



mortimer burnett
certified accountants and business consultants

Employee share schemes



Business UPDATE

The Government encourages trading companies to offer shares in the company to its employees. These are usually given away free or offered at a discounted rate. Sometimes the employer may not provide shares immediately but provides an option that will allow the employee to acquire shares later.

In the absence of any special provisions, issuing shares to an employee at less than full market value is taxable. This remains the case where an employee is granted an option to acquire shares at a specific price in the future but the market value is higher when the option is exercised.

To avoid this tax charge, there are several HMRC schemes that allow for tax-advantaged transfers of shares or the granting of share options to employees. The four most popular are:

- share incentive plans (SIPs)
- company share option plans (CSOPs)
- enterprise management incentive (EMI)
- save as you earn (SAYE) schemes.

These schemes are not mutually exclusive, so you may set up more than one.

In addition to these schemes, there are also specific tax provisions for unapproved schemes, preferential employee allocations in a share issue and for the employee shareholder status introduced on 1 September 2013.

Share incentive plans (SIPs)

SIPs were introduced in 2000. The monetary limits are increased in 2014. A SIP allows an employer to provide free shares to employees, subject to conditions.

An employee may then acquire further partnership shares. The employer may then provide matching shares in the ratio of up to two matching shares for each one partnership share. An employee may elect to reinvest any dividends on these shares as dividend shares.

So, there are four types of share issue under the scheme:

- free shares up to £3,600 a year
- partnership shares equal to the lower of 10 per cent of salary or £1,800
- matching shares in a maximum ratio of two shares for each one partnership share
- dividend shares.

Partnership shares are bought by deduction from gross salary. This means that income tax and national insurance relief is given at source. The net cost to a basic rate taxpayer is typically 68 per cent of the partnership shares bought, after allowing for 20 per cent tax and 12 per cent national insurance saved. For a higher rate taxpayer, the net cost will typically be 58 per cent.

This means that a basic rate taxpayer could acquire £9,000 worth of shares for a net cost of just £1,224.

See next page for example.



Employee share schemes

Value of partnership shares acquired	£1,800
- less 20% income tax saved	£360
- less 12% national insurance saved	£216
Net cost	£1,224
Free shares	£3,600
Partnership shares	£1,800
Matching shares	£3,600
Value of shares acquired	£9,000

If the shares are held for at least five years (or three years for dividend shares) before being sold, they are free of income tax and national insurance. If they are disposed of sooner, there may be a tax charge.

A SIP must be offered to all employees on similar terms except that anyone who already controls more than 25 per cent of the company is excluded. There are also special provisions for employees in groups of companies. It is possible for issues of free shares to be subject to conditions that relate to employment or to the employees' performance.

This scheme provides generous tax relief, provided the many strict conditions are followed.

Company share option plans (CSOPs)

A CSOP allows a company to choose which directors and employees may participate. It does not have to be offered to all employees. However, anyone who controls at least 30 per cent of the company is excluded.

Under a CSOP, the company provides options to acquire shares rather than shares themselves. Provided the conditions are met, no tax is payable when the options are granted.

Each director or employee may be given up to £30,000 worth of options a year. The share price must be specified when the option is granted and must be 'not manifestly less' than their market value at the time.

The options must generally be held for between three and ten years before being exercised in order to prevent any potential tax charges from arising.

There are specific provisions relating to the shares and to employees who die or leave the company before exercising their options. There are also provisions relating to restrictions on share disposals.

Enterprise management incentive (EMI)

EMI allows each director or employee to be given options worth up to £250,000 provided that the total value of all such options does not exceed £3 million.

The employee pays no income tax on:

- the value of the options when granted; or
- any increase in value in the shares between when the option was granted and when it is exercised.

The company must:

- be independent
- have a permanent place of business in the UK
- have gross assets worth no more than £30 million.

The director or employee must:

- not control more than 30 per cent of the company
- work at least 25 hours a week for the company (or 75 per cent of working time if less).

Generally, the option must be exercised within ten years and for an amount at least equal to the value of the shares when the option was granted.

If a company's shares grow to many times their original value while the options are held, the tax relief can be considerable.

Save As You Earn (SAYE) schemes

These schemes allow directors and employees to acquire options to buy shares in a savings contract. The shares are bought for at least 80 per cent of their value when the option is granted.

The scheme must be open to all employees but membership may be restricted to employees who have worked for a qualifying period of up to five years.

From April 2014, an employee may buy options worth up to £500 a month. This is often paid by deduction from salary, though there is no PAYE or national insurance relief. These payments are held in a bank or building society account for the employee.

The savings contract normally runs for three or five years (seven-year contracts ended in 2013). At the end of the period, the shares are purchased for the employee from the account held for that purpose. A bonus may be added at the end of the contract period.

Provided the conditions are met, there is no tax charge on:

- the options when acquired
- the increase in value of the shares between when the option is granted and when it is exercised
- interest and bonuses on scheme savings.