solicitors
TEACHER STERN

Who Shares Wins

Why have an Employee Share Scheme?

As inflationary pressures on payroll mount, have you considered how an employee share scheme could form a key part of your staff remuneration strategy, as well as aligning staff with your interests as owner-managers, shareholders, or directors?

Whether your business is still in a start up phase or already well established, you and your team can implement one or more tax efficient share plans or share option schemes without spending a fortune.

A number of smaller companies have implemented the Share Incentive Plan (SIP), the most tax-beneficial HM Revenue & Customs (HMRC) approved share plan ever, and there are many opportunities to link these advantageously to pension schemes to provide additional benefits to employees. We consider SIPs in more detail below in this, the second of our bi-annual share schemes e-zines.

Many other companies have also implemented Enterprise Management Incentives (EMIs), the share option scheme originally designed for key employees in small and medium enterprises (SMEs). EMI has already attracted over 7,250 SMEs, making it the most popular share scheme ever for smaller companies, who are increasingly using it as an all employee scheme.

Setting up an employee share scheme may help you to:

- beat the skills shortage by retaining your best employees
- boost profitability
- consider exit strategies without surrendering control
- link employee and shareholder interests
- improve corporate governance and image
- attract high calibre staff whilst minimising short term expenditure

Share Incentive Plans

Under a SIP, employees can be rewarded with ownership of shares in the employer company in four ways:

1. **Free shares** are those given to an employee by the employer up to the value of £3,000 per annum
2. **Partnership shares** are bought by an employee out of his or her annual pre-tax and pre-national insurance income (up to a value of the lower of £1,500 or 10% of the employee's salary)
3. **Matching shares** are given to an employee by the employer at a ratio of up to 2 matching shares for each partnership share purchased by the employee
4. **Dividend shares** are bought by an employee out of the dividends paid on other SIP shares owned by the employee, up to the value of £1,500 per annum

The SIP's flexibility is demonstrated by the fact that an employer may pick which elements of the SIP best suit its business. For example, an employer might decide to relate the award of free or matching SIP shares to the performance of an individual, a team or the company itself. Alternatively, a company may choose to link the award of shares to more unusual performance measures, such as meeting increases in profits before tax, or sales growth.

In certain circumstances, a company may require an employee to forfeit his or her free shares in the company on leaving the company or require an employee to hold some types of SIP shares for a certain period before disposing of them.

To operate a SIP, a company must set up a UK resident trust to allocate the shares to employee participants. Although setting-up and running the trust operating a SIP will involve some cost to the company, the company will be entitled to corporation tax relief in respect of those costs.

Apart from the benefit to employees of owning assets which can appreciate in value, participation in a SIP will allow an employee to reduce his or her tax liability. For example, partnership shares are bought from gross pay. Provided that the employee's shares are held within the plan for five years there will be no charge to income tax or NICS (although this does not reduce the employee's relevant earnings when calculating his or her salary for pensions and annuity purposes). Likewise, if the shares are held within the plan for five years and the employee sells the shares immediately on removing them from the plan, there will be no charge to capital gains tax on any profit made on the sale.

The requirement that shares be held within such a plan for five years to enjoy the full tax benefits (and the possibility of forfeiture of certain shares on leaving the company) will encourage employees to take a longer term interest in the performance of their company. In particular, it may help companies to achieve and sustain increases in performance under a variety of different performance measures and improve retention rates of high-performing employees. It will also serve to align the interests of the company's employees and its shareholders as employees will be directly interested in the company's shares value.

A SIP has additional quantifiable benefits for employer companies. A company may normally make a deduction against corporation tax in the amount of the company's payment to the SIP Trust for the acquisition of the shares that are to constitute the basis of the employee incentives. In respect of partnership shares, the company may make another deduction against corporation tax in the amount by which the market value of the partnership shares, at the time that they are acquired by the trustees of the plan, exceeds the amount of partnership money subsequently paid by the participant to acquire the shares.

To take advantage of any of the tax benefits outlined above, any proposed SIP must be approved by HMRC. While a SIP can be a valuable tool in incentivising employees, appropriate tax and legal advice should therefore be sought before designing and implementing such a scheme.

Stay Ahead of the Game

Recruiting, rewarding and developing high performing employees will be an important differential for successful companies over the next few years. Finding effective ways to attract and keep key individuals who can help your company negotiate this difficult economic environment will be vital.

If you would like to discuss any share incentive issues with us, why not contact:

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Further information is available at www.teacherstern.com