Share Incentives Toolbox

Share incentives, long favoured by technology companies as a way to attract and retain top talent, are finding favour in other business sectors. As the economy improves, ambitious entrepreneurs looking to ride the wave of recovery are finding that, this time round, there is a surprisingly wide range of tools for incentivising staff.

For most companies, the Enterprise Management Incentive (EMI) plan is still the definitive share scheme. It is the single most tax-advantaged form of remuneration available. And if structured correctly, can result in a tax charge as low as 10%.

Unfortunately, not all companies or employees are eligible for EMI. Problems arise where gross assets exceed £30 million, companies have more than 250 staff and if employees do not work sufficient hours.

The good news is that, if EMI is not possible, there are a number of alternatives.

Company Share Option Plan (CSOP)

CSOP also allows share options to be granted to chosen employees, and although it does not have the size limits of the EMI, it is less flexible and less generous. Options must be granted with a market value option price and the employee normally has to wait three years before exercising. Even then the best tax rate they can hope for is likely to be 28%. Furthermore an employee may only hold options on up to £30,000 worth of shares at the time of grant. EMI allows up to £250,000.

Share Incentive Plan (SIP)

This share plan must be offered to all eligible employees on broadly the same terms. Shares are awarded to employees and are then held on their behalf in a SIP trust. They can be awarded as free, purchased or matching shares.

An employee can receive up to £9,000 in shares per tax year and once an award has been made, the SIP trustees hold the shares until the employee wishes to release them. If the shares are withdrawn from the trust after five years there is no income tax or NIC, and if they are then sold on the same day they are exempt from capital gains tax.

Employee Shareholder Status (ESS)

In 2013 an entirely new share-ownership regime came into force that allows employees to trade certain statutory employment rights for shares. The rights to be surrendered include the right to request flexible working, the right to request training and the right not to be unfairly dismissed. For many this would be an unacceptable trade, but senior employees are unlikely to place much value on these rights so ESS could prove useful for attracting key executives. There are some conditions. The shares must be given to the employee for no consideration and they must have a minimum market value of £2,000. There is no income tax or national insurance on the first £2,000 but it does apply to amounts above this level.

When the employee eventually disposes of the shares, the first £50,000 will be exempt from capital gains tax. Importantly, the CGT calculation is based on the value of the shares when awarded. So if a share award worth £10,000 was eventually sold for £500,000 it would be totally exempt from CGT.

ESS will not suit everyone, but where initial share price is low and there is an appetite for risk, it could be better than EMI because of its scope for tax-free growth.

Growth Shares

Growth shares have no interest in the current value of the company, but in its growth potential. The value of growth shares acquired by employees is initially low, but there is potential for capital growth as long as nothing is done to trigger a charge under anti-avoidance legislation.

The simplest way to structure a growth interest is to create a new class of share, often referred to as hurdle shares. For example, if a company is currently worth £1 million, the hurdle above which the growth shares would participate might be set at £1.2 million. If the company is worth £1.1 million when it is finally sold, the growth shares would not participate in the proceeds. But if it was sold for £1.5 million, the growth shares would participate in a proportion of £300,000.

Nil-paid or partly paid shares

This involves issuing shares to an employee, leaving them unpaid, and agreeing that he or she will pay full market value for them at some point in the future, typically just before they are sold.

While the employee holds the shares and has not paid for them, they will be treated as having an employment-related cheap loan and will be subject to a 3.25% annual tax charge on the benefit of the loan. However, there are a number of reliefs available that could negate the tax charge. The proceeds from the disposal of the shares will be taxable under the normal CGT rules. In certain circumstances, Entrepreneurs' Relief may be claimed.

Conclusion

EMI is rightfully seen as a straightforward and advantageous way to structure employee share awards in smaller companies. However, there are viable alternatives if a company or individual does not meet the criteria to participate.

For further information please contact your usual Menzies representative or email taxconnect@menzies.co.uk.