MOORE Kingston Smith

SHARE OPTIONS AND INCENTIVES

Share ownership

The continued growth and success of your business is likely to be heavily dependent on your workforce. It is therefore important to ensure that you are recruiting, incentivising and retaining the right people. Operating a share based incentive scheme can help you achieve these goals.

Most share incentive schemes will fall into one of two categories:

- those which involve the company issuing shares to employees directly; and
- those which involve the company granting employees options to acquire shares in the future (commonly referred to as ‘share options schemes’).

Existing shareholders will often prefer options to be granted, as their current holdings will not be diluted until such time as the options are exercised. In addition, options offer employees protection against any fall in value of their employer’s shares, as they will have flexibility as to whether they exercise any vested options and acquire their shares.

This summary covers some of the key share incentive routes available.

Direct Share Issue

Employees will be subject to income tax on any difference between the market value of any shares they are issued, and the market value of those shares.

For there to be no income tax charge on a direct share issue, therefore, employees would need to pay the full market value for the shares at the date of the award.

A company may choose to issue shares to employees for their current market value, but to allow the employee to leave them as unpaid. This provides a cashflow advantage for the employee, but the employee will remain liable for the unpaid subscription price for the shares, which may be called on, for example when the company is in financial difficulty.

Joint Share Ownership Plan (“JSOP”)

A JSOP is an arrangement whereby an employee jointly acquires shares with a third party, such as an Employee Benefit Trust (“EBT”). The third party will acquire the beneficial interest in the shares up to a specific value. The employee will acquire a restricted beneficial interest in the shares, entitling them to receive only the growth in the value of the shares over and above that specific value.

When the employee’s rights over the shares crystallise, they may receive absolutely a fixed number of shares equal in value to the growth of the jointly acquired shares, or the appropriate proportion of the sale proceeds from the sale of the shares.

Providing the employee pays the market value for the interest initially acquired, there should be no income tax implications on acquisition. Capital gains tax will need to be considered on the disposal of the shares.

Share options

Share option schemes can be split into two types:

- Approved schemes, which receive favourable tax treatment.
- Unapproved schemes, which carry no tax advantages.

Enterprise Management Incentives (“EMI”)

EMIs EMIs are tax advantaged share options. Under an EMI scheme, employees are granted the option to acquire shares within a specified time period or on the meeting of certain conditions. EMIs are flexible and can be offered to select employees.

The Income Tax and CGT implications are dependent on the exercise price of the option and the market value of the shares at the date the options are granted.

If the exercise price is at least equal to the market value of the shares at the date of grant, there will be no income tax or national insurance contributions payable when the options are exercised.

If the EMI options are granted at a discount (i.e. if the exercise price is less than the market value of the shares at the date of grant), an income tax liability will arise when the options are exercised on the value of the discount.

Capital Gains Tax will need to be considered when the shares are eventually sold. Any gain will generally be calculated as the difference between the sale proceeds and the market value of the shares at grant.

An additional tax advantage of EMI Options is that any gains made on shares acquired through exercising EMI options on or after 6 April 2013 may be eligible for Business Asset Disposal Relief (BADR) (previously known as Entrepreneurs' Relief), if the shares are disposed of at least 24 months after the date the options are granted (and if certain other conditions are met).

There are a number of qualifying conditions to be satisfied for Companies that wish to issue EMI Options. The key ones are:

The company must not be under the control of another company (i.e. it must be a parent company if part of a group) and it must be carrying on a qualifying trade.

The company's gross assets must be less than £30 million at date of grant.

The company must have fewer than 250 full-time employees.

An individual cannot hold unexercised EMI options over shares with a total market value of more than £250,000 and cannot own or control more than 30% of the ordinary share capital of the company at the date the EMI option are granted. The employee must be required to work for the employer for more than 25 hours per week, or, if less, 75% of their working time.

Company Share Option Plans ("CSOP")

This is an alternative to the EMI and is an HMRC approved scheme which enables companies to grant options to particular employees.

There is no tax or national insurance liability for the individual on the exercise of the option, providing the option is exercised between 3 and 10 years from the date of grant.

Capital gains tax will be need to be considered when the employee sells his shares and any gain will generally be calculated by taking the sale proceeds and deducting the market value of the shares at grant.

There are a number of qualifying conditions that need to be met. The key requirements are:

If the company is under the control of another company, that company must be listed.

The options must be granted with an exercise price at least equal to the market value of the shares at the date of grant.

An individual cannot hold unexercised CSOP options over shares with a total value of more than £30,000.

An individual cannot hold an interest of more than 30% of the share capital of the company.

Generally, CSOP options are not used when EMI is available, as they are more costly to implement and less flexible.

Unapproved employee share option schemes

An unapproved share option scheme is one that does not meet the qualifying conditions of one of HMRC's approved schemes.

On exercise, an income tax charge will arise on the difference between the market value of the shares at the date of exercise and the exercise price.

Capital gains tax will need to be considered on the disposal of the shares in the normal way.

Share Incentive Plans (SIPs)

Share Incentive Plans (SIPs) are approved all-employee plans. Shares acquired under a SIP must be held in a trust established for the purpose of the SIP for at least three years, or at least five years for the maximum tax advantages to be available. Provided the shares are left in the trust for at least five years, there is no income tax or NICs due on the receipt of SIP shares. No Capital Gains Tax is due on any increase in value as long as the SIP shares are kept in the trust.

The shares acquired under the SIP can relate to a number of categories, with flexibility for employers as to which categories they use. The categories are:

- 'Free' shares of up to £3,600 per year, which must be awarded to employees on similar terms.
- 'Partnership' shares, whereby the lower of £1,800 or 10% of salary annually can be deducted from pre-tax and NICs salary and used to buy shares. Shares can be bought monthly or at the end of an accumulation period.
- 'Matching' shares may be offered as long as partnership shares are offered. Matching shares allow employees to acquire additional shares at the ratio of 2 free shares for each partnership share purchased.
- 'Dividend' shares enable an unlimited amount of SIP share dividends to be reinvested in additional shares.

SIP shares must be ordinary, non-redeemable shares, either in a listed company or in a company which is not under the control of another company.

Growth shares

This approach involves the issue of shares which are only entitled to participate in sale proceeds above a set 'hurdle' value. Normally the 'hurdle' value is set at a little more the current market value of the shares, meaning the market value of the growth shares should be low and that the acquisition of these by employees for market value will generally be affordable.

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Because this approach involves a specific class of shares, repeated use with a new class of shares each time can make the approach complex.

Care will be required when considering whether the qualifying conditions for Business Asset Disposal Relief are expected to be met on the disposal of these shares.

Corporation Tax

At the point where shares are acquired (either by way of an award or by way of the exercise of an option), a corporation tax deduction may be available on the difference between the market value of the shares acquired and the amount paid for the shares.

It should be noted that there are detailed conditions that need to be met for the corporation tax deduction to be available.

PAYE and National Insurance Contributions

In certain circumstances, the income tax due on the issue of shares or exercise of share options will be collected through the PAYE scheme. This will be the case where the shares in question are 'readily convertible assets'. This will usually mean that a market exists for the shares i.e. the employee could quickly sell them if they so wished.

Where the shares are readily convertible assets, there will also be a liability to employee's and employer's Class 1 National Insurance Contributions (NICs) which will also be collected through the PAYE scheme. If the shares are not readily convertible assets, then there is no NIC liability due either by the employee or employer.

There are complex tax rules that apply to share incentives and also important company law requirements to observe. The above notes are intended to only be a summary of the main alternatives available. Further, more detailed advice should always be obtained before implementing any form of share incentive scheme.

Please get in touch with us if you would like to discuss share options and incentives further.