A Guide to Employee Share Schemes

Business Information Factsheet
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Introduction

Employee share schemes provide benefits to employees of a company in the form of shares or options to purchase shares in the company. By owning shares in the company, employees can gain financially when the company performs well, through the payment of dividends or via capital growth.

This factsheet covers the different types of employee share schemes available, the advantages and disadvantages of each and the practical issues involved in setting up an employee share scheme.

Benefits of employee share schemes

The benefits to a company operating an employee share scheme are:

- The provision of a valuable benefit to employees.
- The provision of a benefit that may improve the profitability of a company by incentivising employees and increasing productivity.
- A reduction in absenteeism and staff turnover due to increased motivation.
- The offer of an attractive and competitive remuneration package to executives.
- An incentive for senior executives to consider the best interests of company shareholders when they are managing the company.
- Potential tax relief (for certain employee share scheme structures) for both the company and employees.

Types of employee share schemes

Employee share schemes can be categorised into three main types:

- Tax-advantaged share schemes.
- Non-tax advantaged share schemes.
- Fully taxable schemes.

Within each of these categories there are share schemes that are offered to all employees and those that are offered on a discretionary basis. However, it is unusual to offer a non-tax advantaged share scheme to all employees.

The main types of share scheme and the key features of each are set out below:

Tax-advantaged schemes

Company Share Option Plan (CSOP)

The CSOP allows companies to grant share options (the right to buy shares) to employees. Employees are given the right to buy a set number of shares at a set price and at a set time in the future.

Advantages

- This arrangement does not have to be offered to all employees to be approved by HM Revenue & Customs (HMRC). It is often directed at key employees in senior management positions.
- As long as the statutory conditions have been met, there is no income tax or National Insurance (NI) contribution payable on the grant of the share option or on the exercise of it (when shares are bought by an employee). However, if the employee gains financially from the shares, then capital gains tax (CGT) will be payable.
- A company may be able to claim a deduction in corporation tax when a CSOP is put in place.

Disadvantages

- A company must make a written application for approval of a CSOP to HMRC. A CSOP can only be set up after HMRC has approved it.
- The maximum market value of the shares an employee can buy is £30,000.
- In order for the tax advantages to apply, the share options must be exercised at least three years and no more than ten years following the grant of the options or by someone who is classed as a 'good leaver' (which effectively means that they are leaving employment due to redundancy or because they have reached retirement age).

Save As You Earn (SAYE)

SAYE schemes operate in two parts: savings and share options.

First, an employee enters into a HMRC-certified savings contract that requires the employee to save £5-£500 a month for a period of either three or five years (usually by deduction from the employee's wages).

The employee is then granted an option to buy shares in the company which can be purchased using the savings at the end of their savings period. If the employee decides not to exercise the share option then the savings will be paid back to the employee along with any interest payable.

Advantages

- This share scheme is often popular with employees and rewards employees who make a financial commitment to the company.
- It is risk-free for the employee until the share option is taken and the shares are granted.
- As long as the statutory conditions are met the employee will have no tax liability on the exercise of their share option. CGT may be payable on the sale of the shares.
- As with a CSOP, a company may be able to claim a deduction in corporation tax when a SAYE scheme is put in place.

Disadvantages

- A company must invite all eligible UK-resident employees and full-time directors to participate in a SAYE share scheme.
- The shares that are under option must be ordinary shares and the company granting the option must be listed on a recognised stock market or free from the control of another company, unless the other company is listed on a recognised stock market.

Share Incentive Plan (SIP)

A SIP allows employees to acquire shares in a company, rather than just giving employees options to purchase shares. The company sets up a trust that acquires the shares in the company and the trust distributes the shares to employees in accordance with the SIP.

Advantages

- Employees share the same risks with the other shareholders of the company and the scheme therefore aligns the interests of shareholders and employee shareholders.
- It is a tax-advantaged scheme, subject to certain statutory conditions being met. If shares are held in the SIP for three to five years or if the employee ceases to be employed for a 'good leaver' reason then income tax and NI are not payable by the employee.
- Capital gains on shares are exempt from CGT as long as the shares remain in the SIP.
- Corporation tax relief is available for contributions made to the SIP and for the costs of establishing and administering the SIP.

Disadvantages:

- This type of share scheme must be offered to all employees.

Enterprise Management Incentives (EMIs)

EMIs are the right to purchase a set number of shares in the company at a set price. The share price is usually the market value of the shares when the right to buy option is given to the employee.

Advantages

- EMIs are designed to assist small and higher-risk companies when recruiting and to retain employees in the company.
- EMIs are tax advantaged subject to the statutory conditions being met. For employees there is no income tax or NI payment on the grant of the option or on the exercise of it. However, CGT may be payable on the sale of the shares.
- A company does not have to offer the scheme to all employees to be tax advantaged and therefore the scheme can be directed at key employees of the company.

Disadvantages

- EMIs are only applicable if the company has fewer than 250 full-time employees. There are limits in relation to the company's gross assets.
- To be eligible to join an EMI scheme, an employee must work at least 25 hours per week for the company, or 75% of their working time.

Non-tax advantaged schemes

Unapproved Share Option (USO) schemes

These are similar to CSOPs but have the following advantages and disadvantages:

Advantages

- USO schemes are more flexible than CSOPs and other tax-approved share schemes. There are no statutory requirements in relation to a company that establishes the scheme or the share classes that must be used.
- These schemes may be used in addition to CSOPs in order to grant share options above the limits imposed in a CSOP or if a company or employee does not meet the statutory conditions for a CSOP.
- On grant of share options, an employee does not suffer income tax liability. CGT may be payable on disposal of share if there is a financial gain as a result of the shares gaining in value.
- A USO scheme does not have to be offered to all employees and is therefore discretionary.

Disadvantages

- Because the scheme is not HMRC approved, employees will not qualify for income tax or NI relief.

Long Term Incentive Plan or Performance Share Plan (LTIP)

In a LTIP, shares are awarded at £0 or minimal cost and are usually held in a trust subject to the employee meeting certain performance conditions. Once the employee has met the performance conditions then the trustees of the trust will release shares to the employee.

Advantages

- LTIPs are often used to encourage employees to improve their performance in order to gain a shareholding in a company.
- LTIPs are discretionary and therefore a company can choose which employees it offers the scheme to.
- A company will normally be able to obtain a corporation tax deduction on any bonuses that are paid out of the scheme.

Disadvantages

- When an employee receives the shares they are subject to income tax and NI.

Issues involved in setting up an employee share scheme

Companies should consider the following when setting up a share scheme:

- What does the company wish to achieve? What other types of employee benefits does it offer? Does the company want to award share scheme benefits to all employees or just senior management?
- Does the company meet the eligibility criteria for tax-advantaged schemes, especially in relation to its size and the number of employees?

- Does the company have employees that live outside of the UK? If so, it will need to consider whether certain schemes will benefit these employees as they may not benefit from the income tax and NI advantages that other employees would get.
- How much ownership of the company should be provided to employees?
- The legislation and regulations that govern HMRC's approval of these schemes is complex. Any company that is considering putting an employee share scheme in place should seek professional advice.
- Detailed documentation will need to be drafted and adopted in respect of any employee share scheme. Consider who will draft it.
- Communications will need to be drafted and distributed to any employees who will be given the option to benefit from an employee share scheme.
- Annual information returns should be submitted to HMRC in respect of most employee share schemes.

Further information

BIF 516 Classes of Private Limited Company Shares

Useful contacts

Companies House provides registration and filing services for companies and partnerships, as well as useful leaflets and information.
Tel: 0303 123 4500
Website: www.gov.uk/government/organisations/companies-house

HM Revenue & Customs (HMRC) is responsible for the collection of taxes in the UK.
Website: www.gov.uk/government/organisations/hm-revenue-customs

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