

UK share plans for US companies

About this Guide

The UK has a strong culture of equity reward which will be familiar to US companies and their advisers. Although there are plenty of similarities in how we do things, there are of course many differences too. This guide sets out very briefly some key information about the main UK plans and summarises some of the areas where seeking additional guidance is often wise.

Share plans with tax incentives

Selective plans

Company Share Option Plan (CSOP)

- Option to buy shares at no less than today's price, after 3 to 10 years.
- Option gains are free of income tax and National Insurance (NI)
- Capital gains (CGT) on sale of shares

Main requirements

- Company must not be controlled by another company unless it is listed
- Ordinary shares, fully paid, not redeemable
- Shares must not be inferior to other shares

Limits

- Maximum £30,000 share value at date of grant

Enterprise Management Incentives (EMI)

- Similar to a CSOP, but with no minimum 3 year period, and superior tax breaks. EMI is only for smaller companies in certain trades.
- Option gains are free of income tax and NI
- CGT on sale of shares

Main requirements

- Company must not be controlled by another company
- Ordinary shares, fully paid, not redeemable

Limits

- Maximum £100,000 value per employee, £3 million for the whole company, at date of grant

All employee plans

Share Incentive Plan (SIP)

Employees can:

- Be given shares tax free (Free Shares); and/or
- Buy shares out of their pre-tax pay (Partnership Shares;) and
- If they buy Partnership Shares, be given matching free shares (Matching Shares)
- Receive dividends as further tax free shares (Dividend Shares)

Main requirements

- Inland Revenue approved trust
- Company must not be controlled by another company unless it is listed
- Ordinary shares, fully paid, not redeemable
- Shares must not be inferior to other shares

Limits

- Free shares - £3,000 a year
- Partnership Shares - £1,500 a year (or 10% of annual pay if less)
- No more than two Matching Shares for each Partnership Share
- Dividend Shares - £1,500 a year

SAYE options

- Employees are given an option to buy shares at today's price (or less 20%) in 3, 5 or 7 years' time
- Must save each month to build up the money to exercise the option (but they can keep it at the end if they don't exercise).
- CGT on sale of shares

Main requirements

- As for CSOP

Limits

- Employee may not save more than £250 a month, or less than £5

Share plans without tax incentives ("unapproved" plans)

Options
Free shares
Restricted shares
Shares held in trust (EBT)

- Despite name, legitimate way to reward employees and/or executives
- No tax advantages
- No limits to value of shares or options that can be received by participants
- No eligibility requirements for companies or participants

Other issues - before and after the introduction of a share plan

Prospectus Directive

Applicable from: 1 July 2005

Applicable to: All companies (including unlisted, and non-EU) offering EU "traded securities" (shares) to their employees

Requirements: Companies must at least consider the production of a prospectus. Although this may not always be necessary, the question needs to be covered with care. Position likely to be more involved for many US companies wishing to offer stock to UK or other European employees.

Accounting treatment

1 January 2006 (1 January 2005 for listed companies)

All UK companies (except smaller companies) providing share based benefits for their employees

Companies must show any benefit to employees as cost in accounts. Value of any options granted must be charged as cost to the company over the expected life of the option (usually between 3 and 5 years)

Tax treatment

Tax treatment of the various share plans available in the UK is complex. The following table gives a broad outline of the likely tax treatment and highlights some potential pitfalls.

CSOP, SAYE options	<p>Summary of tax treatment</p> <p>Generally no tax on grant or exercise of options. There are statutory time limits when options can be exercised; if these are not complied with a tax charge may arise. CGT on sale of shares at 18% rate (with annual exemption).</p>
EMI	<p>Generally no tax on grant or exercise of options – but there may be a tax charge on exercise if options are granted at a discount. Strict eligibility criteria. A change in the circumstances of the company may result in a loss of tax benefits for participants. CGT on sale of shares at 18% rate (with annual exemption).</p>
SIP	<p>Partnership Shares are purchased out of pre-tax salary. Free and Matching Shares are tax-free. However, if the participant leaves the company in certain circumstances tax can be charged after all.</p>
Unapproved share options	<p>No tax on grant. Income tax on exercise of options on the difference between exercise price and market value at date of grant.</p>
Restricted securities	<p>Highly complex! Under the restricted securities regime, if shares are acquired at a reduced value because of restrictions there may be a further income tax charge on the date the restriction is lifted. A restriction can include a risk of forfeiture, or a restriction on the holder's freedom to retain or dispose of the shares. Employers and employees may jointly elect to opt out of this deferred tax charge by paying income tax on the immediate value reduction caused by the restriction, allowing any subsequent gain in value to be taxed under CGT.</p> <p>Where income tax or NI is payable</p> <p>Income tax payable at up to 40%. Employee's (primary) NI rate: variable; employer's (secondary) NI rate: 12.8% (uncapped). Companies may choose to transfer their employers' liability for NI onto the employee by requesting them to enter into an election.</p>
Summary	<p>Capital Gains Tax</p> <p>Payable at 18% (for disposals from 5 April 2008) but annual exemption may apply. In limited circumstances a reduced rate of 10% may apply (at least a 5% holding is sold by an employee or director who has held it for at least one year)</p>
Summary	<p>Corporation Tax</p> <p>Provided the company is not controlled by another company, a corporation tax deduction can be claimed by a company paying UK corporation tax which provides provided share-based benefits for its employees. Note that the corporation tax deduction will only be provided once the benefit has been provided to employees.</p>

Comparison with US plans

Type of Plan	What it means in the US and in the UK
Employee Stock Ownership Plan (ESOP)	Tax qualified employee benefit plan in which most or all assets are invested in the employer's stock.	No exact equivalent. "ESOP" in the UK is a generic term for any employee share ownership plan, or trust. An ESOP normally involves a simple unapproved employee benefit trust (EBT), which merely holds shares on behalf of employees, but has no significant tax benefits for the participants. Furthermore, a UK ESOP, of whatever kind, usually only deals with shares of the employer company, or group of companies.
Non Qualified Stock Option Plan	A right to buy company stock at a specified price during a specified period once the option has vested. No special tax consideration. No requirement for a participant to be an employee.	Unapproved share option plan.
Incentive Stock Option Plan	Stock option plan but with special tax treatment. No tax on grant or exercise; all gains are charged under capital, rather than income. Plan must meet certain requirements.	CSOP and EMI.
Restricted Stock Plan	Stock option plan. Employees can't take possession of the shares until specified restrictions lapse. Section 83(b) elections are permitted.	Share plans providing rights over restricted securities. A similar election process is allowed for.
Employee Stock Purchase Plan (ESPP)	Gives employees the chance to buy stock, usually through payroll deduction. Discount of up to 15%. If set up as a tax-qualified Section 423 Plan, the plan must be offered to most full-time employees with 2 years + service. Purchase period between 3 and 27 months.	Similar to the SAYE option plan, but note that the discount and time period in the UK are different. Employees can also buy shares in their company via a SIP out of pre-tax salary, thus getting a discount (the value of which will depend on the level of income tax paid by the employee). Further discounts can be given by offering Free or Matching Shares. Purchase period of up to 12 months.
Section 401(k) Plan	Tax-qualified retirement plan designed to provide employees with a portfolio of investments	Employee share plans in the UK are not designed with this aim in mind, although there are some similarities with SIP.