USE OF SHARES AND SHARE OPTIONS TO REWARD AND INCENTIVISE EMPLOYEES

Innovative Strategies For Your Clients

7 July 2014

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THE TAX SPECIALISTS

Agenda

1.30pm	Registration	
2.00pm	Welcome address / Tax Bites / FD App	Michael Dawson/Tom Minnikin
2.10pm	Employee Share Ownership - Setting the Scene	Michelle Hogan
2.40pm	EMI Share Options – Hurdles and Benefits	Andrew Marr
2.55pm	Green Sky Energy Limited - Use of Share Options	Simon Oldfield
3.15pm	*Coffee Break*	
3.40pm	Employee Shareholder Status	Haydn Rogan
4.10pm	Using shares to pay dividends to employees	Tom Minnikin
4.30pm	Realising the capital value for the employee	Michael Dawson
4.50pm	Questions to the floor	
5.00pm	Closing remarks followed by drinks	Michael Dawson

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Employee Share Ownership - Setting the Scene

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What’s covered:

- Overview – changing climate of employee share ownership
- Unapproved arrangements
- History of approved schemes
- Enterprise Management Incentive Scheme (EMI)
- Employee Shareholder Status

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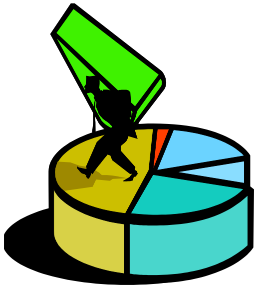
Two ways of getting value to employees:

salary / bonus



company shares

dividends

capital

income tax & NI
IT: 40%/45%

income tax
25% / 30.56%

CGT
10%..?

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Why use share plans?

- Longer term incentives
  - linking rewards to shareholder value
  - motivating employees to build value
  - Lock-in employees for an exit

- Shorter term incentives
  - Linking rewards to results
  - Attractiveness of dividends over salary / bonuses

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The changing climate of share ownership

Management pay & incentives

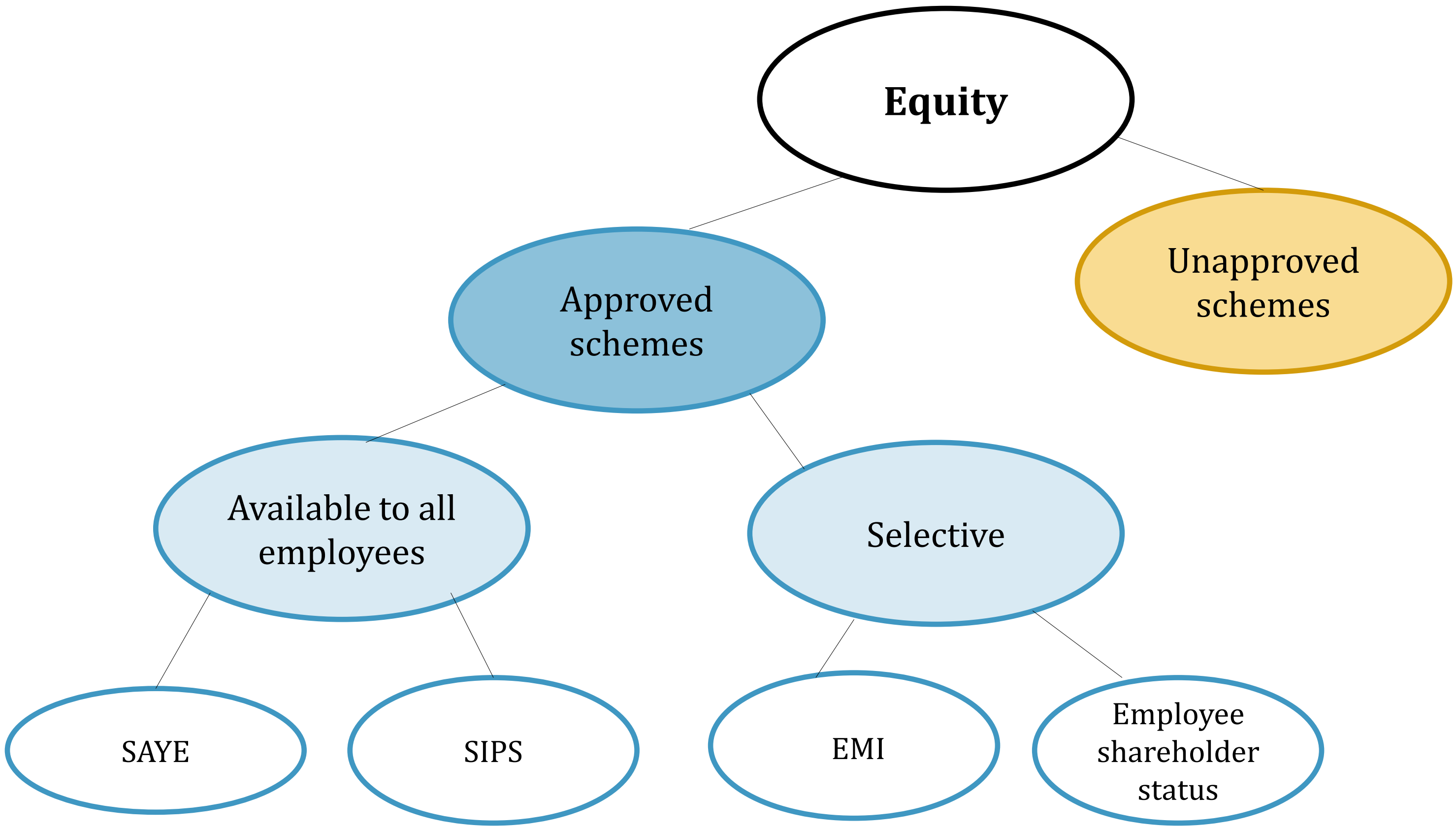
- Changing over last 10 years
- Historically a contentious area
- ‘Cat & mouse’ legislative measures
- Negative press
- 2012 push to more employee ownership & Nuttall report
- FA2013 changes

The changing climate of share ownership

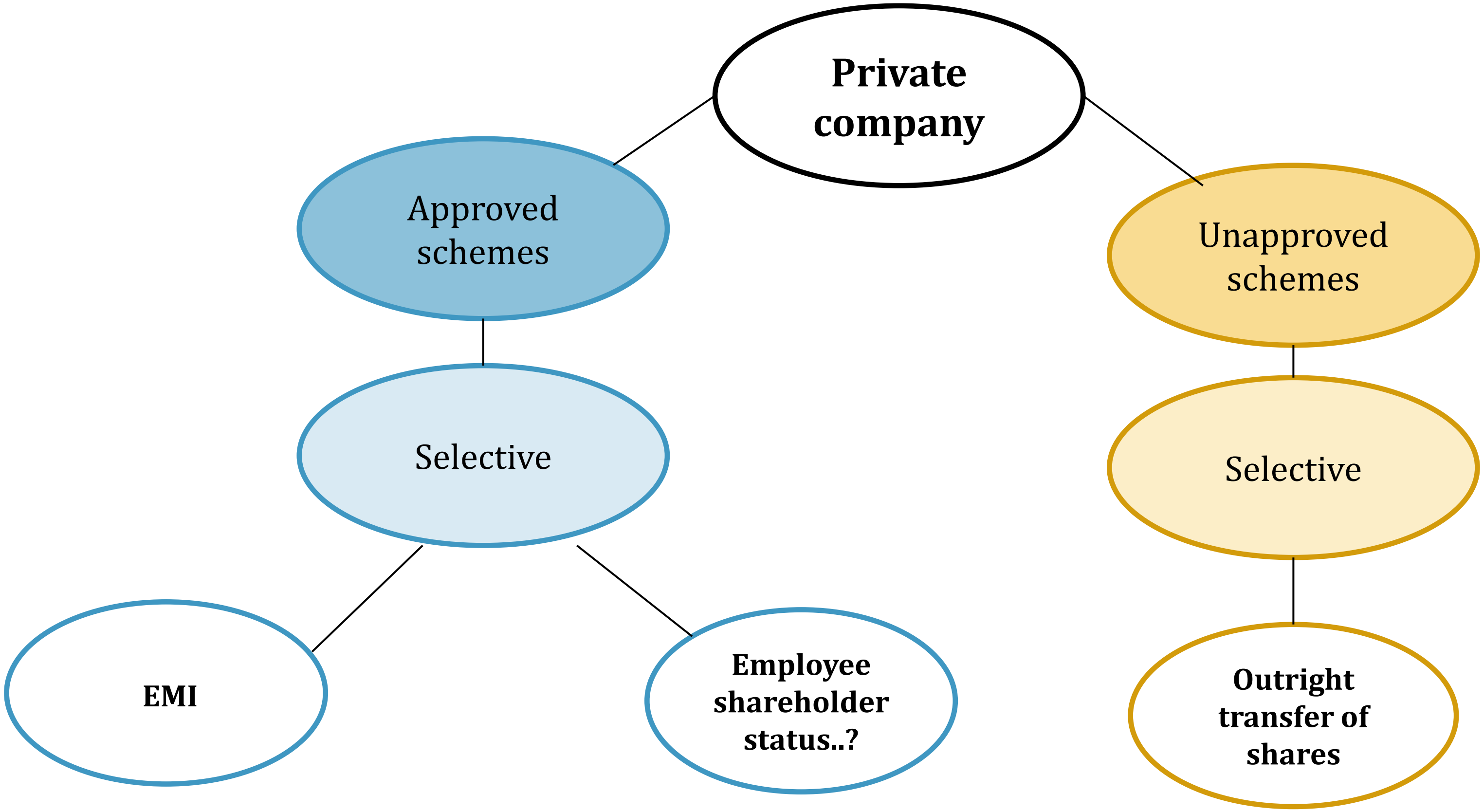
"…too few people have capital…We need more individuals to have a real stake in their firms. More of a John Lewis economy… Firms that have engaged employees, who own a chunk of their company…[have] weathered the economic downturn better than other companies..."

Nick Clegg, January 2012

Two ways of giving equity stakes to employees



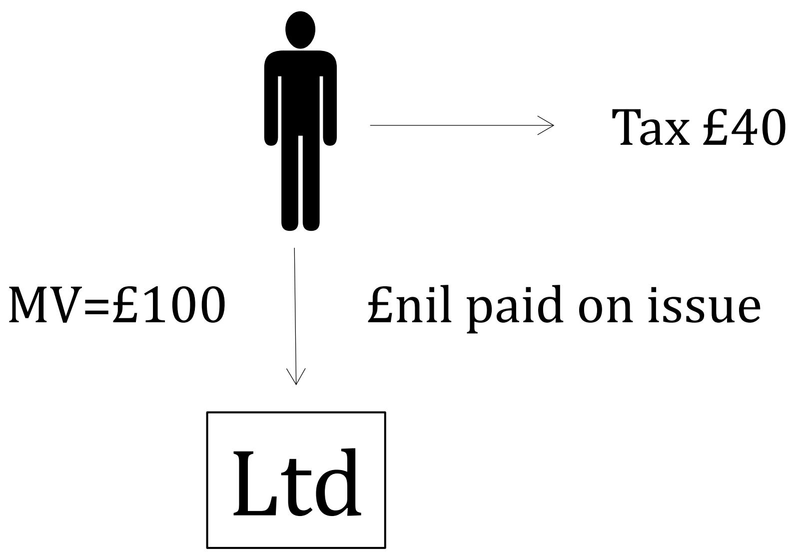
Private companies – most commonly used schemes



Unapproved schemes – outright transfer of shares

How it works:

- Governed by employment related securities (ERS) legislation, 2003
- Income tax where shares acquired at undervalue
- No tax where UMV for shares paid on issue
- S.431 election ensures subsequent increases subject to CGT, not income tax



Unapproved schemes – outright transfer of shares

Pros

- Selective
- Increased popularity on abolition of taper relief in 2008
- Loan interest relief may be available on borrowings to acquire shares

Cons

- Penal tax regime
- Value of shares cannot usually be agreed with HMRC in advance
- Risk if business hits buffers – amount paid on shares lost

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Unapproved schemes – outright transfer of shares

Partly paid shares / Nil paid shares

- Uncalled amount is a loan
- BIK under ITEPA 2003 on beneficial loan, at 3.25%, but:
- Can be avoided if interest relief under ITA 2007 s383 – cancels out tax
- BUT – share capital is payable if company gets into difficulty

History of approved schemes – changing popularity of EMI

Overview of current EMI rules (1)

- Independent, ‘qualifying’ trading companies with:
  - Gross assets < £30 million
  - Full-time equivalent employees < 250

- Eligible employees
  - No material interest i.e. < 30%
  - Min 25 hours / week or 75% of working time

History of approved schemes – changing popularity of EMI

Overview of current EMI rules (2)

- No income tax or NI on:
  - Grant of options to acquire shares at exercise price
  - Exercise of options within 10 years of grant

- CGT on disposal of shares
  - 10% of CGT with Entrepreneurs' Relief

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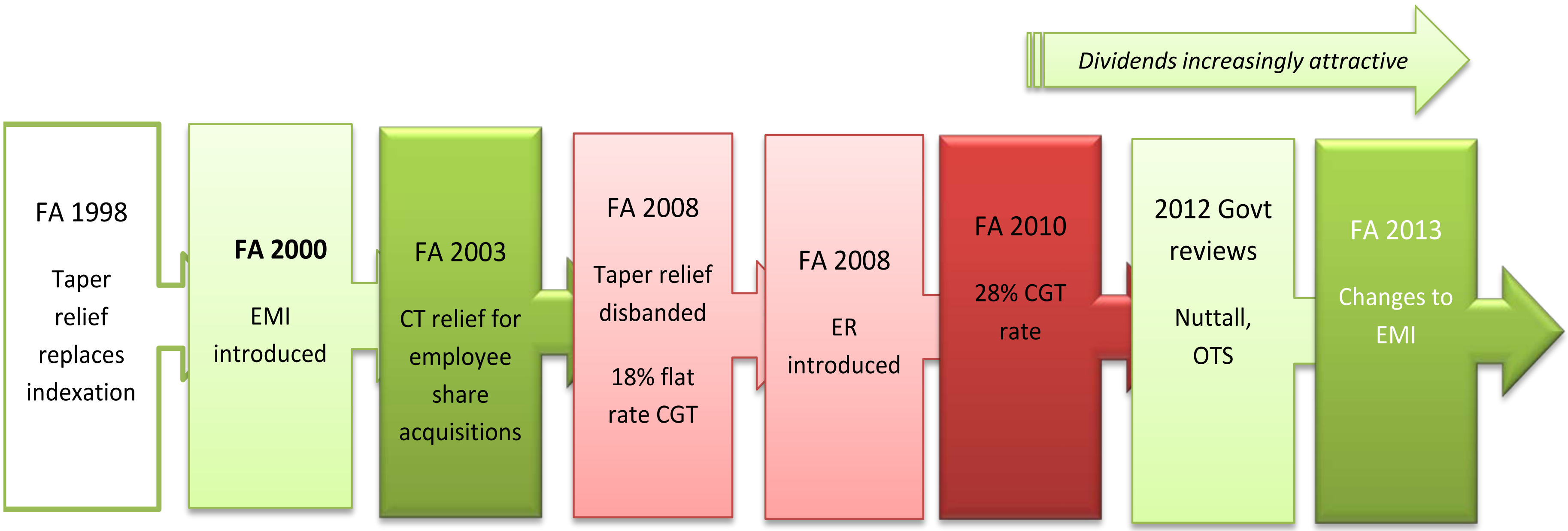
History of approved schemes – changing popularity of EMI

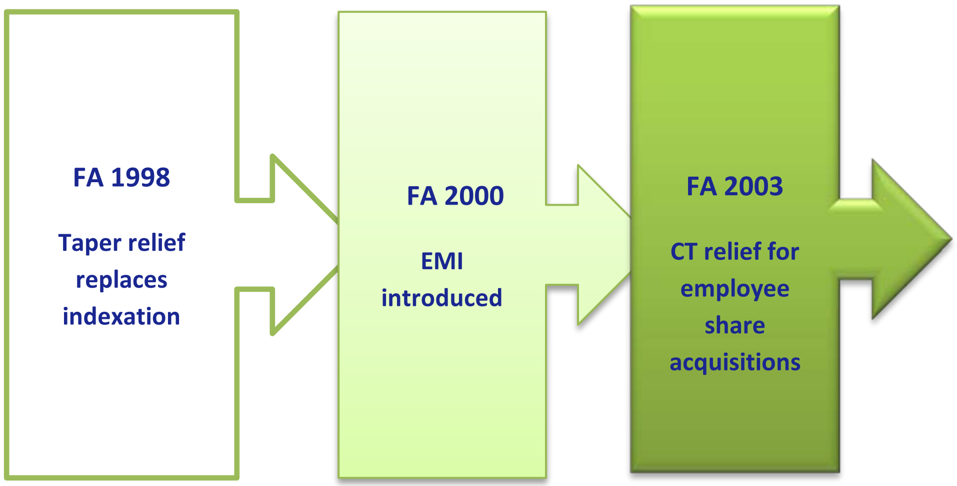
Timeline overview



- 2012 – Nuttall Review, OTS promotion of EO by government leading to FA2013 changes

History of approved schemes – changing popularity of EMI

Early years

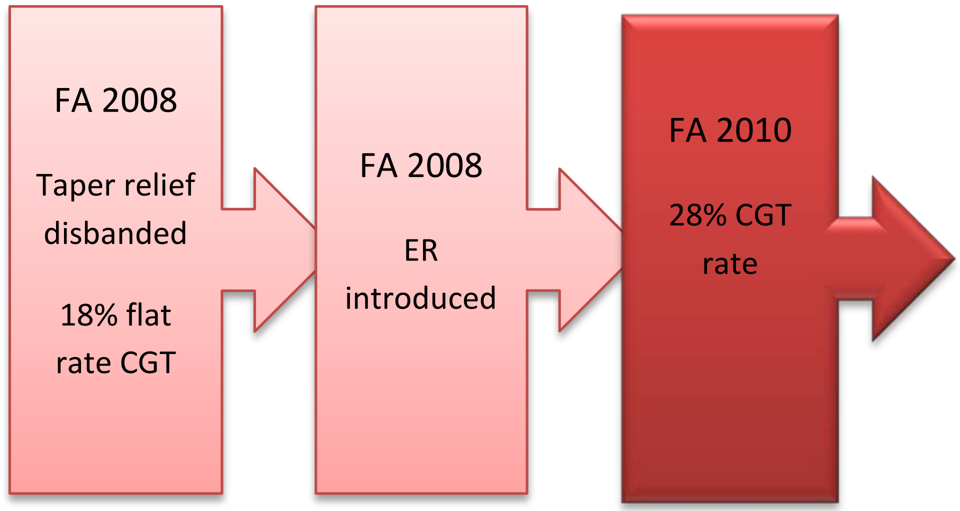


- Taper relief replaced indexation for individuals' capital gains
- Business Asset Taper Relief (BATR) – effective 10% rate of CGT on share disposals
- BATR – min 2 year holding period

- EMI introduced in 2000 – no tax until disposal of asset
- BATR holding period started on grant of option – effective 10% CGT rate
- CT relief: market value – price paid by employee
- Low set up / admin costs

History of approved schemes – changing popularity of EMI

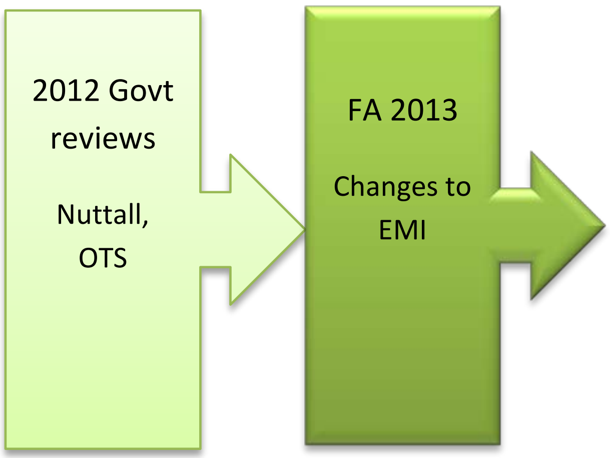
Declining popularity



- Flat rate of 18% CGT replaces taper relief, followed by 28% higher rate in 2010
- Effective 10% CGT rate no longer easily attainable on share sales
- Introduction of Entrepreneurs' Relief – min 5% shareholding requirement
- Climate of negative press surrounds management incentives

History of approved schemes – changing popularity of EMI

Government backing & legislative changes from 2012



History of approved schemes – changing popularity of EMI

Government backing & legislative changes from 2012

- Government promotion of employee ownership (EO)

- 2012 Nuttall Review finds evidence based benefits from EO

  - Improved business performance
  - Increased economic resilience
  - Greater employee engagement & commitment
  - Enhanced employee well-being & reduced absenteeism

- Barriers to EO includes:

  - Lack of awareness of concept of employee ownership
  - Lack of awareness amongst legal, tax & accountancy advisors
  - Actual & perceived legal, tax & regulatory complexities

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History of approved schemes – changing popularity of EMI

FA 2013 changes mean..

…..back to (potentially) 10% CGT on share disposal with ER!

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History of approved schemes – changing popularity of EMI

Private companies and share schemes:

? Limited value for minority shareholdings in private companies…?
- Lack of immediate market to sell shares
- Income subject to discretion of directors

✓ Evidence based benefits of participation in success of company – involvement
✓ Legislation changes and flexibility of EMI
✓ Flexibility of reward – dividends far better than bonuses

History of approved schemes – changing popularity of EMI

Conclusion:

EMI is now a ‘no-brainer’ if all the requisite conditions are met!

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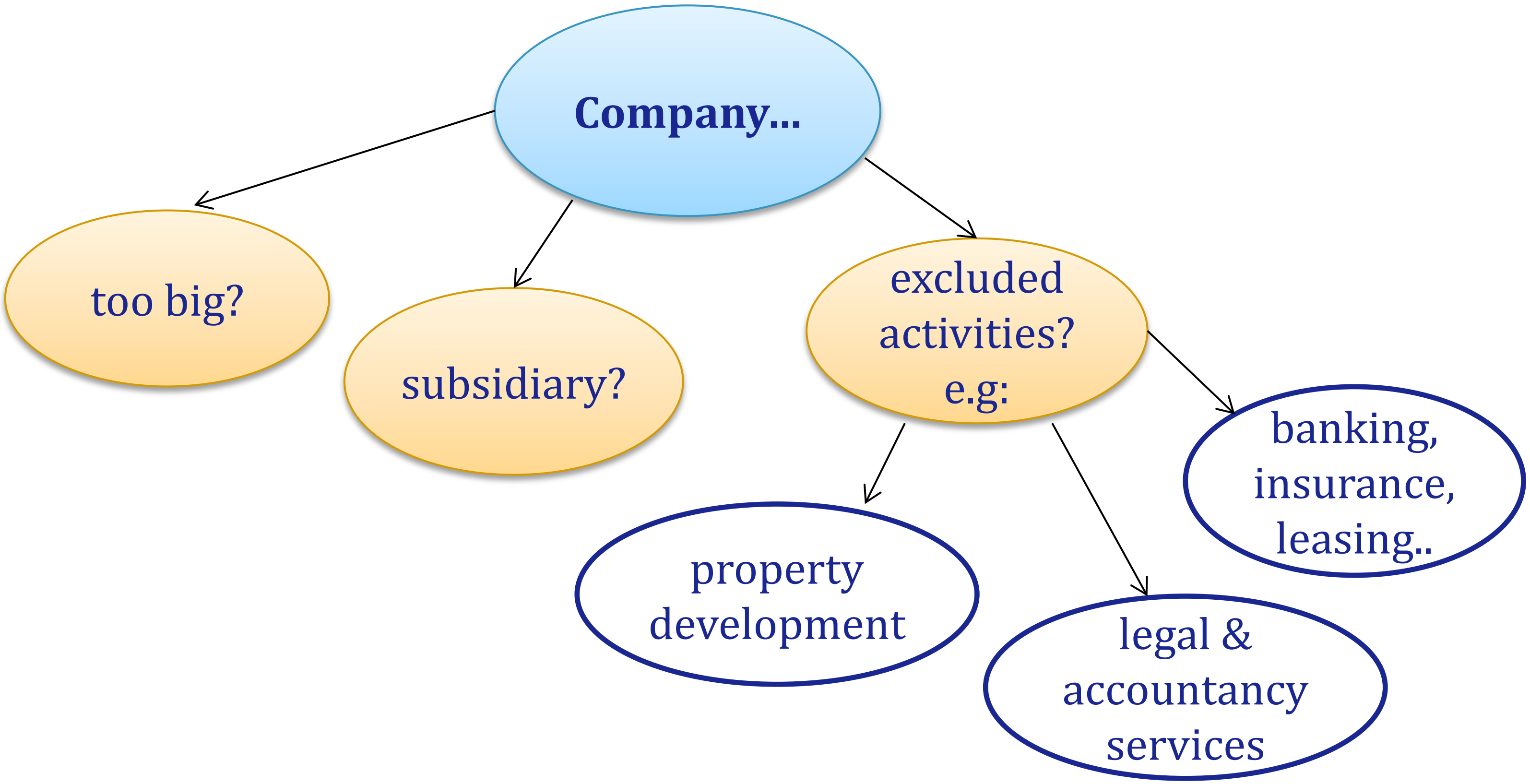
What if the criteria for EMI are not met..?



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Employee shareholder status – main points

- Main uses
  - When EMI conditions (e.g. trading requirements) not met
  - Where short term sale and no ER (eg. sale taking place within a year)
- Forfeit of statutory rights (unfair dismissal and lesser)
- Value between £2,000 and £50,000 – no CGT on disposal
- Anything over £2,000 subject to income tax and NI on acquisition
- No material interest i.e. < 25%
- No tax deduction in company

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EMI Share Options – Hurdles and Benefits

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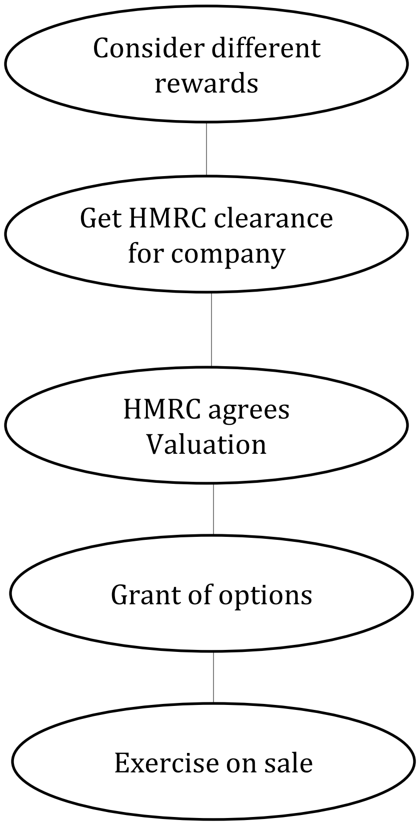
Overview

- How do EMI options typically work?
- Valuation Issues
- Tax Benefits
- Company Qualifications
- Employee Qualifications
- Exercise Events
- Questions

How do EMI Options Work?

- Agree value now
- For employees to buy shares in the future (if they want)
- On the occasion of an exit event
- Grant means issue of the option / exercise means share acquisition under terms of the option
- HMRC agree that all subject to capital gains tax (at 28% or 10%)

How do EMI Options Work?



- Straight gift of shares, unapproved options, employee shareholder status, others
- Not always necessary but some marginal cases (eg. asset backed trades, issues of independence)
- Generally trying to get HMRC to agree low value (maximise minority discounts)
- Usually grant with exercise price on ‘exit event’ being current market value
- Cash not usually paid out. Employee receives profit element.

Valuation Issues

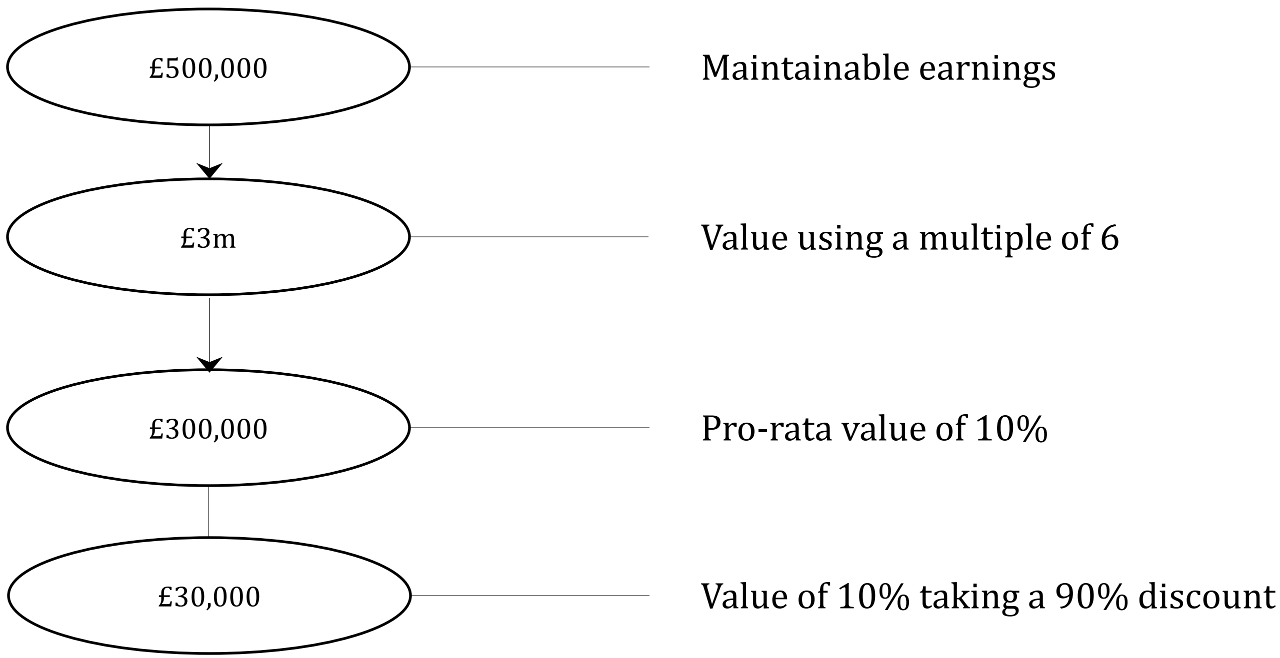
- Agree upfront (before grant) with HMRC
- Change in HMRC procedure

Typical Steps

1. Calculate ‘maintainable earnings’
2. Apply suitable multiple
3. Relate global value to share structure (growth shares etc)
4. Minority discounts (try for 90% discount)
5. HMRC negotiation

Example Valuation

Take trading company with 'maintainable earnings' of £500,000 issuing EMI options over 10% of shares.



Valuation Issues

- Actual Market Value (AMV) v Unrestricted Market Value (UMV)

  MV Including Restrictions

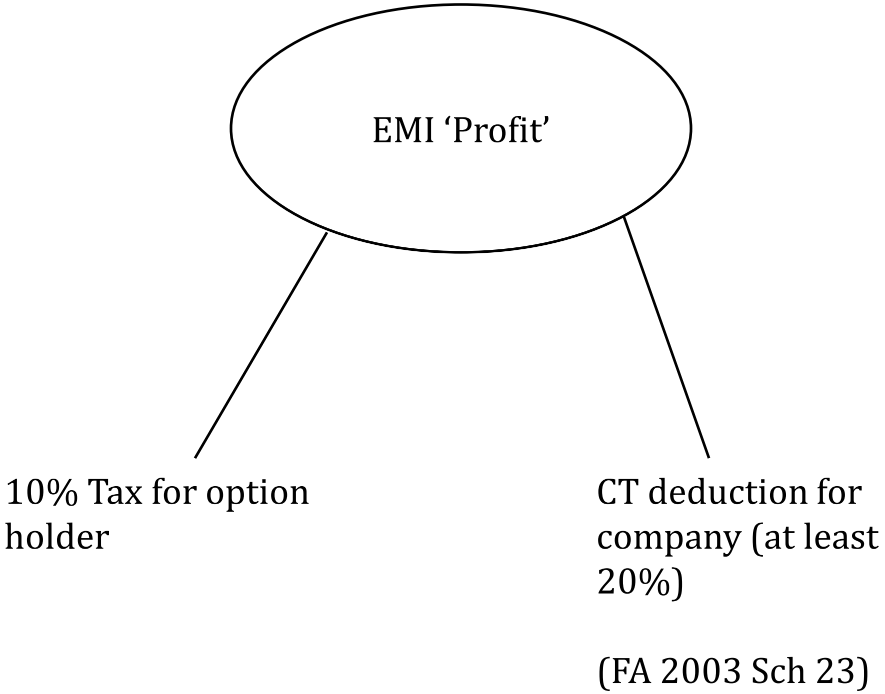
  Excluding Restrictions

- Forfeiture, minimum holding requirements are restrictions

- Agree value for each

- HMRC sometimes agree AMV = UMV / sometimes insist on 10% add on for unrestricted

EMI Tax Benefits



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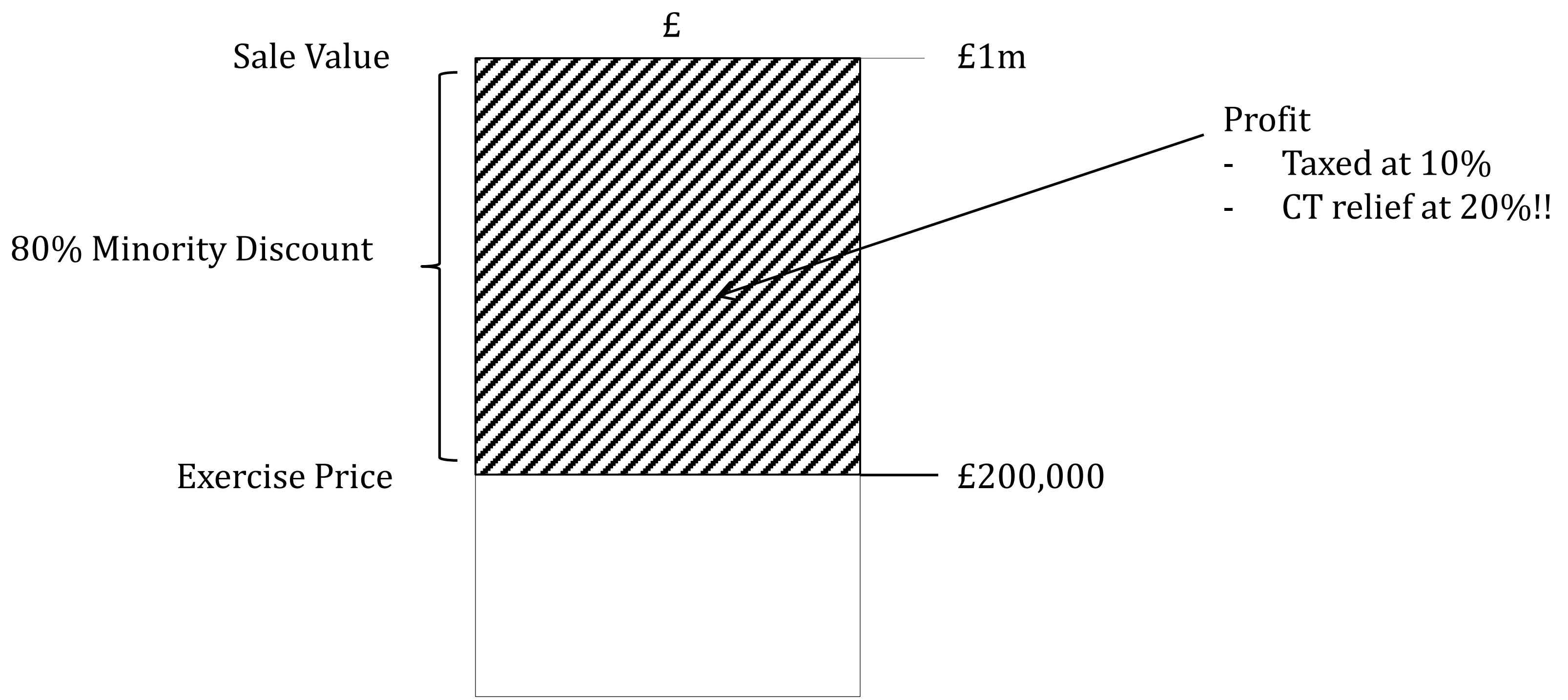
EMI Tax Benefits

- Eg. £10m company issues options over 10% of shares



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EMI Tax Benefits

Example

- £10m company
- 10% share options
- Current share value £200,000 (taking 80% discount)
- £800,000 profit

	EMI	Employer Shareholder Status	Unapproved Share Options
Employee tax liability (assume Entrepreneurs' Relief)	80,000	0	360,000 (at 45%)
Company tax saving (assume 20% rate)	(160,000)	0	(160,000)
Net tax (total)	(80,000)	0	200,000

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EMI Tax Benefits

- No tax on grant
- No income tax <u>ever</u> unless option granted at a discount (unusual)
- No tax on exercise (assuming no discount at grant)
- Tax on sale but at what rate? (10% with Entrepreneurs' Relief/otherwise 28%)

EMI Tax Benefits

Entrepreneurs' Relief

- 5% problem has been removed (5% voting power, share capital requirement)
- Year shareholding requirement removed
- But no ER between 5/4/08 and 5/4/13 (usually 28%)
- Just need 12 months from date of grant to sale
- Other ER conditions need to be met

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Lesser known Tax Benefits

- Employee 2% shareholding subscription – Plan A
- EMI option grant at market value followed by immediate exercise – Plan B

(Assume market value paid)

Plan A	Plan B
No Entrepreneurs' Relief	Entrepreneurs' Relief!
If restricted, income tax charges	No restricted securities issues

Company Qualifications

- Independence (not under control of other company)
  (Venture capital firms)

- Property managing subsidiaries (must be 90% owned) – strange rule

- Qualifying subsidiaries – controlled company must be 51% subsidiary (49% shares, 55% votes?) – again strange rule!

- Gross assets do not exceed £30m
  - all assets of subsidiary counted
  - No deduction for liabilities
  - Accounts basis
  - Goodwill

- UK permanent establishment requirement

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Company Qualifications

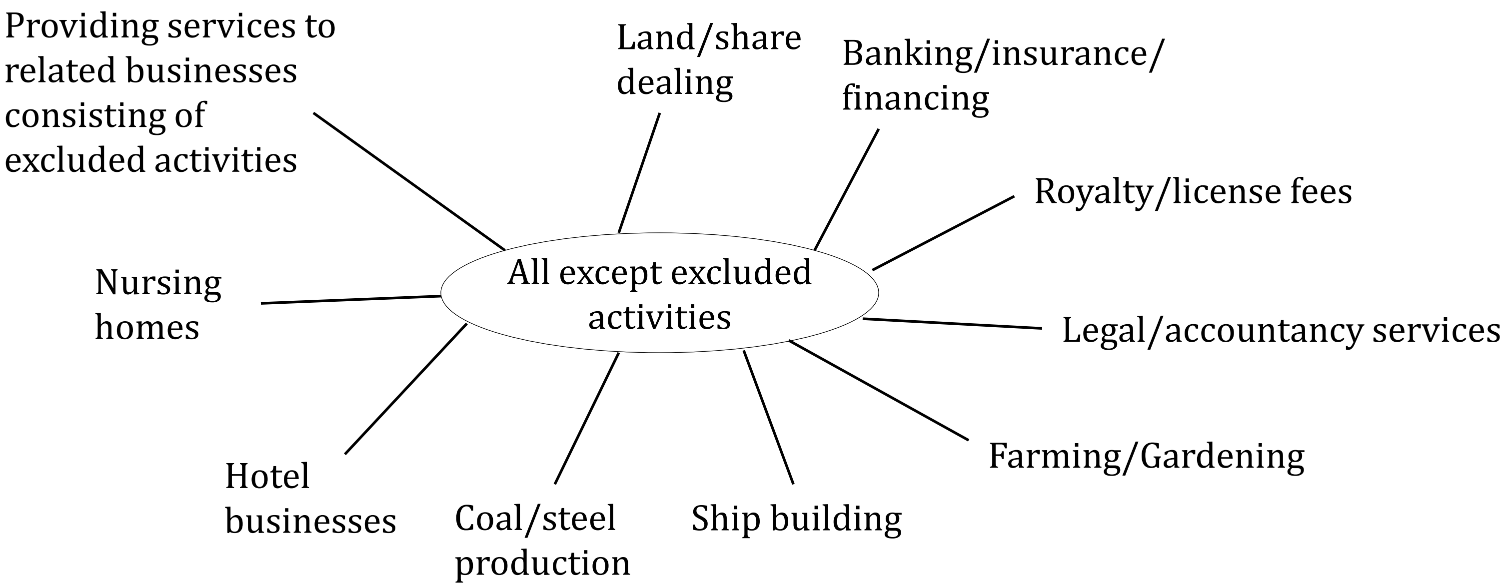
- Number of employees

  - Introduced from 21 July 2008
  - Less than 250 full-time equivalent (at least 35 hours per week)
  - Don’t count maternity / paternity leave
  - Exclude apprentices
  - No averaging (based on time of grant)

- Also restricted to £3m of unexercised EMI options

Company Qualifications

Trading Activity Requirement

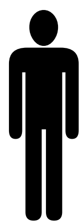


- **Needs to be 'substantially' qualifying (80%)**

Employee Qualifications

Employee of company or subsidiary

Working time requirement (25 hours average, or 75% of working time)



Granted by ‘reason of employment’ (when would this not be the case?)

No material interest

- No more than 30% ordinary shares
- Or entitlement to 30% of assets on a distribution
- Associates
- Count non-EMI options

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Employee Qualifications

Individual Limits

Unrestricted value

- Unexercised qualifying EMI options cannot be worth more than £250,000 (only excess is non-qualifying)

- Market value at date of grant (exercise irrelevant)

- Parallel options?
  - Different options
  - Only one class can be exercised
  - 'Only the maximum number of shares which may be acquired under either option need be counted'

- Not usually a problem

Exercise Events

Individual Limits

- Capable of exercise in 10 years
- Usually only exercisable on ‘exit events’ (third party sale)
- This doesn’t breach 10 year rule
- Generally flexible and no need for exit events
- Exercise and sale to company etc (later)

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Examples of Flexible Exercise Conditions

- Exercisable on meeting specific performance targets
- Variable number of options exercisable at management discretion
- Exercise on almost unlimited variety of events
- Very few limitations

Eg. Sales staff

Performance related bonus

or

- Taxed at 45% (top rate)

- 10,000 share options (subject to value)
- Number exercisable based on sales figures
- (possibly management discretion)
- Need internal market (later……..)
- 10% if sold after a year

Any Questions?

matrix

Green Sky Energy Limited - use of share options

Background

- Green Sky Energy Limited formed in 2010:
  - Plan to create the UK's leading energy management and carbon reduction business
  - Private equity backed
  - Grown in 3 years from shell company to:
    - £50m+ turnover
    - 350 employees
    - Blue chip customer base
  - Trades as "Matrix: Sustainable Energy Efficiency"

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Provision of services to customers with large building estates and a desire to reduce their energy consumption

TESCO

YOUR M&S

BT

DIXONS RETAIL
BRINGING LIFE TO TECHNOLOGY

Boots

Virgin media

Sainsbury's

TK maxx

JD

Bloomberg

WHSmith

HOUSE OF FRASER

Nationwide
On your side

LLOYDS BANKING GROUP

Background

- Business was 100% acquired by E.ON in October 2013:
  - Created exit for Lloyds Development Capital
  - Business plan developed with existing management team to continue growing the business
  - Provides access to E.ON customer base, finance and resources across Europe

My role

- Built infrastructure from zero base!
- Manage day to day finances
- M&A
- Stakeholder management

Shareholding structure – early 2011

		Number of individuals	Shareholding
Lloyds Development Capital	Private equity investor	n/a	46.4%
Ex shareholders of Matrix/DWEC	Businesses acquired in 2010	26	25.9%
Original buy-in team		4	22.7%
Unallocated shares		n/a	5.0%
TOTAL		**30**	**100.0%**

Nearly 50% of the company owned by 30 employees (total workforce at that time circa 170)

matrix

Challenges created by offering further employees direct share ownership

- Legal fees/documentation
- Companies House disclosure
- HMRC valuation
- Risk of creating PAYE liability
- Limited opportunity for Entrepreneur Relief
- High level of admin and aggravation associated with leaving shareholders

A potential solution

- **Enterprise Management Incentives ("EMI")**
  – tax advantaged share options
- **Available to companies with:**
  – No controlling parent company
  – gross assets below £30m
  – Less than 250 employees
  – Qualifying activities

matrix

EMI – how did it work for us?

- Scheme created/implemented in Autumn 2011
- Granted employees options to acquire shares for £1 each on an "exit event"
- £1 agreed with HMRC as the fair market value of the shares at the date the options were granted
- Options lapse if the employee leaves

EMI – how did it work for us?

- EMI options granted to 14 employees:
  - 2 existing shareholders
  - 12 others where retention/incentivisation was felt to be important to business success
  - Created shareholding interests between 0.12% and 1.5%
- Options granted over all unallocated shares plus others held by CEO

EMI – what was required to implement the scheme?

- Assessment to check eligibility
- Discussions with employees to explain why we would like to make them shareholders
- Relatively simple legal documentation
- Letter to HMRC to agree valuation
- Ongoing annual HMRC reporting

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Questions from employees

- What will it cost me?
- What’s the impact on my ongoing remuneration package?
- How will it be taxed?
- Why are you not giving me real shares?

What was the outcome for the EMI option holders?

- 3 left the business:
  - Options lapsed on leaving
  - No legal documentation required
  - No cost to the business or the option holders
  - Freed up the CEO shares which had been subject to options

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What was the outcome for the EMI option holders?

- Remaining 11 exercised their options when Green Sky Energy was sold to E.ON:
  - Cost them £16k in total to exercise the options
  - Received initial cash proceeds of £0.75m
  - Right to receive substantial additional consideration dependent on performance
  - Eligible for ER so capital gain taxable at 10% vs 28% for most other shareholders

What benefits did EMI offer us?

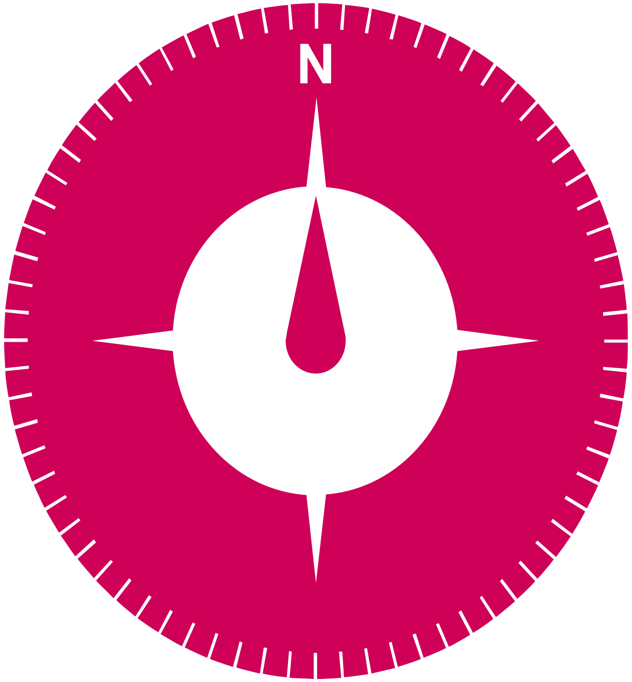
- Company
  - Simple to set up and administer
  - Flexibility vs direct share ownership
  - Secure employee loyalty with no P&L impact
  - Corporation tax deduction available when options exercised
- Employees
  - Incentive to stay with the business
  - Alignment with other shareholders
  - No cost to enter scheme
  - Tax efficient exit proceeds

matrix

Use of shares and share options to reward and incentivise employees - innovative strategies for your clients

Employee Shareholder Status

Go further



Haydn Rogan

7 July 2014

Employee Shareholder Status°

History and Background

- Announced by Government and consultation launched in October 2012
- Primarily aimed at small fast-growing companies that want a flexible workforce
- Creates a third class of employment status - ‘employee owner’ (renamed “employee shareholder”)
- Employee shareholders given shares in exchange for giving up certain statutory employment rights
- Idea is to create a more engaged workforce
- Legislative framework set out in Growth and Infrastructure Act 2013 and Finance Act 2013
- Came into effect on 1 September 2013

Overview

- Directors/employees give up the following statutory employment rights:
  - the right to a statutory redundancy payment;
  - the right to claim unfair dismissal (except for reasons that are automatically unfair or which relate to discrimination);
  - the right to request flexible working in certain circumstances;
  - the right to request time off for study or training; and
  - agree to an increase in the amount of notice they must give of their intention to return to work during the maternity/paternity leave period to 16 weeks (as opposed to 8 weeks/6 weeks),

- In exchange they receive shares worth at least £2,000 (at the time of acquisition) in their employer (or its parent undertaking).

- Employment rights can be given back on a contractual basis

Tax treatment

- ESS shares attract both income tax (IT) and capital gains tax (CGT) reliefs
- Reliefs subject to conditions

IT

- First £2,000 worth of ESS shares exempt from IT and NICs.
- If given shares worth > £2,000 (immediate) IT charge on the excess
- No IT relief if employee (or a connected person) has or is entitled to acquire a material interest (25%) in the employer or parent undertaking (1 year look back)
- Exemption from usual IT charge on buyback of ESS shares (provided buyback takes place **after** termination of all employments and offices and shares qualify for ESS CGT relief).

CGT

- Disposal of ESS shares (valued at up to £50,000 at date of acquisition) is exempt from CGT
- No CGT relief if material interest (1 year look back)
- No exemption for inter spouse transfer of ESS shares and care required re share exchanges

Who can become an employee shareholder?

- Both existing or new employees can become employee shareholders
- Can be an employee of a UK or overseas company
- Existing employees cannot be required to become an employee shareholder (and have additional employment protections against being discriminated against or unfairly dismissed due to any refusal to do so)
- All other rights same as for employees
- Employee shareholder status not dependent upon continuing to hold the shares
- Tax benefits only if no material interest

Practical issues and considerations

- Need to check if shareholder authority required
- Can use any class or type of shares (can be non-voting shares)
- Shares can be subject to forfeiture if the employee leaves the company (eg good leaver / bad leaver)
- Need to consider forfeiture/buyback provisions in articles
- Shares must be issued fully paid up
- There can be no consideration for the shares (other than agreeing to become an employee shareholder)
- Mechanism for allotting shares (capitalise reserves or treat as issue for non cash consideration)
- May be technically possible to issue in tranches (but number of issues)
- Need to consider general directors duties (promote success of company for benefit of members as a whole)

Valuation

- Shares must be worth at least £2,000 at time of acquisition

- Problem for small / start up companies?

- May be able to underpin the £2,000 minimum valuation in other ways (HMRC appear relaxed)

- Process in place for agreeing valuation with HMRC Shares and Assets Valuation in advance of allotment

Procedure

- Provide employee with:

  - a written statement of particulars of the status of employee shareholder; and
  - a copy of the proposed contractual documentation/agreement to become an employee shareholder;

- They must then receive advice from an independent adviser as to the terms and effect of the proposed agreement with the company (with the reasonable costs of this advice being met by the company); and

- 7 days after they have received the independent advice the agreement can be entered into.

Written statement of particulars

Must include:

- A statement of the rights that the individual will not have as an employee shareholder
- The increased notice periods on returning early from maternity, adoption or additional paternity leave.
- What voting rights / dividend rights / rights to distribution of surplus assets attach to the ESS shares.
- If the company has more than one class of shares explain how the rights attaching to the ESS shares differ from the equivalent rights that attach to the shares in the largest (or next largest) class
- Whether the ESS shares are redeemable and any restrictions on transfer
- Whether the ESS shares are subject to drag along and tag along rights
- Whether any statutory pre-emption rights are excluded in the case of the ESS shares

Independent advice

– Once given written statement of particulars, individual must receive advice from an independent adviser as to terms and effect

– Reasonable costs of such advice to be met by company (whether or not take up offer to become employee shareholder)

– Independent adviser

  – Qualified lawyers
  – Officers, officials, employees or members of an independent trade union who have been certified by the union as competent to give advice and as authorised to do so on its behalf.
  – Those working at an advice centre (whether as an employee or a volunteer) who have been certified as competent to give advice and as authorised to do so on its behalf, provided the employee has not paid for the advice
  – Those specified in an order made by the Secretary of State (Fellows of the Institute of Legal Executives employed by a solicitors' practice).

– No income tax charge (benefit in kind) on individual re payment of such costs by employer

When to consider ESS

- Company / individual does not qualify for EMI or other approved options due to:
    - size requirements
    - independence requirements
    - working time requirements

- To date most widely taken up in context of venture capital backed companies
    - CGT exemption as compared to 10% rate with benefit of Entrepreneurs' Relief
    - No 5% or 12 month holding requirement
    - Loss of employment rights not as onerous for senior management
    - Can be used in overseas companies
    - No restriction on type of shares

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Using shares to pay dividends to employees

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Use of dividends as remuneration planning

What's covered:

- Comparison of dividends v salary
- Scenarios where dividend planning may be appropriate
- Methods
  - Spousal income splitting
  - Dividend waivers
  - Differential share classes
- Tax issues, anti-avoidance rules etc.

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Taxation of dividends v salary

		Higher rate	Additional rate
Dividend paid (A)	9,000		
Grossed up value (x 100/90)	10,000		
Taxation		x 32.5% = 3,250	x 37.5% = 3,750
Tax credit		(1,000)	(1,000)
Tax payable (B)		**2,250**	**2,750**
Net receipt		**6,750**	**6,250**
Effective rate of tax (B/A)		**25%**	**30.56%**

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Taxation of dividends v salary

Extra £100,000 to be extracted:

SALARY	Higher rate	Additional rate
Profit before tax	100,000	100,000
Deduction for gross salary + Employers NIC	(100,000)	(100,000)
Taxable profits	0	0
Corporation tax	0	0
Employers NIC (13.8%)	12,127	12,127
Gross salary paid to employee	87,873	87,873
Employees NIC (12.8%)	(1,757)	(1,757)
Income tax (40%/45%)	(39,149)	(39,543)
Net take home amount	**50,967**	**46,573**
Combined effective rate of tax	**49.0%**	**53.4%**

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Taxation of dividends v salary

Extra £100,000 to be extracted:

DIVIDEND	Higher rate	Additional rate
Profit before tax	100,000	100,000
Corporation tax (20%)	(20,000)	(20,000)
Profits available for distribution	80,000	80,000
Income tax payable	@ 25% = (20,000)	@ 30.56% = (24,448)
Net receipt	**60,000**	**55,552**
Effective rate of tax	**40.0%**	**44.4%**
Saving compared to paying salary	**9.0%**	**9.0%**

Taxation of dividends v salary

Tax planning optimum:

- Paying salary of up to £10,000 will make full use of personal allowances.
- Even better, pay salary at least up to the NIC secondary threshold (£7,956)
  - Ensures deemed contribution for social security without NIC cost

BUT:

- National minimum wage rules
- Pension issues
- May complicate matters with regard to obtaining finance (mortgages etc.)

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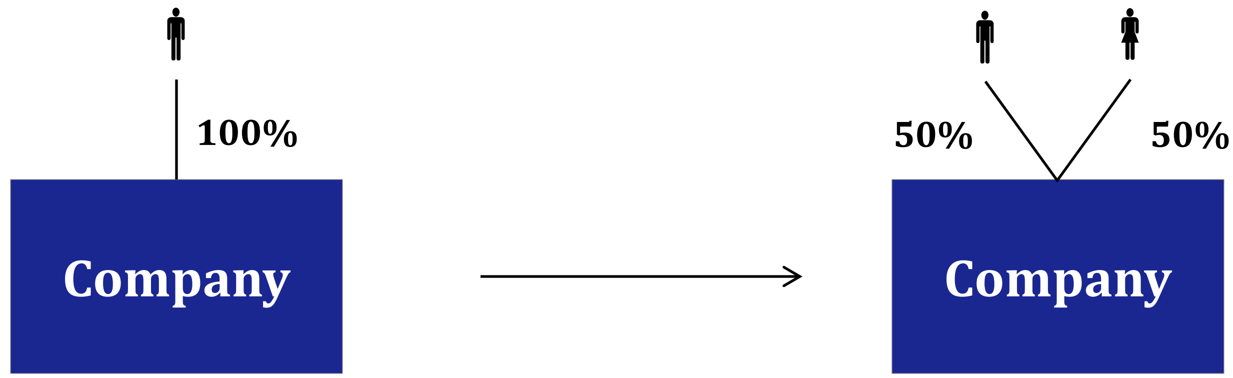
Scenarios where dividend planning may be appropriate

- Husband and wife owned company
- Professional practice which incorporates
- Company which wants the ability to incentivise/reward employees with (dividend) bonuses

Income splitting with spouse



- Utilise spouse's personal allowance / basic rate band
- HMRC historically argued that the settlements legislation applied
- *Jones v Garnett ("Arctic Systems")* case (2007)
- Planning works provided there is an outright gift of shares (not merely a right to income)

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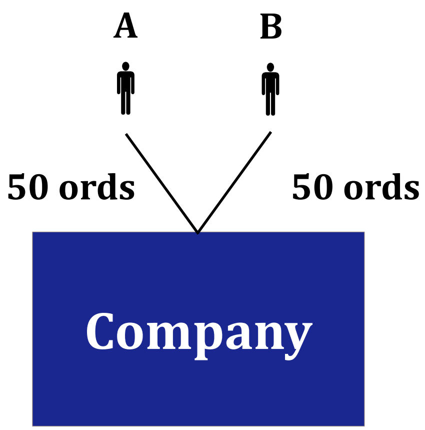
Dividend waivers



Company wants to pay extra £100k to B.

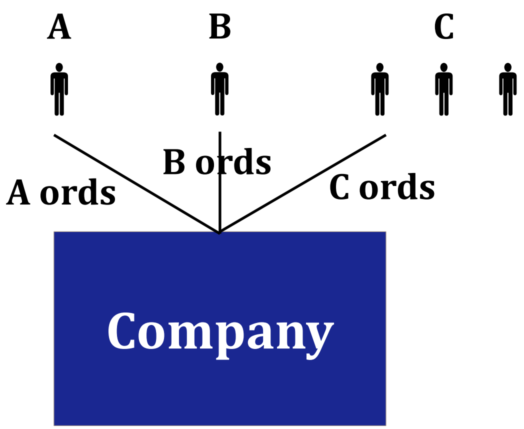
Company declares dividend of £200k.

A waives the right to his £100k dividend.

B receives £100k.

- If there are other shareholders in the same class unless they choose to waive their rights they too would be entitled to a dividend payment
- Requires distributable reserves equal to the total dividend declared (including amounts waived)
- The dividend waiver should be made before the right to the dividend accrues
- Care needed where there is a succession of waivers (see *Donovan & McLaren v HMRC)*

Differential share classes



Company wants to pay variable dividends.

Shares or different denominations set up (A, B, C etc.)

Issues:

- How does the company get shares into the hands of employees?
  - Tax charge on acquisition equivalent to market value
  - Employee shareholder status?
- Valuation issues
  - Consider what rights attach to the shares
  - Minority discount

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Further issues

- HMRC may seek to treat dividends as employment income
- Is this correct?
  - Dividends are already taxable (as investment income). S.716A ITEPA – dividend treatment takes priority
  - HMRC argue that the dividend constitutes a "post acquisition benefit), taxable under s.447(4) ITEPA if "something has been done that affects the securities" as part of a "tax avoidance arrangement".
  - *PA Holdings* case – dividend taxed as employment income
- More likely in circumstances where dividends have been used to replace previously contractual rights or where there are huge disparities in dividends being paid to different shareholder classes
  - HMRC less likely to challenge where risk-taking is present

Final remarks

- In the current climate dividends are a more tax efficient form of reward
- Restricting salary to the extreme is likely to be viewed as provocative
- Using dividends to pay profit shares as an addition ‘top-up’ to normal salaries has lower risk (and more likely to be accepted by employees!)
- Made easier through the new employee shareholder status scheme

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Realising the Capital Value for the Employee

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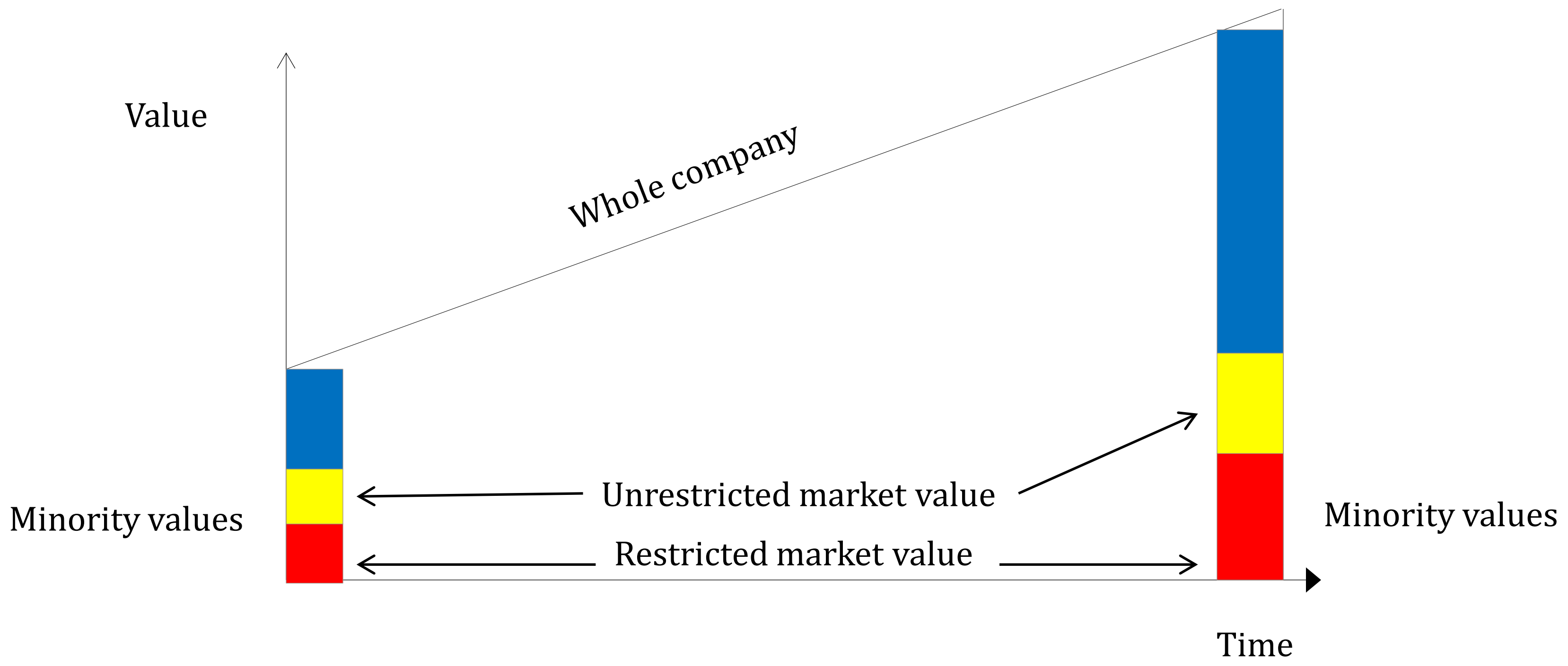
Tax objectives for employee

- Capital gains treatment
- Tax free, or
- 10% with entrepreneurs’ relief

How do the shares increase in value?



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Example – Widgets Ltd

	2010	2020
Whole company	5M	15M
Shares in issue	1,000	1,000
Pro rata share value	£5,000	£15,000
5% share values:		
Unrestricted	£500	£1,500
Restricted	£400	£1,200

Widgets Ltd – Whole company sale in 2020

	£
John – 5% Holding	750,000
Cost 50 x £400	20,000

Gain	730,000

Tax at 10%	73,000
Net	£657,000
	=======

Whole company sale maximises value for minority shareholders

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If no company sale – alternatives

Company Share Buy Back

	Share	Employee Share	EMI
Value	Good	Good	Good
- Per share	£10,000	£10,000	£10,000
CGT Treatment	Conditions 5 years	Yes	No
Tax rate	10%	Nil	28%
Net receipt	£452,000	£500,000	£360,000

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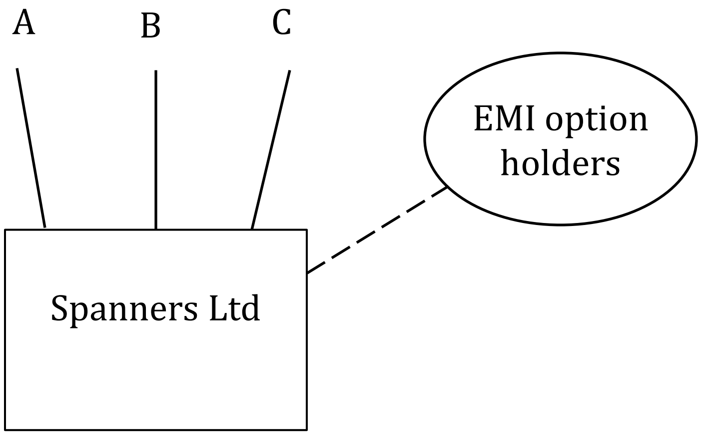
If company share buy back not feasible – what next?

- Internal reorganisations
  Value good – up to £15,000?

- Employee Trust
  Minority value likely – up to £7,000?

Excess over market value subject to income tax (Grays Timber)

Company reorganisation – typical scenario



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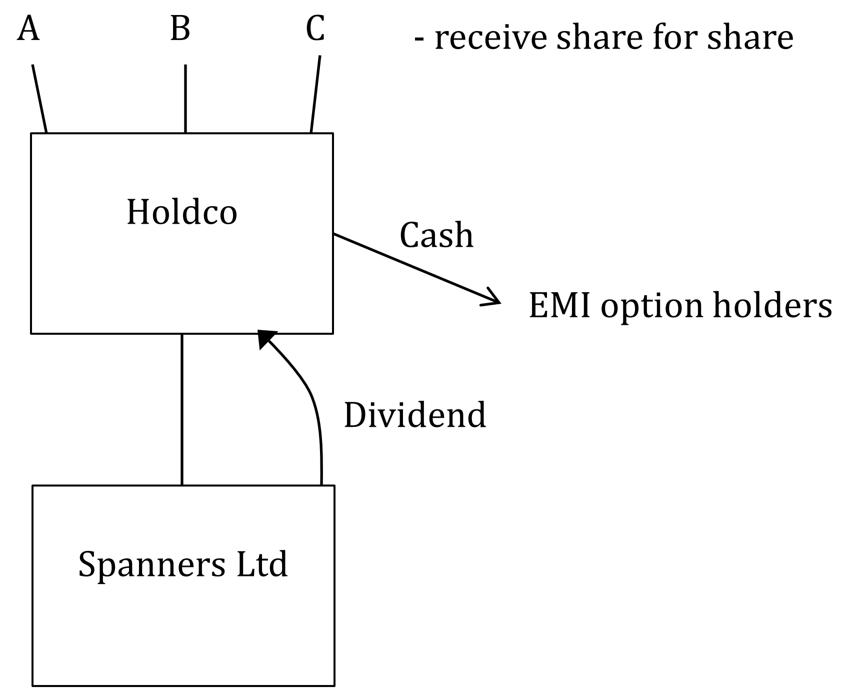
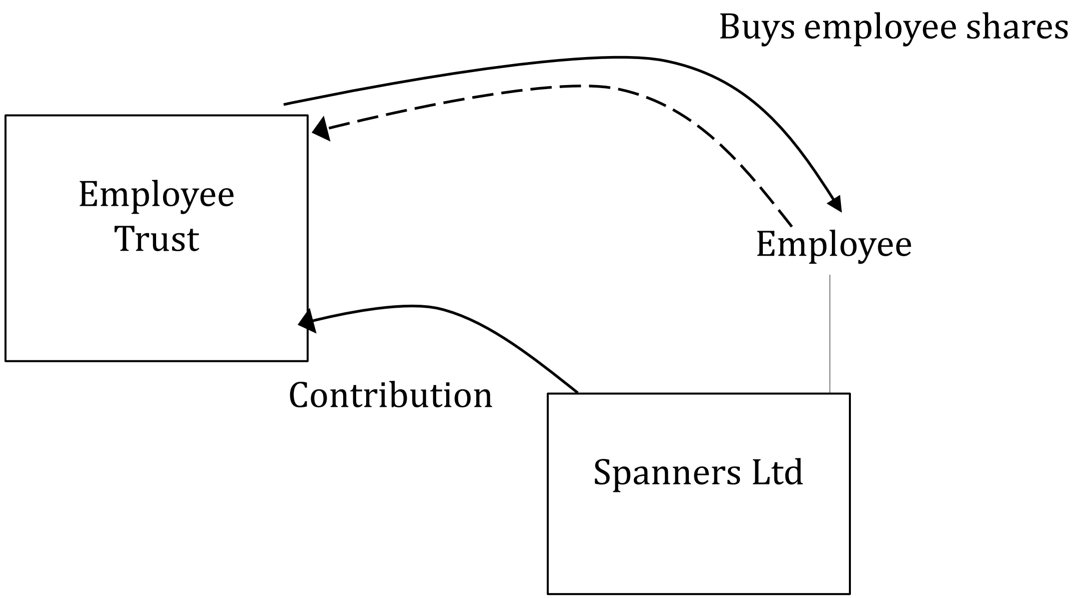
Company reorganisation – insert Holdco



Company reorganisation – tax issues

- Clearance under Sections 701 ITA 2007 and 138 TCGA
- Commercial reasons; consolidate group
  separate assets from trade
  bring new shareholders into trading company (eg. as employee shareholders)
- EMI options; exercise before tradeco becomes subsidiary

Employee Trust



Employee Trust - Issues

- Disguised remuneration – avoid any earmarking
- How do you unwind?
- Use Guernsey purpose trust – allows surplus assets to return to sponsoring company
- Transactions in securities clearance

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Conclusions

- Company sale intention makes share schemes work best

  BUT

  - Real benefits can be obtained by other routes
  - HMRC accept favourable values on issue

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Thank you for Listening
Any there any Questions?