Employee share schemes
1. Introduction

Employee share schemes are designed to encourage employees to become shareholders in their employer company. These schemes can take a variety of forms. Most involve share options but with some schemes employees are awarded actual shares. A basic distinction is between schemes with special tax advantages and those without. ‘Phantom’ schemes only involve cash payments but aim to replicate the effect of a share scheme.

2. Tax Advantaged Schemes

2.1 Enterprise management Incentives (‘EMI’)

This is a highly flexible arrangement with substantial tax advantages, under which employees are granted options in the employing company:

- Participants do not suffer a charge to UK income tax or NIC on grant of an EMI option
- Participants do not suffer a charge to UK income tax or NIC on exercise of an EMI option within ten years of grant (so long as the exercise price is at least equal to the market value of the underlying shares at the date of grant)
- Participants may suffer a charge to UK capital gains tax on a subsequent disposal of shares acquired on exercise of an EMI option
- The employer company can decide which directors and/or employees receive EMI options (so long as they satisfy certain minimum working time requirements) and many of the terms (e.g. performance conditions) of those options
- Maximum value of £250,000 of shares over which options can be granted to any single participant
- Maximum value of £3 million of shares over which options can be granted in total by the employer company
- Only small and medium sized companies (i.e. those with less than £30 million gross assets and fewer than 250 full-time employees) can offer EMI options
- The company must not be controlled by another company
- Non-trading companies and companies carrying out certain ‘lower risk’ trades (e.g. dealing in land and certain financial activities) cannot offer EMI options
- An employer company cannot offer both £30,000 of CSOP options (discussed below) and £250,000 worth of EMI options to a single participant. The maximum value of EMI options that can be granted is reduced by the value of CSOP options in issue (and vice versa)

2.2 Employee Shareholder Status (‘ESS’)

This was another flexible scheme with substantial tax advantages. However, the government was concerned that the scheme was being abused by highly paid directors, who were not the people the scheme was intended for. Consequently, the government announced in the November 2016 Autumn Statement that the ESS tax advantages will no longer apply for arrangements entered into on or after 1 December 2016.

2.3 Share Incentive Plans (‘SIPs’)

An arrangement under which an UK resident trust acquires shares in the employer company for the benefit of employees. Participants acquire shares by gift, purchase or ‘matching’.

- Participants obtain full exemption from UK income tax and NIC if shares are held by the UK trust for five years
- Limited flexibility in the terms of the SIP
- All employees must be invited to participate (subject to a minimum service requirement of up to 12 months)
- The UK trust must hold all shares for at least three years
- Participants may obtain shares by:
  - Gift of up to £3,600 worth of shares per year
  - Partnership shares can be bought up to a maximum of the lesser of £1,800 per year and 10% of pay for each year from pre-tax income.
  - Matching (i.e. an employer may ‘match’ partnership shares at a ratio of up to 2:1)

2.4 Company Share Option Plans (‘CSOPs’)

An arrangement under which an employer company grants options to specific directors and/or employees to acquire shares in the employer for a price not manifestly less than the market value of the company’s shares (as at the date of grant).

- Participants must retain CSOP options for a minimum period of three years to qualify for full exemption from UK income tax and NIC
- Reasonable flexibility (e.g. performance conditions can be incorporated in a CSOP)
- The employer company can decide which directors and/or employees participate in the CSOP (so long as they satisfy certain minimum working time requirements)
- No restrictions on participants retaining CSOP options on termination
- Maximum value of £30,000 of shares over which options can be granted to any single participant
2.5 **Save As You Earn (‘SAYE’) Plans**

A Savings Related Share Option Scheme is simply an arrangement whereby employees save a fixed amount each month into a designated building society account (an SAYE account). This is topped up by a tax-free bonus from the building society and the funds can then be used to exercise options over employer company shares.

- There are no income tax or NIC implications an grant or exercise of the share options
- Participants may suffer a charge to UK capital gains tax on a subsequent disposal of shares acquired on exercise of an SAYE option
- All employees must be eligible to participate although those with less than 5 years service can be excluded
- Employees with more than 25% of the shares cannot participate
- The options granted can be at a discount of up to 20% of the value of the shares at the date of the grant
- The SAYE account must be for 3, 5 or 7 years and the length of the contract and monthly savings are fixed at the start
- The maximum contribution is £500 per month
- The bonuses awarded are a multiple of monthly contributions
- If an employee leaves voluntarily the options lapse, but the employee can either continue saving and earn the tax-free bonus or withdraw the savings with tax-free interest to that point

3. **Other schemes**

There is immense flexibility in the other types of arrangements that can be adopted; however, UK tax legislation generally charges participants to UK income tax (and NIC where appropriate) in respect of most employment-related gains arising under these arrangements. Two of the more common types are described below.

3.1 **Option Plans**

An arrangement under which an employer company grants options to specific directors and/or employees to acquire shares in the employer.

- Participants suffer no charge to UK income tax on grant of an unapproved option
- Participants suffer a charge to UK income tax (and NIC, where appropriate) on a ‘chargeable event’ (e.g. exercise, assignment or release of an unapproved option) – the amount of the charge is generally calculated by reference to the difference between the value received on exercise, assignment or release and the price paid by the employee
- Participants may suffer a charge to UK capital gains tax on a subsequent disposal of shares acquired on exercise of an unapproved option.

3.2 **Restricted Share Schemes**

An arrangement under which an employer company grants shares or other securities in the employer (or another entity) to specific directors and/or employees

- Participants may, in certain circumstances, suffer a charge to UK income tax (and NIC, where appropriate) on acquisition of restricted shares
- Participants may also suffer a charge to UK income tax (and NIC, where appropriate) on a subsequent ‘chargeable event’ (e.g. the cessation or variation of restrictions affecting the shares, or a disposal of the shares while they are restricted) – the amount of the charge is calculated as a proportion of the restricted share’s value on a chargeable event
- To the extent that an income tax charge has arisen, future growth in the value of the shares will generally be subject to capital gains tax
- Elections can be made on acquisition of restricted shares that may affect an income tax charge. However, as future growth in the value of the shares will be subject to capital gains tax, this may result in a lower overall charge

4. **‘Phantom’ schemes**

Directors and/or employees who participate in ‘phantom’ or ‘shadow equity’ schemes receive a cash payment (i.e. a bonus) calculated by reference to the appreciation in value in shares or options in the employer company. The cash payment is subject to UK income tax and NIC in the hands of participants in the same way as salary or wages.

The Clyde & Co employment tax team is able to advise on selecting the optimum arrangement for your company from the full range of possibilities and then seeing that arrangement through from design to implementation.

If you require further information, please contact David Blumenthal (Legal Director) or Malcolm Frost (Associate).