



Capital Gains Tax implications for employee share plans

ifs ProShare is a not for profit organisation that seeks to promote the benefits of employee share ownership. Established by the Treasury, London Stock Exchange and a number of FTSE 100 companies in 1992, we have approximately 100 members.

These include companies such as Lloyds TSB, HSBC, ITV, BT Group, BP, Asda, Marks & Spencer plc and J Sainsbury plc as well as share plan administrators and advisers such as Equiniti, Killik, Linklaters and PWC.

As the collective voice for the employee share plans industry, we are concerned by the potential impact of the Capital Gains Tax (CGT) simplification recently announced by the Chancellor.

Enterprise Management Incentive (EMI) Plans

EMI plans were designed to help small companies attract and retain the people they need and to reward these employees for taking a risk and investing their energy and skills in helping the company achieve its potential. The new regime will disadvantage employees with EMI options as they are currently only subject to CGT a 10% tax liability if they exercise their options two years or more after the date of grant. From April 2008 they will be subject to CGT at 18%.

Share Incentive Plans (SIP)

It is important to acknowledge that the majority of employees participating in their employers' share plans are doing so via a SIP which shields employees from any capital gains. The new CGT arrangements will only have an impact on these employees in very limited circumstances.

Sharesave Save As You Earn Schemes (SAYE)

Approximately 1.7 million UK employees are making monthly savings through a Sharesave Save As You Earn scheme and a significant minority of these could now be subject to an 18% CGT charge from April 2008, regardless of how long they have held shares in their employer. The new rate of 18% applies equally to basic rate and higher rate taxpayers and to business and non-business assets.

Previously, higher rate taxpayers who held their shares for at least 2 years would have been subject to 10% CGT (the change means such shareholders will now be 8% worse off.) Basic rate taxpayers who held their shares for at least 2 years would have been subject to 5% CGT (the change means such shareholders will now be 13% worse off).

So, employees who have contributed to the success of their employer are now going to be worse off than under existing legislation whilst non-employee shareholders who have not done so are to have their CGT liabilities substantially reduced (from 40% to 18%).

The new flat rate of CGT at 18% could discourage employees from holding on to their shares as the abolition of taper relief may make doing so less attractive.

There are numerous examples of employees saving modest sums over 3, 5 and 7 year periods who have had gains in excess of the £9,200 CGT threshold and more are set to do so in the future.

Also of significance is the fact that many employees use SAYE schemes as a long term savings mechanism i.e. when their 3, 5 or 7 year plan matures, they commence another 3, 5 or 7 year plan. Under the new CGT regime, long standing employees who have committed to saving for the long term could be considerably worse off.

Whilst the Treasury may have sound reasons for simplifying CGT, it would appear the consequences for employees saving through employee share plans contradict Government's oft stated commitment to encouraging long term saving/investment and to their support for wider share ownership.

SOLUTIONS

1) A CGT exemption for employees who participate in SAYE schemes. This would demonstrate Government commitment to all employee share plans, the importance of employees saving regular amounts and taking a stake in the company that they work for.

HMRC have stated that they believe the impact of CGT changes on SAYE would be negligible, believing few employees will be affected. We have consistently stated that these changes will not affect the majority of workers participating in an all-employee share ownership scheme but that these changes will affect a significant minority. As the industry and Government are agreed that we are not talking about the majority of participants, exempting SAYE participants from CGT should not adversely affect tax receipts.

2) Alternatively, if HMRC accepts the fact that a significant minority of SAYE participants will be negatively affected by the proposed changes to CGT then the maintenance of taper relief for SAYE schemes must be a priority. Otherwise, Government is sending out a message that medium and long term investments are not to be encouraged.

3) There are other possible solutions, for example an exemption for shares purchased through a SAYE scheme and then held for a longer period (e.g. five years) an increase in the ISA allowance solely for these types of shares (at present employees have 90 days from the date of exercising their SAYE options in which to put their shares in an isa up to the existing isa limit of £7,000, thus avoiding CGT).

However, we believe the simplest and most effective solution would be a complete exemption for SAYE or for the maintenance of taper relief.

Should Government refuse to accept any of the above solutions then *ifs ProShare* believe it is imperative that a grandfathering arrangement be introduced. This would enable existing participants in SAYE schemes to continue to benefit from taper relief at the current rates for a specified period of time e.g. 10 years.