Designing and using employee share schemes

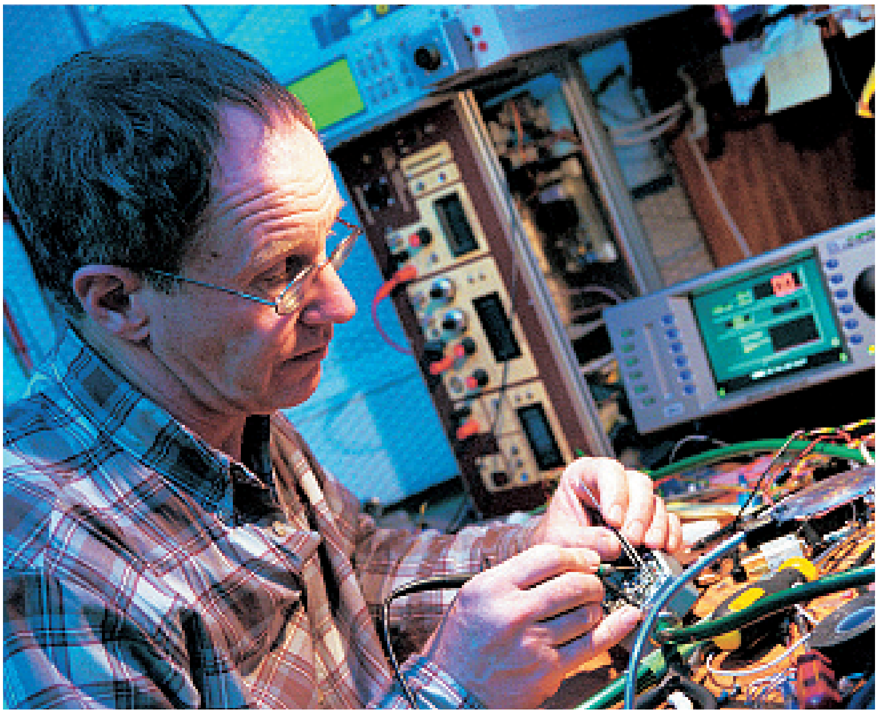
Norman Watson looks at tax efficient schemes to transfer company ownership

The Wales Co-operative Centre has gained a great deal of expertise over the past 10 years in designing employee share schemes for its clients. We believe they offer employees an extra reward for working in the company, while the company gets commitment, loyalty and increased productivity as well as possible tax concessions in return. According to Government research both here and in the USA, companies with share schemes are 15 per cent more productive. As the Americans say: "If you want to make the pie bigger – give everyone a slice."

The way to start any share scheme in a private company is to set up an employee benefit trust (EBT). This is a legal vehicle into which a company can transfer funds or shares for the benefit of employees. They are often used in succession planning because they are useful in purchasing shares over a period of time from departing shareholders. Once the shares are in the trust, they can be transferred or sold to employees over a number of years.

This means that the owner has an exit route when he or she is ready to leave the company, and it's one which is very tax efficient as any shares sold to the EBT are subject to capital gains tax tapering relief. It also means that employees investing for the first time in the company have an exit route for their shares when they eventually leave.

The EBT cannot easily gift shares to employees without them incurring a tax charge, but the use of an Inland Revenue approved share incentive scheme (SIP) gets round this problem. Transferring shares from the EBT to the SIP allows the company to distribute shares to employees subject to a qualifying period of 18 months. There are three ways in which the shares can be distributed:



- Free shares. Shares worth up to £3,000 in a tax year can be awarded. The number can be linked to level of pay, length of service or even performance.
- Partnership shares. In addition, employees can be invited to purchase shares up to £1,500 per year by deduction from gross salary, before tax and national insurance, thus providing a saving on the cost of the shares.
- Matching shares. Where an employee buys partnership shares, the employer can match this with up to two additional matching shares. In this way an employee can acquire shares to the value of £7,500 in each tax year.

As long as the shares are held in the SIP for five years the entire value of the shares, including any gain, is tax free. There is also a tax advantage to the company providing the shares through a SIP, because it could claim a deduction in corporation tax based on the total value of the shares allocated through the SIP in any one tax year.

In addition to the SIP, the Government has also recently introduced enterprise management incentive options (EMIs), which allow share options to be granted to key employees up to a limit of £100,000 of market value, with generous tax concessions on the exercise of the options.

Aber Instruments Ltd in Aberystwyth has been operating an EBT and an SIP for the past five years. Having such a scheme in place means that there is an internal market for the three founding owners to retire and sell their shares, while giving the employees an incentive to stay and help the company grow. Managing director Barry Wise believes that having such a scheme has a huge impact on staff commitment and productivity.

The Wales Co-operative Centre has considerable experience in installing these schemes, so if you are thinking of introducing a share scheme into your company just give us a ring.

Contact

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