

# HIVE of Industry



## Employee Share Incentivisation ...

...Who shares wins



**Establishing an employee share scheme is an effective 'non cash' method of incentivising and motivating key members of staff which in turn can help improve the overall performance of the company.**

Employee share options are also a tax efficient way of rewarding employees where the objective is to lock in key employees within the company and to incentivise them towards achieving the company's desired target growth by giving them an equity stake in the company. Rewarding key employees with a stake in the business can also encourage loyalty as in many situations, employees are unable to keep the shares unless they remain with the company.

A share scheme approved by H M Revenue & Customs can provide both employees and employers with significant tax advantages, making it a cost effective way of providing employee incentives.

### The Basics

A **share option** is a legal right granted to an employee which enables him to acquire a specified number of shares in the company at a future date for a fixed price. There are different types of share option scheme available including those approved by H M Revenue & Customs (HMRC) and those not formally approved by HMRC.

An HMRC approved share scheme provides additional tax advantages to the employee and the company compared to an unapproved scheme. In most cases, an unapproved scheme will only be implemented where the qualifying conditions that need to be met for an approved scheme to be implemented are not capable of being satisfied.

### HMRC Approved Share Schemes

The type of share scheme most suitable for your business will depend on whether you wish to reward a few key employees or whether you wish to incentivise the entire workforce.

The share schemes most suitable for rewarding individual key employees are the Company Share Option Plan (CSOP) and the Enterprise Management Incentive (EMI) Scheme.

The share scheme most suitable for rewarding all employees are the Save As You Earn Scheme (SAYE) and the Share Incentive Plan (SIP).

HMRC approved schemes (CSOP, EMI, SAYE and SIP) provide tax advantages to the employee on acquiring shares under an HMRC approved scheme, including;

- There is no charge to income tax on the grant of the option;
- There is no charge to income tax on exercise of the option apart (as employees are required to pay at least market value at the date of grant for the shares).
- An EMI option may be granted at a discount to market value at the date of grant in which case, an income tax charge will arise on exercise of the option on the difference between the market value at the date of grant (and not exercise) less the price paid.

## Unapproved Share Scheme

- An unapproved share scheme is entirely flexible as there are no specific qualifying criteria that need to be met.
- An unapproved scheme does not however provide the employee or the company with any tax incentives and as such is usually seen as a last resort in terms of awarding employee shares.
- Under an unapproved scheme, the employee either has to pay market value at the date of exercise for the shares or if the employee is not required to pay for the shares, he/she would have an income tax liability arising the date of the award/exercise on the market value of the shares gifted.

## Employee Share Award

- If the relevant qualifying criteria for an HMRC approved share scheme cannot be satisfied and an unapproved scheme is undesirable, you could consider making an immediate share award to employees.
- A straight forward share award would give rise to immediate income tax liabilities for the employee unless the employee were required to pay market value for the shares.
- An alternative solution may be to make an immediate share award using nil or partly paid shares which can usually be structured to defer the payment of any income tax liability arising on the employee.

## Corporation Tax Relief

A corporation tax deduction is given to the employer company for the cost of providing shares to an employee, in circumstances where the employee is taxable in respect of the shares they acquire or would have been taxable on if the scheme were not an HMRC approved share scheme with specific tax reliefs.

Under HMRC approved share schemes, the company will be entitled to a corporation tax deduction based on the option market value at the date of exercise of the option (less any amounts paid for the shares by employees) provided certain conditions are satisfied.

## Case Study – EMI Scheme Tax Implications

Company A is looking to incentivise 2 key employees in

order that the company can achieve its corporate objectives of increasing pre-tax profits to £1million per annum in 5 years time.

Current value of company is £2million.  
Shareholders

looking to build company value to £10million by Year 5.

Company grants EMI share options to 2 key employees over 5% of the ordinary share capital of the company. Current value of a 5% shareholding (after minority interest discounts) is formally agreed with HMRC at £25,000. Options granted at current market value and are exercised 5 years later on reaching company performance targets when 5% shareholding is worth £125,000 (after minority discount). Employees sell shares one year later when company is sold, realising £500,000 each.

## Tax Implications

1. No Income Tax or NIC liabilities on grant of options.
2. No Income Tax or NIC on exercise of options.
3. Company obtains Corporation Tax deduction of £100,000 in year of exercise.
4. Employees sell shares for £500,000 each and pay £25,000 each to acquire the shares and £37,500 each in Capital Gains Tax (assuming Entrepreneurs Relief is available) i.e. net amount received £437,500.
5. For comparison, if the £500,000 were paid as a cash bonus, the employee would have received net income of only £240,000 (assuming income tax rate of 50% and NIC of 2%).



## How we can help

At Cowgill Holloway we have a dedicated team of tax specialists who can assist in advising of the best scheme for your circumstances.

For further information on Cowgill Holloway LLP and how we may be able to assist you, visit [www.cowgills.co.uk](http://www.cowgills.co.uk) or contact Paul Stansfield on 01204 414262.



The information in this fact sheet must not be relied upon as giving sufficient advice in any specific case

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