Share Schemes

In an ever-evolving world where companies and individuals are constantly considering and trying to understand tax and wealth implications, having the right support is essential. Our global team of experts will give you the advice you need to overcome the challenges and relish in opportunities, by helping you to plan for a successful future, whether managing commercial change or personal risk.

What are Share Schemes?

Employee share schemes represent an increasingly significant part of a company's overall remuneration strategy. Well-designed share incentive arrangements can be an important factor in attracting and retaining key personnel as well as helping to motivate staff by aligning the interests of employees with those of the company. The key to a successful scheme is careful design and implementation as well as effective communication of the scheme and its benefits. The available options range from schemes approved by HM Revenue & Customs (HMRC), which can offer significant tax advantages to both employer and employee, to more flexible unapproved arrangements.

Share Schemes and Tax

Share schemes are divided into two categories: tax advantaged and non-tax advantaged.

Tax-Advantaged Share Schemes

These are approved by HMRC and aim to reduce an employee's liability to income tax on the acquisition and on the subsequent disposal of the shares. In certain cases, the shares also qualify for a beneficial 10% rate of capital gains tax. Certain employee share schemes also generate a corporation tax deduction for the employer company.

The type of share schemes available to a company can be dictated by a number of factors, such as the size of the company.

The "pay-off" for the beneficial tax treatment for tax advantaged share schemes is that they have less flexibility with regards to who can participate and the terms of the schemes.

Non- Tax Advantaged Share Schemes

Under a non-tax-advantaged share option plan, employees chosen at the discretion of the company are granted an option to acquire shares at a specified future date for a price normally set at the date of grant. In tax terms, the company grants a benefit (ie the option) to employees and employees only pay income tax when they choose to exercise their options.

There is no statutory restriction on the level of participation for an employee in a non-tax-advantaged share option plan. However, the company is free to impose restrictions on individual participation and the overall percentage of share capital which can be placed under option to employees (shareholders may insist on such restrictions before they are prepared to accept the adoption of the plan).

Tax Advantaged

There are five main tax advantaged share schemes that are set out below;

EMI	CSOP	SIP	SAYE	EOT
Enterprise Management Incentive Scheme	Company Share Option Plan	Share Incentive Plan	Save As You Earn Scheme	Employee Ownership Trusts

Enterprise Management Incentive (EMI) Scheme

This discretionary scheme allows qualifying employees to subscribe for shares with a value of up to £250,000. There is a £3 million overall limit on the value of shares in a company that can be subject to unexercised EMI options. The scheme is generally available to UK trading companies with gross assets below £30 million and fewer than 250 full time employees.

Provided that the exercise price for the shares under option are granted at full market value the options do not usually attract any income tax or national insurance liabilities at the time of grant or upon exercise.

Company Share Option Plan ("CSOP")

This a discretionary scheme which allows qualifying employees to receive share options up to a value of £60,000. The scheme is available more widely as the conditions are less restrictive than under an EMI scheme. Qualifying options must be granted at market value and can generally only be exercised within strict time limits to obtain any tax advantage.

Provided that the above requirements are observed, qualifying options do not generally attract any income tax or national insurance liabilities at the time of grant or upon exercise.

Share Incentive Plan ("SIP")

This all employee share plan is operated in conjunction with an employee trust set up to 'warehouse' shares whilst they are held within the plan.

Four different types of share can be awarded under a SIP: free shares; partnership shares; matching shares; and dividend shares. The company has discretion to award free shares worth up to £3,600 per annum to all of its employees. All employees may be offered the opportunity to purchase shares under the SIP and those that do may also be offered free 'matching' shares up to the same value.

There is generally no tax charge when shares are awarded but if the shares are removed from the plan within five years of award income tax and national insurance liabilities may arise.

Save As You Earn ("SAYE") Scheme

This is an all employee share scheme, subject to a minimum length of service, combined with a savings arrangement under which the employee saves a fixed monthly amount usually by a deduction from salary over a three or five year period. At the end of the contract, a tax free bonus is added to the savings to fund the purchase of share under option. Alternatively, the employee is free simply to keep the cash.

Options may be granted at a discount of up to 20% below market value and the exercise does not generally attract any income tax or national insurance liabilities provided that the options are exercised after the required option period of three or five years.

Employee Ownership Trusts ("EOT")

An EOT is a specific type of employee benefit trust ("EBT"). EOTs are established to acquire all of the shares in a company that will become employee controlled. A qualifying EOT provides: capital gains tax relief on the disposal of shares to an EOT; limited exemption from income tax on bonus payments up to £3,600 per year paid to employees; and relief from inheritance tax on certain transfers to and from EOTs.

There are conditions that must be met to obtain these reliefs. In brief, these are that the settled property in the EOT must be for the benefit of all of the employees; any distribution must be for the benefit of all eligible employees on the same terms; the trustees must hold more than 50% of the ordinary share capital of the company; and the company must be a trading company or the principal company of a holding group.

Non-Tax Advantaged

There are five main tax advantaged share schemes that are set out below;

- Unapproved Share Option Scheme
- Phantom Share Options
- Nil-Paid and Partly-Paid Shares
- Growth Shares
- Shared Ownership Plans

Unapproved Share Option Scheme

Unapproved share option schemes are extremely flexible as, unlike approved schemes, they are not subject to qualifying requirements. These schemes are generally discretionary and there are no limits on the value of options which may granted to an individual employee.

Whilst options will not generally attract any tax charges at the date of grant, there are likely to be income tax and national insurance liabilities when the options are exercised.

Phantom Share Options

This is a discretionary scheme which provides employees with the right to receive a cash bonus calculated by reference to a notional share option. Effectively, the employee is entitled to receive the increase in the valuation of the company's shares without actually receiving any shares. It is not unusual for these arrangements to be subject to performance criteria and include a payment cap in case of an unexpected steep increase in share prices.

The payment made on exercise will normally be subject to both income tax and national insurance contributions.

Nil-Paid and Partly-Paid Shares

This works by the company issuing new shares to the employee in return for a subscription usually equal to market value, but with the subscription price (or part thereof) left outstanding until 'called for' by the company. These arrangements offer the advantages of immediate ownership, i.e. the growth in value being subject to capital gains tax as opposed to income tax, without any upfront payment. Payment is usually triggered by certain specified events.

Provided the subscription price is at least equal to market value there should be no income tax and national insurance liabilities when the shares are issued. Depending on the circumstances, however, there may be an ongoing income tax charge until the subscription price is paid.

Growth Shares

This discretionary arrangement involves a new class of shares being created with limited rights to income and generally no voting rights. The shares have capital rights which entitle the holder to a share in the future growth in value and to participate should a specified event occur (e.g. sale, listing or winding up). Often these rights are triggered upon satisfaction of specific performance criteria.

The shares will not generally incur any income tax and national insurance liabilities provided that the shares are initially acquired at market value. However, given the limited rights attaching to the shares, the market value is typically significantly less than the market value of an ordinary share.

Shared Ownership Plans

Shared ownership plans allow employees to acquire shares together with a co-owner, typically an EBT. This ensures that the cost of the shares is split between the two co-owners and the cost to the employee is reduced. A joint ownership agreement will govern ownership of the shares including voting rights, dividends, those circumstances in which the shares will be sold (usually a sale, listing or upon winding up) and also each co-owner's entitlement to the proceeds of sale. The employee is typically entitled to receive an amount equal to the growth in value of the shares above a fixed target growth rate.

The acquisition of the shares should not attract any income tax or national insurance liabilities provided that the employee acquires his or her interest at full market value. Given the limited nature of the employee's interest, it is anticipated that market value should be significantly lower than the market value of ordinary shares.

The use of these share schemes has declined as they have received a lot of scrutiny from HM Revenue & Customs.

Our Recent Share Scheme Experience

Our tax team advises a wide range of clients from small and medium sized enterprises to large international publicly listed companies in relation to share schemes.

We advise on:

- the design, structuring and implementation of multi-jurisdiction all-employee share schemes, tax approved and unapproved share schemes (including CSOPs and EMI), discretionary arrangements, long term incentive plans, virtual or phantom share schemes;
- private company employee or manager equity participation, including at subsidiary level, through management incentives and/or growth or flowering shares, and the use of ratchets, particularly in private equity fund-backed Management Buy-Outs/ Management Buy-Ins/Institutional Buy-Outs;
- private company investments, M&A and public company takeover (including reverse takeovers) involving due diligence; exercising arrangements; employee communication; and share option roll-over; and
- providing tax, employment law and corporate advice in respect of all aspects of share schemes

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A Collaborative Tax Team

With our presence on the global stage, DWF can rely on an extensive network of skilled lawyers in all major jurisdictions to provide our clients a seamless and co-ordinated approach to significant cross-border cases.

In addition, we draw on recognised experts in key industry sectors and specialist areas of law, making us well placed to advice on the full range of tax issues - whatever sector or sectors the insolvent company operates within.

• Belfast • Birmingham • Bristol • Dublin Edinburgh • Glasgow • Leeds • Liverpool • London • Manchester • Newcastle

James Cashman
Partner

M +44 (0)7860 259 566
E James.Cashman @dwf.law

Caroline Colliston
Partner

M +44 (0)7841 843 744
E Caroline.Colliston@dwf.law

Tom Rank
Partner

M +44 7754 053247
E Tom.Rank@dwf.law

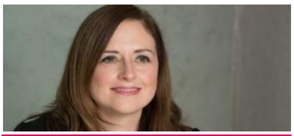
Calum Young
Associate

M +44 7745 735020
E Calum.Young@dwf.law

Alex Tolcher
Associate
M +44 7936 335462
E Alex.Tolcher@dwf.law

Douglas Pyrke
Solicitor
M +44 (0)7845 264 235
E Douglas.Pyrke@dwf.law

Amy Deal
Senior Paralegal
M +44 (0)7355 018 851
E Amy.Deal@dwf.law



Colleen Dooner
Professional Support Lawyer
M +44 (0)7936 335 448
EColleen.Dooner@dwf.law

Our Global Offices

UK – France – Germany – Australia – U.S.A – Canada – United Arab Emirates – Kingdom of Saudi Arabia – Hong Kong – India – Italy – Poland – Portugal – Qatar – South Africa – Spain – Turkey.