

European Commission and Intercentar Conference, Brussels

Taking Action: Promotion of Employee Share Ownership

Debating concrete policy options in the context of the EC Action Plan on Corporate Governance

Panel 1 – Impulses for EFP

Talk by Graeme Nuttall

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Notes:

These are the background notes from which Graeme Nuttall's talk was delivered. Please check against delivery for final version of talk – see [Internal Market and Services DG video of conference](#).

Most Nuttall Review materials may be found in the [Nuttall Review of Employee Ownership – quick guide to source materials](#) tax blog materials.

Please refer to <http://taxdeductionsblog.ffw.com/category/employee-ownership> and <https://twitter.com/nuttallreview> for Nuttall Review updates

Employee Ownership as a distinct policy area

Thank you for this opportunity to speak at a European Commission Conference on employee financial participation (EFP) and employee ownership (EO) and participation.

The potential in March 2012

When I spoke at the public hearing on EFP and EO in the European Parliament on 22 March 2012, I explained how the UK Government had taken a serious interest in EO and I talked of the potential for change in the UK.

The hope was that EO would become a distinct policy area for the UK Government, which would be promoted throughout the *private sector* and not just in relation to *transforming public services*.

The signs were promising. I had been appointed as the Government's first independent adviser on EO and in the 2012 UK Budget, the Chancellor of the Exchequer had announced that HM Treasury would carry out an *internal review* of UK tax law to see what might be done to promote EO.

The meaning of EO

In March 2012 I explained what I meant, and what I did not mean, by EO. I was encouraged at the response to my vision of EO and to discover that it had support from around Europe.

EO policy is not just about EFP

For too long the debate around equity incentives has focused on incentives for senior or key executives and it has not involved "all employees".

Even when all employee share plans are considered the emphasis has very much been on financial participation or providing tax effective pay to staff.

And the focus has often been on share plans in listed companies, or perhaps in technology start-ups. .

EFP of this sort clearly has its place and is to be encouraged. If any European country does not yet have the necessary legal and tax framework to support EFP then it must put that framework in place. In the UK we have had a full range of tax advantaged share and share option plans for discretionary and all employee share plans for many years, with the first of the modern plan put in place in 1978. The UK has had a programme of updating this legislation through the work of the Office of Tax Simplification.

The debate has not been on a wider basis, so as to include all types of private companies, and how EO can work, in particular, as a succession solution, or about the "collective" ownership of shares on behalf of employees.

EO policy is not just about employee engagement

The employee engagement agenda has not been joined up with the employee share ownership agenda. Companies can have good employee engagement without any employee share ownership. But I believe that organisational structures are needed to underpin and sustain good employee engagement.

Co-operatives

The UK has a legal framework for workers' co-operatives. But this has been seen very much as something separate, and only of interest to those that support the international co-operative principles, and not linked to EFP.

EO is a distinctive business model

There is a different perspective. And for some companies this is life changing; both for the business and its employees. It is important that policy in this area also covers EO.

My definition of EO goes beyond the conventional business model and conventional attitudes to EFP and employee engagement. EO is about taking a conventional company with a board of directors, chosen because of their skill set, and changing how it is traditionally owned, so that:

- all employees have an ownership stake in the employing company not just senior executives or key individuals; and
- the employees' stake is significant and meaningful:
 - it must underpin organisational structures that promote employee engagement in the company, and
 - provide financial participation (if this is what the employees want¹).

Or, as Deputy Prime Minister, Nick Clegg explained succinctly "it is about a significant number of employees owning a big chunk of the company".

¹ In public service mutuals employees may agree to reinvest profits in improving services rather than in receiving bonuses.

For many companies the aim is for employees to either directly or indirectly have a controlling stake.

Political support for EO in the UK has materialised

My optimism was well-founded. In July 2012 my review of employee ownership was published and well received at the Deputy Prime Minister's Summit on EO. On 30 October 2012, the Government accepted wholly or in part all 28 recommendations in the Nuttall Review. Jo Swinson, Minister for Employment Relations and Consumer Affairs, has chaired an implementation group to work through these EO recommendations. HM Treasury followed up on its internal tax review with a public consultation on new tax exemptions to promote EO.

EO is now a policy area in its own right

Over the last two years there has been tremendous support from many UK Government Ministers for EO, from across the Coalition Government.

- Already this year, Francis Maude, Minister for the Cabinet Office, has continued to promote what we call "public service mutualisations".

[A fund has been launched, called Delivering Differently, to help local authorities develop and implement new models of delivering services. Francis Maude explained that:

"We know that by letting front-line staff leave the bureaucratic state hierarchy behind and take ownership of their services, greater efficiency and success can be achieved. That's why thousands of public servants across the country are taking control of their services and developing innovative delivery models, such as mutuals".

This measure is in addition to the many measures already in place to promote public service mutuals, such as the Mutuals Information Service.]

- Health Minister, Norman Lamb has continued to show his support by including EO within the remit of the Ham Review into improving employee engagement in the National Health Service.
- Danny Alexander, Chief Secretary to the Treasury, spoke to the UK EO sector at a Cass Business School symposium in London this month to confirm support for EO.

"... Many traditionally structured companies go to inordinate lengths to try and engender a sense of 'ownership' in their staff.

They try and 'train' it into their staff...

But you, in your organisations don't need to create a sense of 'ownership'.

You have the real thing!"

Action has been taken

The Nuttall Review set an agenda for promoting EO in the UK. The One Year On Report published in November 2012 found that significant progress has been made on more than half of the Review's 28 recommendations.

The Review identified three main obstacles to getting more EO in the UK. Progress has been made in tackling all of these:

- there is greater awareness of the concept,
- there are more resources to implement EO, and
- the implementation of EO has been simplified.

[Ministerial support and the contributions of officials from the Department for Business, Innovation & Skills (BIS), the Cabinet Office, HM Treasury and HM Revenue & Customs have all helped implement this agenda and this has made a difference.]

There are tangible non-regulatory changes.

- *There is a series of official reports that create a body of information, ideas and decisions that should ensure a continued, co-ordinated approach to EO.*

[In addition to the Nuttall Review, the formal response by the Government and the One Year On Report, there have been consultation documents, responses to consultation documents and related speeches and Press Releases.]

- *There is official guidance.* There are guidance materials endorsed by or produced by the UK Government on EO and available on Government websites.

[There is, for example, for the first time, a guide for *employees* who wish to talk to their manager about a move to EO published jointly by BIS and the Advisory, Conciliation and Arbitration Service (ACAS). There are dedicated web pages on the gov.uk website, the ACAS website and the UK tax authority's website which direct the public to tax and other guidance on EO. There are links from these Government websites to guidance produced by sector bodies such as the Employee Ownership Association and Co-Ops UK and research produced by CASS Business School and others.]

- *There are precedent documents* for companies that wish to introduce EO. These are available from the BIS website with accompanying tax and other guidance materials.
- In addition to publications we also have *additional events for the EO sector calendar*. We now have EO Day in the UK, held for the first time on 4 July 2013, the anniversary of the publication of the Nuttall Review. This was promoted by BIS, with Government Ministers visiting employee owned companies and speaking at EO Day events. We also now have the Robert Oakshott Memorial Lecture, in memory

of Robert Oakeshott, who was responsible for laying the foundations for all that is now happening in the UK to promote EO. The inaugural lecture was delivered by the UK Deputy Prime Minister, Nick Clegg.

- The *EO sector bodies* are all stronger as a result of this increased interest in EO. They have more members and a stronger, more confident, voice.
- The political support for EO and the BIS led implementation group has also helped bring together a wider group of stakeholders, including professional associations. This is very important.

[The Nuttall Review was launched at the London headquarters of the Institute of Chartered Accountants of England & Wales. The Government's formal response to the Nuttall Review took place at the London Stock Exchange. The Robert Oakeshott Lecture took place at the London headquarters of the Law Society. The One Year On Report was hosted by the City of London Corporation. The UK Employee Ownership Index has been checked out by FTSE and new versions launched, with the support of the London Stock Exchange Group which are calculated by FTSE.]

There is definitely a momentum in favour of EO.

But there is a long way to go. UK audiences are still hearing about EO for the first time.

We have to move away from companies introducing EO in the UK because of serendipity or because they have invented it from scratch. We have to get to a position where EO is as well known a concept as establishing a charity or franchising or a management buyout.

[Until the last few months most companies with EO introduced it because a manager or owner once worked for the UK's flagship employee-owned company, the John Lewis

Partnership, or otherwise met someone from the EO sector; others have built the idea from scratch.]

We are fortunate in the UK that the legal system supports a diverse range of forms of EO.

The three basic types of EO are all supported:

- **The employee benefit trust model** - where the employees' stake is held collectively on their behalf by the Trustee of an employee trust.

[Take for example Arrowfield Veterinary Practice Limited which is a vets practice now owned wholly by an employee trust. The business was run by an individual who agreed to sell it to a newly established company wholly owned by an employee trust. This is an example of employee ownership working well as a succession solution.]

- **a combination of ownership of a collective nature through an EBT and also direct employee ownership**

[This is the model adopted by Wilkin & Sons Limited - here employee ownership takes on a combination of ownership of a collective nature through an EBT and also direct employee ownership by employees through one of the UK's tax advantaged share plans – the share incentive plan.]

- **Employee ownership may also consist wholly of direct employee ownership.**

[This is what we see at City Healthcare Partnership CIC. The opportunity is there for each employee to own a share in their company directly without any trust involvement.]

If EO is to enter the mainstream of the UK economy it is important that we maintain this vitality. *There is currently an emphasis on the employee trust model because that is the one that has been overlooked*

by policymakers. We have had decades of UK Government support for direct EFP. The current UK Government is the first to support collective EO.

In order to maintain the momentum in the UK action is needed from throughout the EO sector and from the new broader group of supporters as well as the Government.

BIS has agreed to check progress on implementing employee ownership in the UK by reference to a check list set out in the One Year On Report.

I believe this same checklist can help other countries work out how well they are promoting EO.

- Is the meaning of employee ownership sufficiently clear?
- Does the expertise and experience exist among professional advisers and more generally across the business community to support employee ownership?
- Are the benefits of employee ownership understood and are they demonstrated by success stories, backed up by research?
- Are there practical tool kits in use to implement every form of employee ownership?
- Do we have the necessary champions of employee ownership?
- Is there an ambitious target against which we are measuring success?
- Is there Government support for employee ownership backed up by incentives and a commitment to remove obstacles?

EO in listed companies

In 2014 one aspect of employee ownership where I would like to see progress is in relation to promoting EO in listed companies.

The re-launched UK employee ownership index looks at listed companies with 3 per cent or more employee ownership. This is ownership by or on behalf of employees *excluding main board directors*. The total return of shareholders in "ESOP" companies like this rose by **53 per cent** in 2013 compared with **21 per cent** for the FTSE All Share Index. It is unlikely in UK listed companies that at the 3 per cent level employee engagement will be underpinned by structural measures but clearly something better is happening in companies with this level of employee share ownership.

I would like to see more publicity for ideas to enhance employee engagement in listed companies through the use of all employee share schemes.

10% Index

You will be interested to know that the 10% Index has also been re-launched. It is also now calculated by FTSE on a total return basis. The 10% Index performed even better in 2013 than the 3% version. The total return from listed companies with 10% or more "Employee Ownership" was 65% compared to the 21% for the FTSE All Share Index, and 53% for the 3% version.

In relation to the last point in my checklist, is the UK Government tackling obstacles, the answer is currently, a clear yes.

I have described the non-regulatory changes. There are also significant regulatory changes.

Last year the UK Government changed company law. These changes helped direct employee ownership, by making it easier for a company itself to buy shares from employees who leave and cancel them, or hold them in treasury. Instead of establishing an employee trust as a market maker, which adds to the complication and cost, it may be that a company can operate its direct share ownership model better by the purchase of its own shares using these relaxations in company law.

The Government has also set us homework with answers needed by 4 February and 19 February 2014 in relation to other changes.

- **There is a consultation on abolishing the perpetuity period for employee trusts.**

Under English law newly established employee trusts can only last for a maximum of 125 years. So when a client asks me to establish a trust forever to own shares in a trading company I have to say is 125 years good enough? An English charity can exist forever, a trading company can exist forever, a pension scheme can exist for ever, why not an employee trust? There has been a lot of concern that the business community is only interested in the short term, well here is an opportunity to make a very long term difference. We need legal forms that are fit for purpose. I hope the UK Government will agree to make this change.

- BIS is also asking, again, are there any other non-tax regulatory changes that would help simplify employee ownership?

The indications are that the EO sector does not believe it is unfairly disadvantaged by existing law and regulations. But if there are ideas that have been missed, then BIS wants to hear them.

- *Finally, there is a consultation on the new tax exemptions that apply from the next tax year.*

As a result of the findings of the Nuttall Review the Government has introduced a capital gains tax exemption and an income tax exemption that could be key in maintaining the EO momentum in the UK.

- The capital gains tax exemption will apply when a controlling interest is transferred to what is called an employee ownership trust. The CGT exemption will be available from April 2014 and is unlimited. This promotes EO as a succession solution.
- The income tax exemption is for certain cash bonuses paid to employees by a company that is controlled by an employee ownership trust. From October 2014, bonus payments made to employees of companies which are controlled by an employee ownership trust will be exempt from income tax up to a cap of £3,600 per tax year. This promotes the trust ownership model.

My hope is that the framework for obtaining these tax reliefs will be commercially acceptable, to the point of setting a new benchmark for the design of employee trusts going forward. In other words companies will establish employee ownership trusts of this sort because this is what is right for them commercially, as an employee ownership solution, not because they want to get the tax breaks.

Thank you again for the opportunity to explain how EO is very different from EFP and how it enhances the employee engagement agenda and should be part of the range of measures available to companies.

I trust that what has been achieved over the last two years in the UK can help inform and direct the wider debate on the role of employee ownership, and more widely EFP, throughout Europe as a means to promote better business outcomes and happier employees, at a corporate level, and healthier more sustainable economic prosperity, at a national level,.

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Employee Ownership as a UK Government policy area

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The nut and bolt has innumerable uses in countless industries, providing fundamental structure and strength. It's amazing how just one simple connection can be the basis for a successful relationship.

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“Taking Action” Conference
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Employee ownership is different from employee financial participation

Key points are that:

- *all employees* should have a stake in the employing company, not just senior executives
- employee ownership is *not just about financial participation*
- it is *not just about delivering tax effective pay* even if that is to all staff
- employee ownership is about enhancing life as an employee:
“the employees' stake must underpin organisational structures that promote employee engagement in the company”

The diversity of UK employee ownership

The basic types of employee ownership

Through an employee benefit trust (“EBT”)

e.g. Arrowfield Veterinary Practice Limited



Through a combination of EBT and direct employee ownership

e.g. Wilkin & Sons Ltd (Tiptree Jams)



Through direct employee ownership

e.g. City Health Care Partnership CIC



EO health check: The Nuttall Review One Year On Report

Health check: how well can these questions be answered?

- Is the meaning of employee ownership sufficiently clear?
- Does the expertise and experience exist among professional advisers and more generally across the business community to support employee ownership?
- Are the benefits of employee ownership understood and are they demonstrated by success stories, backed up by research?
- Are there practical tool kits in use to implement every form of employee ownership?
- Do we have the necessary champions of employee ownership?
- Is there an ambitious target against which we are measuring success?
- Is there Government support for employee ownership backed up by incentives and a commitment to remove obstacles?

Regulatory changes made and planned

These include:

- Company law changes - UK Companies Act 2006 (Amendment of Part 18) Regulations 2013 (SI 2013 999) changes to share buy back and treasury shares rules from 30 April 2013
- New tax exemptions for “indirect” employee owned companies from April and October 2014
- Perpetual employee trusts?
- Other simplification measures?



Thank you

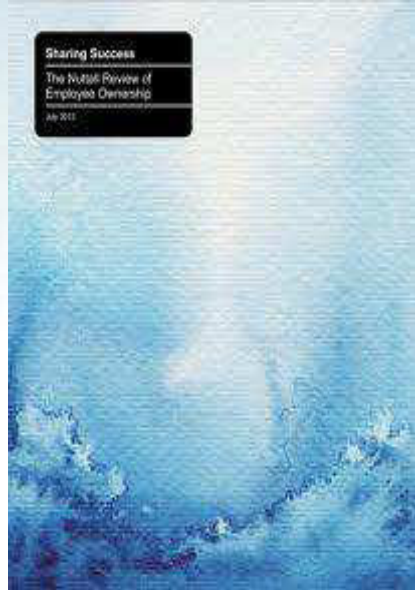
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Further reading

Further reading at:

- HM Revenue & Customs home page for EO:
<http://www.hmrc.gov.uk/shareschemes/ee-ownership.htm>
- BIS home page for EO:
<https://www.gov.uk/government/policies/making-companies-more-accountable-to-shareholders-and-the-public/supporting-pages/making-employee-ownership-more-accessible>
- “Moving to employee ownership: a brief guide for *employees*” (BIS/ACAS)
- “Employee ownership advantage: benefits and consequences” (BIS/CASS)
- “Employee Ownership: How To Get Started” (EOA)
<http://employeeownership.co.uk/publications/new-publication-employee-ownership-how-to-get-started/>

Further reading, continued

- Amending the rule against perpetuities and further reducing the complexity of employee ownership: call for evidence (BIS)
<https://www.gov.uk/government/consultations/amending-the-perpetuities-rule-and-simplifying-employee-ownership>
- Finance Bill Consultation Draft (Companies owned by employee-ownership trusts) <https://www.gov.uk/government/publications/finance-bill-2014-draft-legislation-overview-documents> and <https://www.gov.uk/government/consultations/supporting-the-employee-ownership-sector>
- “Death, taxes and everything – employee ownership in 2014” and other articles at <http://taxdeductionsblog.ffw.com/category/employee-ownership>
- “Employee Ownership: One Year On” article
<http://www.ffw.com/publications/all/articles/employee-ownership-one-year.aspx>

Also, see the UK Employee Ownership Index (10% and 3% versions)

More Nuttall Review materials available from:

<http://taxdeductionsblog.ffw.com/2014/nuttall-review-of-employee-ownership-quick-guide-to-source-materials>