2013-14.

Example B - Restricted Shares (no election)

(i) If £2,000 share value is received on becoming an employee shareholder

- In **December 2013**, Mr Smith receives £2,000 of restricted shares when he becomes an employee shareholder. The restriction applied to the shares is that they cannot be sold for three years. Without this restriction, the shares would be worth £2,500. This restriction has therefore reduced the value of the shares by 20 per cent.
- When Mr Smith receives his shares in December 2013, no income tax or NICs are chargeable because he is treated as having paid £2,000 for them. As the value of the shares Mr Smith gets is £2,000, this special tax rule covers all of the share value he has received.
- In **December 2016**, the 'no sale' restriction falls away, and the unrestricted value of Mr Smith's shares has grown from £2,500 to £5,000. At that time, tax is chargeable on the 20 per cent proportion of value not taken into account in December 2013, when Mr Smith received his shares.
- Therefore income tax (and NICs where relevant) is chargeable at the appropriate rate on 20 per cent of the £5,000 value of Mr Smith's shares in December 2016 = £1,000.
- If the shares are readily convertible assets, income tax and NICs are accounted for by Mr Smith's employer under PAYE. Otherwise, Mr Smith should account for income tax on his Self Assessment return for 2016-17.

(ii) If more than £2,000 share value is received on becoming an employee shareholder

- In **December 2013**, Ms Jones receives £9,000 of restricted shares when she becomes an employee shareholder. The restriction applied to the shares is that they cannot be sold for one year. Without this restriction, the shares would be worth £10,000. This restriction has therefore reduced the value of the shares by 10 per cent.
- When Ms Jones receives her shares in December 2013, she is treated as having paid £2,000 for them so no income tax or NICs are chargeable on the first £2,000 of value she receives. Income tax (and NICs where relevant) is therefore chargeable on £9,000 - £2,000 = £7,000.
- In **December 2014**, the 'no sale' restriction falls away and the unrestricted value of Ms Jones' shares has grown from £10,000 to £11,000. At that time, tax is chargeable on the 10 per cent proportion of value not taxed or covered by the special tax rule for employee shareholders in December 2013, when Ms Jones received her shares.
- Therefore income tax (and NICs where relevant) is chargeable at the appropriate rate on 10 per cent of the £11,000 value of Ms Jones' shares in December 2014 = £1,100.
- If the shares are readily convertible assets, income tax and NICs are accounted for by Ms Jones' employer under PAYE. Otherwise, Ms Jones should account for income tax on her Self Assessment return for the relevant year.

Example C – Forfeitable Shares (no election)

- In December 2013, Mr Collins receives £4,000 of shares when he becomes an employee shareholder. These shares must be sold back to the company for less than their market value if Mr Collins leaves his employment within five years. Without this restriction, the shares would be worth £8,000.
- When Mr Collins receives his shares in December 2013, no income tax or NICs are chargeable under the normal tax rules for forfeitable shares.
- At that time, Mr Collins is treated as having paid £2,000 for the shares, which is 25 per cent of the £8,000 unrestricted market value of Mr Collins' shares.
- In December 2018, Mr Collins is still with the company and his shares cease to be forfeitable. Their unrestricted value has grown from £8,000 to £10,000. At that time, tax is chargeable on the 75 per cent proportion of value not covered by the £2,000 that Mr Collins is treated as having paid for his shares in December 2013.
- Therefore, income tax (and NICs where appropriate) is chargeable at the appropriate rate on 75 per cent of the £10,000 value of Mr Collins' shares in December 2018 = £7,500.
- If the shares are readily convertible assets, income tax and NICs are accounted for by Mr Collins' employer under PAYE. Otherwise, Mr Collins should account for income tax on his Self Assessment return for 2018-19.