BUSINESS HELP SHEET

APRIL 2019

SUMMARY OF SHARE INCENTIVES

Enterprise Management Incentives (EMI)

HMRC approved tax advantaged share option scheme that helps incentivise key employees to help grow the company.

This scheme offers employees the chance to purchase shares at a specified time and price in the future. Performance conditions can be built in, to ensure share options are only exercised when targets have been met.

Up to £250,000 worth of options can be granted to each employee, ensuring a company maximum of £3 million, and they must be in an independence trading company with gross assets no more than £30 million. For subsidiary companies the share options must be granted in the holding company.

Advantages:

- No income tax or NIC charge on grant of options
- No income tax or NIC charge on exercise of options (assuming exercise price is the same as market value upon grant)
- Upon the sale of shares Entrepreneurs' Relief is available (gain taxed at 10%) so long as
- the option/share held for at least two years prior to sale
- Does not need to be offered to all employees
- Motivate and promote long term retention of key employees
- Corporation tax deduction available for the costs of administering the scheme
- Corporation tax deduction available based on the value of the shares at the date of exercising the options

Disadvantages:

- Can be expensive to initially set up the scheme and for further issues of options. There are also yearly administrative requirements
- Working requirements need to be met by the employee – either work at least 25 hours per week or 75% of their working time
- Any employee holding more than 30% of the company's ordinary share capital will not be eligible for the scheme
- The tax advantages can be lost if a disqualifying event occurs e.g. the company's trade ceasing to qualify

Unapproved Share Option Scheme

These schemes are often used when the company and/or employees do not meet the requirements of the approved scheme (EMI).

Employees are offered the chance to purchase shares at a specified time and price in the future. Performance restrictions can be built in to ensure share options are only exercised when targets have been met.

Advantages:

- No income tax or NIC upon grant of the share options
- There are no limits on the value of the options granted to employees and there are no restrictions for which type of company or employees are eligible under this scheme.
- The scheme can be run through a holding or subsidiary company
- Corporation tax deductions are available for the costs of administering the scheme

Disadvantages:

- Income tax is chargeable upon the exercise of the options, which is based on the value at date of exercise. NIC is also due if the shares are readily convertible assets i.e. capable of being sold on a recognised stock exchange and tax/NIC charge has to be accounted for through PAYE
- Upon the sale of the shares capital gains tax is due on the gain at a maximum of 20%. This is unless 5% or more of the shareholding has been held for at least two years, where Entrepreneurs' Relief is available (if all other conditions have been met). The gain is then charged to capital gains tax at 10%

Long term incentive plans

These can be structured either as an award of shares, often conditional on meeting performance conditions, or as deferred share purchase plans where employee has the opportunity to join in future share value growth but at the cost of some investment risk. It is an unapproved scheme and usually used by listed companies.

Advantages:

- Flexible so plan can be designed to meet the needs of the business
- Does not need to be offered to all employees; frequently being offered to key/senior individuals to encourage retention
- No limit on value of shares awarded to employees or restrictions
- No income tax or NIC charge if employee pays market value for the shares

Disadvantages:

- Requires robust valuation to establish the value of the shares being acquired
- Income tax charge for employee if they pay below market value for the shares. NIC is also due if the shares are readily convertible assets i.e. capable of being sold on a recognised stock exchange and tax/NIC charge has to be accounted for through PAYE

- Upon the sale of the shares capital gains tax is due on the gain at a maximum of 20%. This is unless 5% or more of the shareholding has been held for at least two years, where Entrepreneurs' Relief is available (if all other conditions have been met). The gain is then charged to capital gains tax at 10%.

Growth shares

Unapproved scheme where employees can be awarded shares that have no interest in the current value of the company, but have an interest in the company's future growth potential. Therefore the initial value of the shares acquired by the employee is low, but there is potential for capital growth.

The shares can also have a hurdle rate that requires the sale price to be in excess of hurdle rate for the shares to receive any value.

Advantages:

- Helps to deliver target based employee incentives, as capital growth of shares is linked to the company's future growth
- No income tax or NIC charges upon purchase of the shares, providing the employees pay fair market value
- Upon the sale of shares Entrepreneurs' Relief may be available if the conditions are met
- No company restrictions

Disadvantages:

- Requires robust valuation of the shares in order to set the 'hurdle rate'
- Income tax charge for the employee if they pay below market value for the shares
- Not risk free for the employee as they need to purchase the shares up front
- No corporation tax deduction for the company on the capital growth of shares

Phantom share scheme

Allows employees to benefit from the increase in share value, or where "shares" are issued by reference to pre-determined profit targets being met, but without becoming shareholders.

Employees would have a right to a cash sum, which would be determined by the increase of the share value over time. It is essentially a cash based bonus arrangement.

Advantages:

- Can help with retention of key employees and gives employees a long term goal to work towards
- Current shareholders are not diluted
- No complications over dividends, voting rights or capital distributions or buy back of shares if an employee leaves
- Easy to set up and no regulatory requirements to meet
- Minimal administration costs
- Corporation tax deduction available for the full costs paid out under the scheme

Disadvantages:

- Cash payment is liable to income tax and National Insurance
- Company's share price not readily available to determine the cash payment to be made

Nil paid or partly paid shares

Allows employees to become shareholders immediately without paying the full price of the shares up front. The employee would have an obligation to pay the price of the shares at the point in the future, typically before the sale of the shares.

Advantages:

- Employees who may not necessarily have the funds to purchase the shares up front, are enabled to hold shares on deferred payment basis
- Employees will immediately benefit from any potential rights attached to the shares
- If price of shares is at fair market value, no income tax or NIC charges will arise
- Performance conditions can be attached to the award of shares
- Entrepreneurs' relief could be available upon the disposal of the shares, providing the conditions are met
- No company restrictions

Disadvantages:

- The consideration payable on the shares will remain outstanding as an employee loan. If the loan is more than £10,000 it will be subject to an annual tax charge of 2.5%, although it may be possible to mitigate this charge
- This is not a risk free scheme for the employee. If the share value drops, the unpaid balance of consideration on the shares would be taxed as a benefit in kind
- On a liquidation the liquidator will make a call on the unpaid subscription

Gift of shares

Allows employees to become shareholders immediately without needing to pay for the shares and no obligation to pay the price of the shares in the future.

Advantages:

- Employees will immediately benefit from any potential rights attached to the shares
- Entrepreneurs' relief could be available upon the disposal of the shares, providing the conditions are met
- No company restrictions
- Income tax and NIC can be paid on behalf of employee which can be kept outstanding as a loan. If under £10,000 no benefit in kind for employee.

Disadvantages:

- Employees liable to income tax and NIC upon value of gift of the shares
- Valuation needed to determine value of shares at time of gift. HMRC no longer offer approval of valuations for gifts of shares

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This is a detailed and complex area of tax legislation and this guide is a summary only. Professional advice should be sought before taking any action.

If you require any further information on any of the issues raised above, please email taxconnect@menzies.co.uk