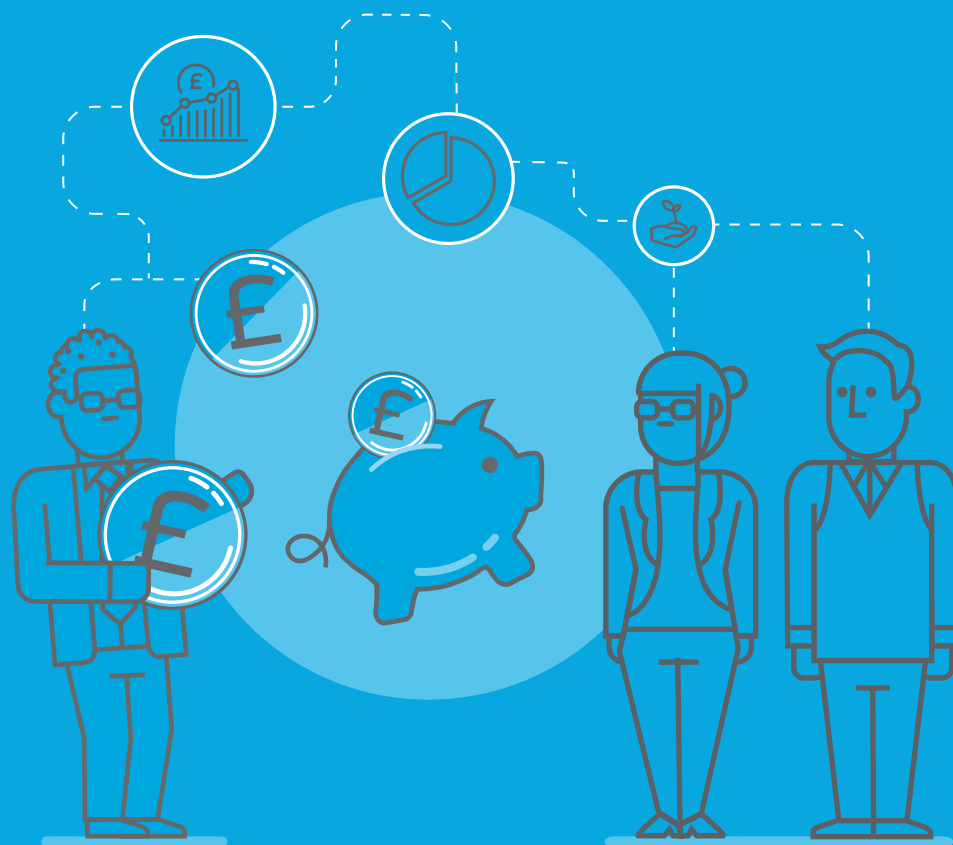


# Reward and retain your employees



## A GUIDE TO EMPLOYEE SHARE PLANS

# A guide to employee share plans

Incentivising your workforce in an appropriate way is empowering.

It brings another level of engagement to your workforce with rewards for both company and employee. There are a number of tax advantaged incentivisation schemes that a company can implement alongside HR engagement strategies.

Have a look at this table to identify the plans that might suit and then look at the summaries of the schemes to find out more. With advice from our specialist teams, you can design strategies tailored to your particular circumstance and objectives.

Key issues	Type of Scheme	Key	
The Company is not under the control (>50%) of any other company	EMI, SIP, SAYE, EOT, CSOP, USOP, PPS, Growth	<b>EMI</b>	Enterprise Management Incentive Scheme
The Company is under the control (>50%) of another company	USOP, PPS, Growth	<b>CSOP</b>	Company Share Option Plan
Discretion to benefit one or more employees	EMI, CSOP, PPS, Growth	<b>SIP</b>	Share Incentive Plan
Participation offered to all employees	SIP, SAYE, EOT, EMI, CSOP, USOP	<b>USOP</b>	Unapproved Share Option Plan
Participation offered to non-UK persons (subject to local laws and taxes)	USOP, PPS, Growth (possibly EMI, SAYE and EOT with adaptations)	<b>SAYE</b>	Savings Related Share Option Plan
Participation offered to non-executive directors, contractors and other non-employees	PPS, Growth	<b>EOT</b>	Employee Ownership Trust
Shares offered at a discount	EMI, SIP, SAYE	<b>PPS</b>	Nil or partly paid shares
Shares offered for free	SIP, EMI	<b>Growth</b>	Growth shares
Simple and flexible	EMI, USOP		
Most tax reliefs	EMI, SIP		
Transfer to full employee ownership	Mostly EOT but could also have EMI, SIP and USOP		

## 1

## ENTERPRISE MANAGEMENT INCENTIVES (EMI) SHARE OPTIONS

EMIs offer your employees the chance to share in company growth and get the benefit of business asset disposal relief in the same way as the main shareholders.

They incentivise your team to increase the company's value without incurring any cash expense other than set up costs (which are generally tax deductible) and can enhance the recruitment and retention of employees for most trading companies with fewer than 250 employees. Tax legislation can be extremely favourable for employers and employees who take advantage of Enterprise Management Incentives (EMI) options.

### Key points:

- engenders greater employee incentivisation and reward;
- employee gains are often taxed at 10 per cent with payment deferred up to 22 months after the employee sells the shares;
- you can set out performance conditions that directly link rewards to performance;
- there is no income tax or national insurance contributions (NICs) or health and social care levy liability (provided exercise price is at least equal to the shares' value at the date of grant);
- there is no loss of control for existing shareholders;
- assists with succession planning or equity release for existing shareholders; and
- there is a corporation tax deduction for the employer company equal to the employees' gains, whether or not any cash costs have been incurred.



# 2

## COMPANY SHARE OPTION PLANS (CSOP)

Company share option plans (CSOPs) are tax advantaged share incentives that allow companies to grant share options to employees selected at the employer's discretion.

### Key points:

- the company must register its CSOP and self-certify that it satisfies conditions to qualify for favourable tax treatment by 6 July following the tax year in which an award is made; and
- the employees and directors taking part should be resident in the UK for tax purposes and must normally be employed at the time of grant and exercise.

CSOP options can be granted by the employer that enable each employee/ director to buy shares at the market value when granted, so that future gains in value can be treated as capital.

# 3

## SHARE INCENTIVE PLANS (SIP)

A share incentive plan (SIP) allows a company to provide shares to employees in a tax efficient way.

### Key points:

- three main types of shares may be used:
  - **free shares** – each employee may receive free shares worth up to £3,600 each year;
  - **partnership shares** – employees can use up to £1,800 per year (or 10 per cent of salary if lower) out of pre-tax/NICs pay to buy partnership shares; and
  - **matching shares** – the employer can give up to two matching shares for each partnership share bought by the employee. The maximum value of matching shares is therefore £3,600 per year.
- an employer can normally claim relief against corporation tax for the value of shares provided under a SIP and is not liable for employer's NICs on shares given to, or purchased by, employees through the plan.
- the costs of setting up the plan are normally deductible by the employer for corporation tax purposes.
- the company can exclude employees with insufficient length of service and is permitted to specify a period of up to 18 months for this purpose.

# 4

## EMPLOYEE OWNERSHIP TRUSTS (EOT)

Employee ownership trusts (EOT) are a method by which the controlling interest in a company can be transferred to a trust to be held for employees, and which brings with it some helpful, tax free bonus arrangements.

Successful examples of this are John Lewis, Richer Sounds and Arup, but each employee owned company is different and the chosen structure should reflect the culture and ambitions of the organisation. EOTs are usually used as an exit strategy for controlling shareholders but are an effective incentivisation tool.

The EOT must meet statutory conditions, and the transferring shareholders may sell their shares to an EOT and claim exemption from tax on all capital gains. Once transferred, the company can pay additional rewards to employees by way of tax free bonuses up to £3,600 a year (though NIC and the health and social care levy may still be payable).

### Key points:

- when creating an EOT the majority of the company's ordinary shares will be transferred to the EOT. Specific tax and legal advice is needed by the transferring shareholders, the company and the trustees acquiring the shares;
- communication with employees, trustees and the current shareholders is a vital part of this process and this should be built into the planning; and
- original or family shareholders can stay involved through management committees or representation on the board of trustees.



# 5

## SAVE AS YOU EARN (SAYE)

Under a save as you earn (SAYE) share option scheme, employees allow a proportion of their salaries to be paid into a bank or building society on a monthly basis in order to fund the price to be paid on exercise of options.

### Key points:

- the company can specify a period of up to five years employment for employees and directors before they can participate in the scheme;
- an option can be granted by the employer to enable employees/directors to buy the company's shares in three or five years' time at a price equal to the market value of the shares at the date of grant, or at a discount of up to 20 per cent of that price;
- shares acquired under a SAYE scheme can be transferred into an ISA or a stakeholder pension on a tax-free basis within 90 days of exercising the option; and
- the company's articles of association need to meet certain conditions.

# 6

## UNAPPROVED SHARE OPTION PLANS (USOP)

An unapproved share option plan (USOP) allows a company to grant share options, or make awards of shares, cash, restricted stock units or growth shares to employees or non-employees selected at the employer's discretion.

### Key points:

- there are no statutory tax reliefs for employees and NICs and the health and social care levy are typically payable (both employers and employees); and
- the arrangements can be completely flexible subject to company law, AIM rules or Listing Rules, corporate governance, etc.

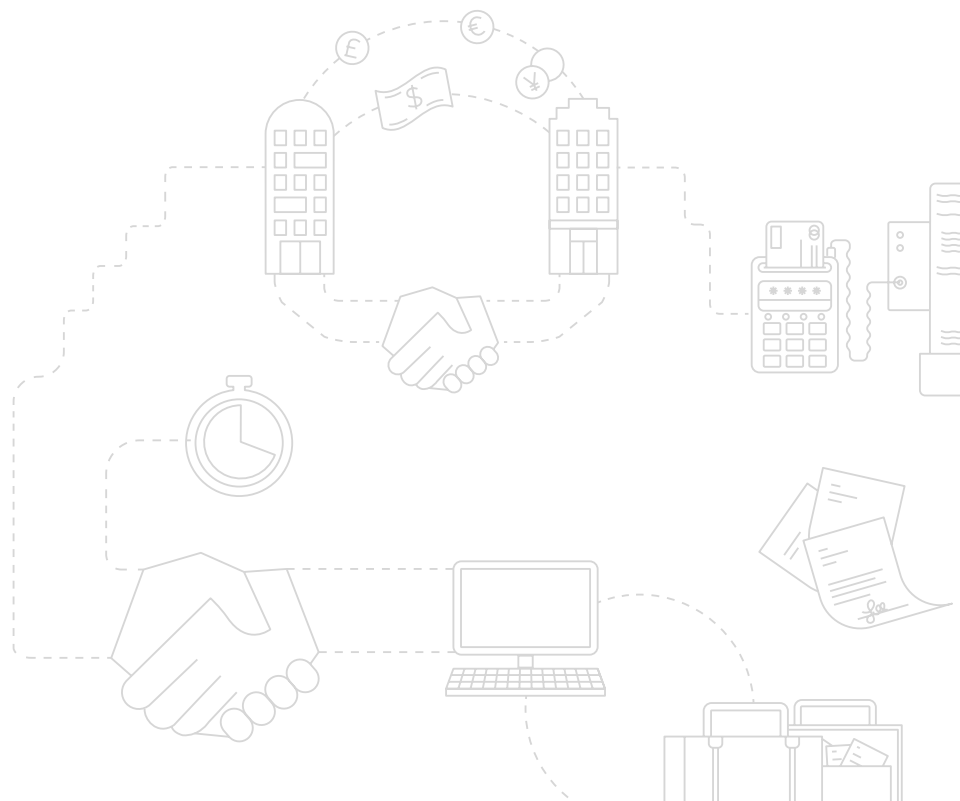
# 7

## GROWTH SHARES

This involves creating a new class of shares with performance conditions embedded in the Company's articles of association but not in the shareholders' agreement or subscription agreement.

### Key points:

- the articles of association need to be amended and that requires a special resolution passed by 75 per cent of the shareholders;
- the initial market value of the shares less the price paid is employment income but the value is likely to be lower than ordinary shares, where the targets have not been met; and
- provided the performance conditions are relatively stretching, when achieved the increased share value should be treated as an inherent capital gain and not employment income. Consequently, the gain is taxable as a capital gain currently at the standard rate of 20 per cent (after an annual exemption and any other allowances) and without NIC and the health and social care levy for the employee or the employer. Income tax, NIC and the health and social care levy could arise if there is a subsequent manipulation of the shares (eg changes in share rights, conversion of shares) or there is no section 431 Election within 14 days of the share acquisition.



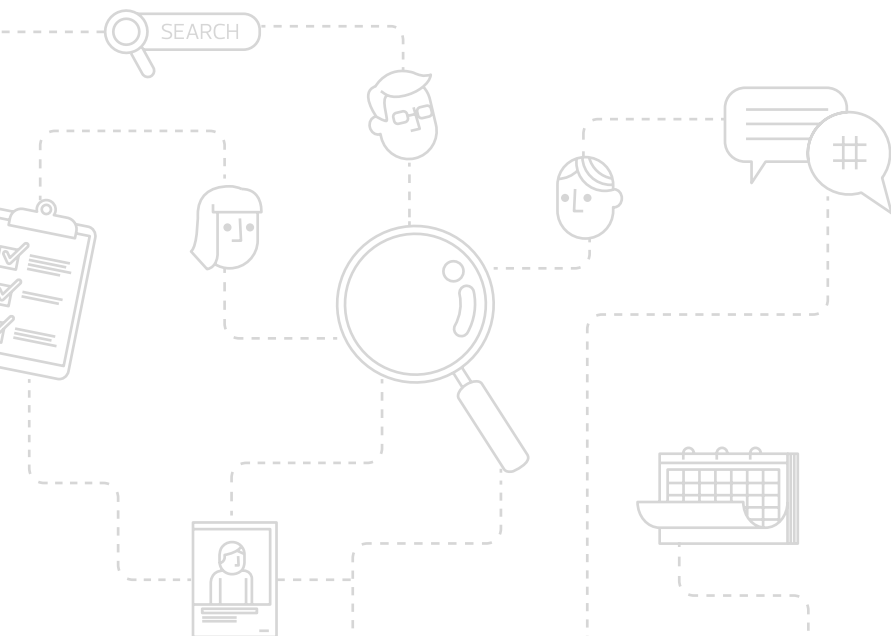
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**NIL PAID/PARTLY PAID SHARES (PPS)**

'Ordinary' shares or growth shares can be issued for their full unrestricted market value but the subscription price to be paid by the employee can be deferred until the occurrence of specific events.

**Key points:**

- the obligation to pay the full value of the shares is sufficient to prevent the unpaid part being treated as employment income. The shares might still be forfeitable if the specific targets are not met;
- the unpaid amount is a notional interest free loan, but that may not give any income tax charge while the employee is engaged as a director involved in the actual management and control of a closely owned company;
- the significant downside is that the employee remains liable for the full sum due and payable on the shares if the values fall and in particular if the Company went into liquidation. In this situation also, there is no facility to agree values with HMRC so there will be some uncertainty whether the initial value will be challenged by HMRC; and
- any growth in value should be treated as a capital gain and not employment income. Consequently, the gain is taxable as a capital gain currently at the standard rate of 20 per cent (after an annual exemption and any other allowances) and without national insurance contributions for the employee or the employer. Income tax and NIC and the health and social care levy could arise if there is a subsequent manipulation of the shares (eg changes in share rights, conversion of shares) or there is no section 431 Election within 14 days of the share acquisition.





# Anything else?

There are other types of plans that are rarer or more complex, either in terms of establishment or the tax treatment or both, these include...



Phantom Share Plans where participants are given the right to an notional share, whether an option or otherwise, and will be given a cash bonus equivalent to a gain measures by the increase in value of the notional share. In the UK this is taxed as a bonus.



Joint Share Ownership Plans where participants jointly acquire an interest in shares together with another person (eg a trust) and the individual participant's interest in the shares varies according the increase in value of the shares. In the UK the growth is usually taxed as a capital gain.



Restricted Stock or Restricted Stock units where participants are given interests in stock but those interests are restricted until time has elapsed or performance conditions are achieved. In the UK, these shares are taxable as income, often on the value when the restrictions are lifted.

# Summary comparison

	EMI	CSOP	SIP	SAYE	USOP	Growth
<b>Who for?</b>	All or any employees	All or any employees	All employees	All employees	Anyone	Anyone
<b>Shares/options</b>	Options	Options	Shares	Options	Options	Shares
<b>Limits</b>	£250k per person £3m per co.	£30k per person	£9k per person p. a.	£500 (savings) per person per month (£6k p.a.)	None	None
<b>Best case tax treatment</b>	No IT or NICs CGT @ 10%	No IT or NICs CGT @ 10%/20%	No IT or NICs or CGT	No IT or NICs CGT @ 10%/20%	IT on value of shares at exercise plus NIC	IT on any undervalue at issue CGT @ 10%/20%
<b>CT deduction</b>	Yes	Yes	Yes	Yes	Yes, in some cases	Not usually
<b>Shares to be used</b>	Any class	Usually ordinary shares (certain conditions apply)	Non voting may be used	Usually ordinary shares	Any class	Growth Share Class
	May be tailored	May be tailored	For free shares only and very limited	No	May be tailored	Yes
<b>Excluded</b>	30% + shareholder	30% + shareholder	No "material interest" test	No "material interest" test	None	None
<b>Other points</b>	Only for independent companies. <250 e/ees, Specific trades	Any size, any trade, must usually not be a subsidiary	Any size, any trade, must usually not be a subsidiary	Any size, any trade, must usually not be a subsidiary	No tax related limits	No tax related limits
<b>On a sale</b>	Can exercise with relief within limited period	Certain limitations apply on sale within 3 years	Usually will deliver tax relief	Can exercise with relief within limited period	Can exercise at any time	Depends on articles of association

**IT** – income taxes    **NIC** – national insurance contributions and includes the health and social care levy

**CGT** – capital gains tax    **e/ees** – employee(s)

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Our team of employee share scheme specialists design and implement all sorts of incentivisation plans for their clients. If you would like to explore any of these options, including seeking advice on which sort of plans might be the best fit for your circumstance and organisational objectives, please contact:

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