s.431(1) Election

About this document

* This is an irrevocable one-part joint election intended to be entered into between a director or employee and his company when he is issued shares by his company, including founder shares acquired on incorporation of a start-up.
* The election is made under Chapter 2 of the Income Tax (Earnings and Pensions) Act 2003, which deals with the taxation of employment-related securities and imposes income tax on any untaxed value of restricted securities when the restrictions are lifted or the securities are sold.
* Shares in private companies are often restricted securities because the company’s articles of association will typically include restrictions on the transfer of shares, such as pre-emption provisions, and/or compulsory transfer provisions in the event that the employee or director leaves the company.
* The income tax charge imposed when the restrictions are lifted or (more likely) when the shares are sold is broadly based on a percentage of the market value at the time of sale. The relevant percentage is the difference between the restricted market value of the shares (i.e. the value taking account of the restrictions) and the unrestricted market value (i.e. ignoring all such restrictions) when the shares are acquired. The percentage of the sale proceeds that represents the difference between the actual market value and the unrestricted market value is taxed as income, potentially subject to PAYE and NICs. The balance is subject to capital gains tax.
* The election allows the employee or director to opt-out of the restricted securities regime, such that no income tax charge arises under the relevant provisions of the Income Tax (Earnings and Pensions) Act 2003 when the shares are sold (or the restrictions are lifted). Instead, the employee or director elects to pay income tax on the unrestricted market value of the shares when they are acquired. However, provided the price paid on acquisition of the shares is equal to or more than that unrestricted market value, no income tax will arise on the acquisition of the shares.
* These types of elections are very common when founders subscribe for shares in a spin-out or start-up company as the unrestricted market value of the shares is typically low but there is potential for the shares to increase significantly in value in the future.
* There are, however, risks associated with entering into an election of this type where the price payable on acquisition is less than the unrestricted market value. For example, the shares could subsequently be forfeited or the value of the shares could fall, in which case the up-front tax paid as a result of the election is a pure cost. It is not possible to claim a refund of the income tax paid on acquisition in these circumstances.
* It is always advisable therefore to seek specific tax and often valuation advice before entering into an election of this type.

Using this document

* To use this document, you will need to:
  + insert the name and national insurance number of the employee or director and the name and company registration number of his company where indicated at part 1 of the election on page 1; and
  + insert the number and class of shares acquired, name of the issuing company and the date of acquisition of the shares at part 3 of the election on page 1.
* The election should be signed and dated by the employee or director and by a director on behalf of the issuing company where indicated at part 5 of the election on page 2.
* The election must be entered into either before the shares are acquired or no more than 14 days after the acquisition. HMRC enforces this time limit rigorously. Making backdated elections after this time limit has expired is fraudulent.
* The signed and dated election does not need to filed within HMRC but should be kept on file for future reference.

What this document does not include

Other forms of election are available depending on the circumstances, for example:

* Similar elections can be entered into:
  + in respect of restricted securities issued to someone other than the employee or director by reason of that employee’s employment or that director’s directorship;
  + in respect of restricted securities issued by another entity “connected” to the employer company;
  + in respect of restricted securities to be issued on more than one occasion in the future;
  + in respect of restricted securities to be issued in the future on the exercise of share options; or
  + to partially opt-out of the restricted securities regime (i.e. such that only a particular restriction (or restrictions) will be disregarded).
* If a company is to issue restricted securities of the same description to multiple employees and/or directors at the same time, a two-part joint election can be used (rather than preparing separate one-part elections for each employee or director).

This election is not suitable for use in these circumstances.

Please do contact us if you would like to discuss this election or elections to be made in any of the circumstances listed above.

**Joint Election under s431 ITEPA 2003 for full or partial disapplication of Chapter 2 Income Tax (Earnings and Pensions) Act 2003**

**One Part Election**

1. **Between**

the Employee *[insert name of employee or director]*

whose National Insurance Number is *[insert NI number]*

and

the Company (who is the Employee's employer) *[insert name of company]*

of Company Registration Number *[insert company number]*

1. **Purpose of Election**

This joint election is made pursuant to section 431(1) Income Tax (Earnings and Pensions) Act 2003 (ITEPA) and applies where employment-related securities, which are restricted securities by reason of section 423 ITEPA, are acquired.

The effect of an election under section 431(1) is that, for the relevant Income Tax and NIC purposes, the employment-related securities and their market value will be treated as if they were not restricted securities and that sections 425 to 430 ITEPA do not apply. Additional Income Tax will be payable (with PAYE and NIC where the securities are Readily Convertible Assets).

**Should the value of the securities fall following the acquisition, it is possible that Income Tax/NIC that would have arisen because of any future chargeable event (in the absence of an election) would have been less than the Income Tax/NIC due by reason of this election. Should this be the case, there is no Income Tax/NIC relief available under Part 7 of ITEPA 2003; nor is it available if the securities acquired are subsequently transferred, forfeited or revert to the original owner.**

1. **Application**

This joint election is made not later than 14 days after the date of acquisition of the securities by the employee and applies to:

Number of securities *[insert number of shares issued]*

Description of securities *[insert class of share issued]*

Name of issuer of securities *[insert name of issuing company]*

acquired by the Employee on *[insert date]*

1. **Extent of Application**

This election disapplies S.431(1) ITEPA: All restrictions attaching to the securities.

1. **Declaration**

This election will become irrevocable upon the later of its signing or the acquisition of employment-related securities to which this election applies.

In signing this joint election, we agree to be bound by its terms as stated above.

……………………………………….. …./…./……….

Signature (Employee) Date

………………………………………. …./…../………

Signature (for and on behalf of the Company) Date

………………………….………………

Position in company

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