

Tax Advantaged Share Schemes (Lecture B1368 – 27.09 minutes)

This article talks about share advantaged share plans.

How did this get its name?

Originally, the tax advantaged share plans were called “approved share plans”. This is because the share plans, needed approval by HMRC to achieve some significant tax advantages. The approval process could be quite lengthy, including HMRC reviewing the scheme rules, the communication and the communication documents. This would be potentially followed by audits to ensure that the scheme was operating as intended.

This was replaced by a system of registration whereby the schemes are registered and a number is given. But HMRC do not give approval to the plan but rely on the taxpayer and their advisors to declare that the share schemes comply with the conditions to achieve their favourable tax status.

Which schemes are tax advantaged schemes?

The four schemes which currently enjoy tax advantaged status are the

1. Share Incentive Plan (SIP)
2. Share Save Plan (SAYE)
3. Company Share Option Plan (CSOP)
4. Enterprise Management Incentive Scheme (EMI)

Comparisons of the schemes is included in the table below:

<u>Scheme</u>	<u>Options or shares?</u>	<u>Tax relief on Contribution</u>	<u>All Employee Plan?</u>	<u>Limit on the size of company?</u>
SIP	Shares	Yes	Yes	No
Share Save	Options	No	Yes	No
CSOP	Options	No	No	No
EMI	Options	No	No	£30m assets

<u>Scheme</u>	<u>IT on Exit</u>	<u>CGT</u>	<u>Max. Contributions</u>	<u>Value of Shares Purchased</u>
SIP	No	No	£9k p.a. exc. div shares	Full MV
Share save	No	Yes	£500 p.m.	Max 20% discount
CSOP	No	Yes	£60k unvested shares	Full MV
EMI	No	Yes	£250k of options	Full MV

Share Incentive Plan (SIP)

The SIP plan is the only one which offers shares rather than options. It has four facets to it;

1. Partnership shares which can be bought from gross salary and individuals can obtain both the tax and NI deduction;
2. Matching shares – any ratio of matching shares can be given up to any 2 matching shares for every 1 partnership share;
3. Free shares – an amount of free shares can be given up to £3,600;
4. Dividend shares – where the shares are invested in the SIP trust and dividends are paid, those dividends can be reinvested in new shares.

What are the tax advantages?

The partnership shares not only achieve a tax and NI advantage for the employee but they also reduce the employer NI liability.

The free, matching and dividend shares are also awarded free of tax leading to potential tax and NI savings for both employer and employee when compared to any cash alternative.

Shares can grow in the SIP trust tax free and if they are kept in the trust for the minimum period of 5 years for a partnership, matching and free shares they will be completely free of both Income Tax and Capital Gains Tax. The dividend shares only need to be kept for 3 years in the trust before being free of tax.

If the shares exit the trust before the relevant three- and five- year periods there may be a tax and NI charge. The size of the charge is dependent on how long the shares have been in the trust (the tax charge is usually less if the shares have been retained for 3 years in the trust). There are also good leaver provisions for death, redundancy or TUPE transfer which can eliminate the tax charge.

Share Save (SAYE)

This scheme allows for options to be granted at up to 20% discount to the current market value. They can be for a three- or five- year term assuming the options remain qualifying. They can be exercised free of NI and Income Tax. Share Save used to be very popular amongst institutions until interest rates collapsed to below 1% because the amounts invested provided a steady stream of capital for the institutions who received the funds and as a result would not necessarily charge for the administration of the plans.

Generally, Share Save is used by larger companies but if interest rates continue to rise, the opportunity for Share Save may open up to more companies.

The individuals save amounts from their net salary each month for the vesting period of the options.

CSOP

This is similar to Share Save except it is on a discretionary basis and there is no compulsory saving towards the option. Here a term of the vesting period could be between three and ten years but is typically three years. Because there is no Income Tax or National insurance on the paper gain of the options, it is very attractive for both employees and employers.

Kirsty is granted 10,000 options on 6th February 2019 when the market value of the shares was £1. This was the strike price.

The vesting period was three years and the options needed to be exercised within ten years of their grant.

On 6th February 2022 the share price was 90p and therefore underwater. Kirsty did not exercise her options at that point.

On 6th February 2023 the share price had risen to £2 and therefore Kirsty exercised her option to purchase the shares. The shares are 'readily convertible assets' (RCAs) as the company provides a market for the employee to sell them.

She made a gain of £10,000.

Exercise price $£2 \times 10,000 = £20,000$

Strike price $£1 \times 10,000 = £10,000$

Tax Advantaged	Non tax advantaged
Kirsty makes a paper gain of £10,000. This becomes a capital gain when she sells the shares. If she has no other gains in the tax year, she can sell the shares CGT free	Kirsty makes a paper gain of £10,000. Assuming she is a higher rate taxpayer, she will pay £4,200 in tax and NI (the latter because the shares are RCAs). Leaving £5,800 proceeds. The company will pay 13.8% NI - £1,380 as the

No NI for either employer or employee	shares are RCAs.
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Even with the reduction of the Annual Exemption to £6,000 in 2023/24, the tax would only be £800 if she has no other chargeable gains in the year.

CSOPs are due to be increased to allow for the maximum grant of £60,000 worth of unvested options. This will make them more attractive.

EMI schemes

EMI schemes have the most generous tax reliefs, allowing options to be granted of up to £250,000 per employee (valued at grant date) and an overall cap of £3 million worth of options by the company. As you might expect, there are significant conditions regarding EMI schemes in terms of restricting the type of company that can participate. Only trading companies with gross assets below £30m can participate. There are also a substantial number of excluded activities.

EMI schemes are targeted at small and medium sized companies but the rules are somewhat onerous and the challenge is not implementing the scheme so much as ensuring the scheme remains qualifying.

What are the effects of recent tax changes?

The doubling of the CSOP limit to £60,000 is likely to make it more attractive. The SIP plan is the only one whose gains are not subject to CGT and therefore by comparison has become more attractive as the annual exemption for CGT is due to fall to £6,000 for 23/24 and £3,000 for 24/25.

Shares which arose out of the exercise of an EMI option plan can qualify for business asset disposal relief (BADR) and therefore a rate of CGT of 10%. It should be noted however that the BADR only applies to the first £1m of lifetime gains and therefore is much less generous than the Entrepreneurs Relief which preceded it and allowed for £10m of gains tax free.

Conclusion

As more employees are pushed by fiscal drag into higher rates of tax, the comparative advantages of tax advantaged plans will become a more important factor in remuneration planning.

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