ifs ProShare 2012 Budget Submission

October 2011

ifs ProShare

ifs *ProShare* is a member led, not-for-profit organisation that acts as the voice of the employee share ownership industry in the UK.

Established by the Treasury, London Stock Exchange and a number of FTSE 100 companies in 1992, ***ifs*** *ProShare* has approximately 100 members. These include a wide range of Small and Medium Enterprises as well as larger companies such as BP, BT, HSBC and Marks & Spencer. Our membership also consists of share plan administrators and advisers including Capita, Computershare, Equiniti, Killik Employee Services, Linklaters and PWC.

Benefits of employee share ownership

A wealth of British and international evidence demonstrates that employee share ownership can lead to higher productivity and financial performance, greater innovation, lower staff turnover and improved employee advocacy; all of which benefits the employer and the wider economy.

Over the last thirty years employee share plans in the UK have also proved to be a very useful, simple and tax efficient savings and share acquisition mechanism for employees on a wide range of incomes thus encouraging medium and long term saving, benefitting millions of individual workers and serving as a useful means of raising the Britain's overall savings ratio.

Recommendations

During Prime Ministers Questions on 18 May 2011 the Prime Minister said, *"I personally strongly support the idea of widening share ownership."* Naturally ***ifs*** *ProShare* welcome this unambiguous statement of support.

Employee share ownership is perhaps the best means by which greater levels of individual share ownership can be achieved, as has been proven by their successful operation over the past 30 years. During this time millions of workers on a variety of incomes have acquired and retained shares.

According to the latest ***ifs*** *ProShare* Annual Survey (2010) there are approximately one million employees participating in a Save As You Earn (SAYE) plan and a similar number participating in a Share Incentive Plan (SIP). Whilst these numbers are impressive, they are not as high as they once were.

ifs *ProShare* and our members would therefore like to see fresh impetus given to the concept of employee share ownership. We believe there are three clear means by which employee share ownership and therefore wider share ownership in general could be reinvigorated.

1) Increasing the amount of money that can be invested in HMRC approved share plans
2) Permitting Private Equity Backed companies to offer all-employee share plans
3) Reducing the minimum holding period for the Share Incentive Plan (SIP)

ifs *ProShare* has also detailed a number of suggested improvements that could be made to the general operation of employee share plans in the UK. These additional recommendations are listed at the end of this submission.

Finally, ***ifs*** *ProShare* welcomes the decision of the Exchequer Secretary to ask the Office for Tax Simplification (OTS) to review the four HMRC approved share plans as well as to look at the complexity around unapproved share plans.

The OTS' work will be informed by consultation with interested parties including forming and working with a consultative committee. Given the wealth of industry expertise that ***ifs*** *ProShare* and our membership can offer, we were naturally pleased to be invited to be represented on this consultative committee and look forward to playing an active role in assisting the OTS in examining simplification measures for employee share plans.

Increasing SAYE & SIP savings limits

As the Government already knows, SAYE and SIP all-employee share plans are a relatively simple but effective method of saving and investing. Employees gain a stake in the company they work for and the opportunity to share in the financial successes of their employer.

At the same time, with regard to SAYE plans, employees also have the reassurance of being able to opt for the return of their cash plus a tax free bonus at the end of the savings plan term if they decide not to purchase shares in the company they work for.

All-employee share plans not only offer clear benefits to UK employees, the employer also gains from increased employee productivity and employee retention as well as enjoying better financial performance than companies that do not offer an employee share plan.

Successive Governments have recognised the above benefits and have encouraged employee share ownership through the provision of SAYE, SIP and other HMRC approved share plans.

However, successive Governments have failed to increase the maximum monthly savings limits for SAYE plans which means employees are currently allowed to invest no more than £250 a month; **this maximum limit has not been increased since 1991**. Had the figure risen in line with inflation (RPI) for each of the following 20 years, the maximum monthly contribution would stand at more than £440 today (September 2011).

ISA savings limits are now increased in line with inflation year on year. This precedent makes the restrictions on the million plus SAYE employee shareholders appear even more unfair, unjust and discriminatory. Furthermore, increasing the monthly maximum savings limit is likely to cost less than £25m per annum in tax and NI relief, compared to the tens of billions in ISA and pensions tax relief.

Similarly, **SIP maximum savings limits of £1,500 per annum have not been increased since 2000**. Had they also risen in line with inflation they would stand at more than £2,000 today (September 2011).

The current limits are out of date and prevent many hard working employees from saving as much as they would like to – there are indications that almost a quarter of all SAYE savers (23%) are saving the maximum £250 a month. An increase for these workers is long overdue.

Recommendation 1

ifs *ProShare* strongly recommends that the Coalition Government should increase the monthly limit for SAYE plans to £450 and to £2,000 per annum for SIPs as soon as possible. Furthermore there should be a clear commitment to annual increases in line with inflation for all HMRC approved employee share plans to avoid future periods of prolonged erosion in value.

Private Equity backed companies

Private equity backed companies should qualify for tax-approved all-employee share plans and statutory corporation tax relief (SCT relief) for share plans to end the exclusion of millions of workers from participating in employee share plans.

Where private equity funds invest in a company, this usually results in more than 50% of the share capital being held by one, or more often, a series of limited partnerships (LPs) (each fund being structured as an LP). The LPs typically hold their shares through a corporate general partner, which may be the same entity for the various LPs that invest in a particular company (or where there are different general partners, each fund may appoint the same fund manager to represent all of the LPs investing in an investee company).

This means that the investee company normally fails the "control test" in the approved share plan legislation (**SAYE and SIP legislation provides that the company whose shares are being used in the plan must not be under the control of any company, unless that company is listed**).

When this legislation was initiated in the late 1970's it was felt that if a company was neither listed nor the subsidiary of a listed company there would be scope for manipulation of the share price – either in favour of or to the detriment of employees. This was understandable but thirty years later we should now recognise that the legislation for share plans has developed considerably, with safeguards against artificial increases and decreases in share values – mainly aimed at preventing tax avoidance where shares in private companies are involved. We should also recognise the tremendous growth of private equity since then.

It is perfectly reasonable – ***ifs*** *ProShare* would argue it is essential - for strict safeguards to prevent share price manipulation. This should be relatively easy to achieve and should not be considered a significant barrier to the successful operation of approved all-employee plans at private equity backed companies.

Many private equity-owned companies used to operate approved share plans before they were acquired by new private equity owners, for example house builder Crest Nicholson and retailers Debenhams and Boots. Such change of ownership makes tax-approved plans unavailable resulting in an immediate and acutely felt loss to these employees.

There are also companies which have always been backed by private equity who, by virtue of their ownership model, have never had the opportunity to allow their staff to share in their success through employee share ownership.

Private equity backed companies are forming an increasingly important part of the UK economy. The UK industry is the largest and most developed in Europe, accounting for almost 60% of the total annual private equity investment, and second only to the US in terms of global importance.

According to a 2007 report from the British Venture Capital & Private Equity Association, companies that have received private equity funding account for the employment of around 3 million people in the UK, equivalent to some 16% of the UK private sector workforce.

Without legislative changes, millions of employees are being prevented access to HMRC approved all-employee share plans. To put this into perspective, consider the example of Travelodge. This company was acquired by global private equity firm Permira in 2003 for £712m. Having sold over £500m of group assets including the loss making Little Chef chain, the business was then sold for £675m in 2006.

BBC journalist Robert Peston conservatively estimated that a handful of senior Permira partners will have shared profits of £100m as a result of their activities over this three year period.

In contrast, during this same period the cleaning staff at Travelodge reduced the amount of time it took to clean a room from 40 to 20 minutes, saving the company millions of pounds per annum. This 50% improvement in productivity was probably rewarded with little or no financial rewards. If a SAYE share plan had been available to all-employees then the cleaners, as well as those at the top of the company, would have had the opportunity to financially share in their jointly achieved success.

It is also worth noting that in 2009 over a third of SAYE participants earned less than £21,000 a year (source: HMRC) thus demonstrating that many on lower incomes at private equity backed companies would benefit from the availability of share plans.

Recommendation 2

To amend the relevant HMRC approved all-employee share plans legislation so that Private Equity backed companies are not disadvantaged and that employees are no longer excluded from the opportunity to participate in all-employee share plans simply because of the ownership structure of their employer.

Share Incentive Plan (SIP): tax free withdrawals

The five year period that employees must wait before they can remove their shares tax and NI free from a SIP acts as a disincentive to saving in such a plan. Other HMRC approved plans offer these benefits after a minimum holding period of three years.

Many employees, particularly those who have not participated in a scheme before, choose to participate for the shortest length of time. This is demonstrated by the fact that well over 60% of Save As You Earn (SAYE) share plan participants are enrolled in a three year plan, compared to approximately 35% for five year plans and only 0.9% for seven year plans.

However, this does not mean that employees only save for a three year period. Many employees go on to participate in another share plan at the end of the three year period as they will have experienced the benefits of participation and have adopted the savings habit. Indeed some employees will repeat the process over and over again.

Reducing the period employees can withdraw shares tax free to three years should therefore result in increasing numbers of employees purchasing shares through a SIP not just in the short term but in the medium to long term too.

Given the increasingly mobile employment trends of the UK workforce a reduction in this period would also better reflect the needs of the labour market in the UK today. As recently confirmed during parliamentary debates around the Pensions Bill (July 2011) the median number of jobs in the UK is 11; more than 25% of employees will change jobs between 11 and 15 times in their working life and 15% of the workforce will have 16 jobs or more. This trend in increasing job changes is likely to continue to increase in future years, making the anomaly of a 5 year period for SIP, even more difficult for the Government to justify.

An ***ifs*** *ProShare* survey found that 93% of companies offering a SIP believe the 5 year period is too long. The same survey also revealed that 35% of companies who do not currently offer a SIP (but do offer another form of employee share plan) would offer a SIP if the period was reduced to three years.

Recommendation 3

ifs *ProShare* believes that reducing this period to three years is likely to increase the number of companies operating SIPs, to greater participation by employees in SIPs and would end the anomaly of SIP not being in line with the other HRMC approved plans. We therefore suggest the minimum period be reduced to three years as soon as is practicable.

Additional improvements

Default Retirement Age

The abolition of the Default Retirement Age (DRA) for employment purposes had some potentially negative implications for SAYE plan participants because it has become less clear whether there is any date on which an employee is contractually bound to retire.

ifs *ProShare* has worked closely with HMRC to find a workable solution to these issues. We are grateful to HMRC for the pragmatic approach they have taken which, following input from our members, has led to an “administrative solution”.

However, whilst draft guidance has now been issued, for the purposes of clarity and certainty there remains a longer term need for amending the relevant legislation so that the wording more closely reflects what is actually happening and indeed there is consistency with the SIP on the retirement provisions.

Recommendation 4

Amend the relevant legislation when the next “tidying up” exercise for share plans legislation takes place – for which ***ifs*** *ProShare* would be willing to assist in the drafting.

Real Time Information (RTI)

The new late payment penalty regime for late paid PAYE has created potentially negative consequences for what could be considered an ongoing historical problem with the timing of the PAYE obligation for certain transactions involving securities.

In relation to employee share plans the employee is ordinarily the originator of the tax crystallisation and in most instances there are third party administrators between the employee and payroll – another complicating factor. For SIP "bad leavers" the employee also has 30 days from leaving to pay over or settle the PAYE. In practice this is 30 days from when the company advises the administrator that the employee has left which inevitably is dealt with on a monthly update cycle. This means it could be more than two months before there is even awareness that tax needs to be collected.

As part of the RTI project, HMRC has already committed to reviewing the timing and nature of the obligations to pay PAYE on share-based remuneration.

Recommendation 5

ifs *ProShare* would welcome confirmation of the timings of this review, the opportunity to participate in any such review and for the Government to ensure that serious consideration is given to accommodating the unique needs of dealing with HMRC approved employee share plans in relation to payment of PAYE.

The European Commission

In April 2011 the European Commission launched a Green Paper on Corporate Governance. This consultation made reference to employee share ownership as follows:

"Employees' interest in the long-term sustainability of the company for which they work is an element that a corporate governance framework should take into account. Employees' involvement in the affairs of a company may take the form of information, consultation and participation in the board. But it can also relate to forms of financial involvement, particularly to employees becoming shareholders. Employee share ownership has a long tradition in some European countries. Such schemes are mainly considered as means to increase the commitment and motivation of workers, raise productivity and reduce social tension. But employee share ownership also involves risks from lack of diversification: if the company fails, employee shareholders may lose both their job and their savings. However, employees as investors could play an important role to increase the proportion of long-term-oriented shareholders."

http://ec.europa.eu/internal_market/company/docs/modern/com2011-164_en.pdf#page=2

As part of our submission to this consultation, ***ifs*** *ProShare* made clear that the implementation of employee share plans already involves companies in considerable expense and administrative burdens and that the Commission should avoid adding extra burdens and regulatory complexity.

The consultation is now closed and the Commission is examining all responses before issuing a feedback statement in the autumn.

Depending on the results, a decision will then be made whether legislative proposals are necessary.

Recommendation 6

The British Government should proactively defend the interests of the millions of employee shareholders in the UK - and the companies that offer their employees the opportunity to share in their financial success - by ensuring no new rules impacting upon the successful operation of share plans in the UK are introduced. It would also be counter productive for the OTS on one hand to be proposing simplification measures whilst on the other hand new layers of complexity are then proposed by Brussels.

Further information

Further information about employee share ownership can be found at www.ifsproshare.org Alternatively, if you have any queries or require any further information about the above Budget Submission please do not hesitate to contact Phil Hall (Adviser to ***ifs*** *ProShare*) at:

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