

# Share Plan Facts

## Private equity

### Are Share Plans worth the effort?

- In 2001, Harvard Business School found a productivity improvement of up to 17% in UK listed companies with employee share plans
- A 1992 investment of £100 in UK companies with an employee share plan would by June 2003 have grown to £349, compared with £161 if invested in the FTSE AllShare Index (source: *Equity Incentives*)

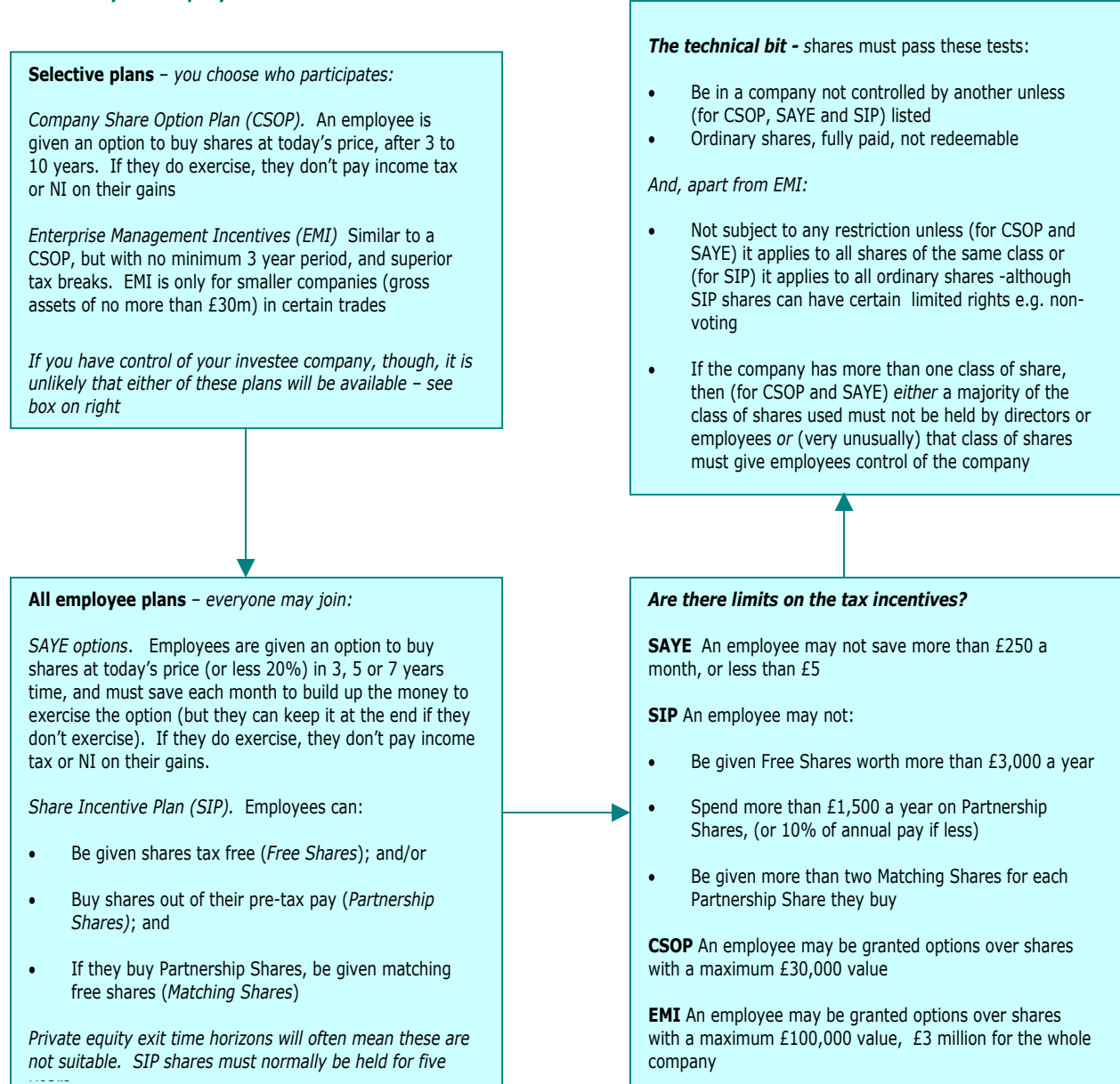
- When Rover Group set up its share plan, absenteeism fell from 22% to 2%

### What would be best for my company?

There are four different plans with **tax incentives in the UK**, described below.

**If none of these suit your company** there are many other choices – generally known as **unapproved plans** – but employees are likely to pay income tax and NI on any benefit.

### Is a share plan with tax incentives suitable for your company?



## Unapproved share plans

Many private equity companies will choose unapproved plans due to difficulties in qualifying for an approved plan. Income tax (and NI where shares can be traded) is normally payable on financial benefits under an unapproved plan:

<i>Options</i>	<i>Free shares</i>
<i>Restricted shares</i>	<i>Shares held in a trust for an employee</i>

### 2004-05 NI rates

- *Employee (primary)* – 11% on any earnings between £91 and £610 a week, plus 1% on anything above that
- *Employer – (secondary)* 12.8%

## Capital Gains Tax (CGT)

When an employee sells their shares, they may have to pay CGT on the shares' growth in value:

- For **SAYE, CSOP and EMI options**, on the difference between exercise and sale price
- But for **SIP shares**, there is no CGT
- For **unapproved options and unapproved free shares**, on the difference between market value when the shares are acquired and their sale

### Reducing CGT

- £8,200 annual exemption
- Taper relief reduces the rate of CGT depending how long the shares have been held\*:

<i>Period</i>	<i>Higher rate taxpayer</i>	<i>Lower rate taxpayer</i>
Less than 1 year	40%	20%
1 to 2 years	20%	10%
2 years or more	10%	5%

\* assumes shares are business assets

## Will the cost of any benefit be an expense in our accounts?

- *Share purchase*. No, unless you allow a discount
- *Free shares*. Yes
- *Options*. Not presently, but this is likely to change under new accounting rules. A value will have to be placed on the option when it's granted, which will be spread as a company expense over the option's expected life. However, in many private companies this value will often be extremely low and any not be considered as material.

In most cases, the value of share-based benefits provided to employees is now deductible against corporation tax.

## What about management investment – hasn't the tax treatment just changed?

Yes, the Finance Act 2003 means that more care needs to go into structuring management investment to minimize income tax. This is complex, but here is a summary:

### New income tax regime under the Finance Act – restricted securities

#### The issue

- Restrictions on shares subscribed by managers may reduce their value
- For example, a requirement on a manager to sell for price paid if they leave
- When restriction lifted (normally on exit, when all shareholders sell for full value), gain in value resulting from lifting is subject to income tax and NI

#### Some solutions

- Manager and the Company can elect to pay income tax on any discount at time of subscription – this will often be small
- If managers pay the same price for their shares as private equity investors, they won't be regarded as having a discount, so no risk of income tax or NI (some other conditions also need to be satisfied)

## What arrangements are the most popular?

- Unapproved Options, exercisable only on an exit. Exercise price may be nil, or market value on grant
- EMI Options – if the company qualifies – also exercisable on exit. Always check if your company will qualify for EMI, because the tax treatment is formidably good. Gains are subject only to CGT, with taper relief starting when options are granted. So a 40% taxpayer who exercises two years after option grant pays tax at only 10%

To find out more, please contact Robert Postlethwaite:

[robert.postlethwaite@consortes.com](mailto:robert.postlethwaite@consortes.com)

+44 20 7470 8805  
[www.consortes.com](http://www.consortes.com)

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