

Share gifts to employees – PAYE & NIC (Lecture B1268 – 10.05 minutes)

Giving shares to employees

Statistics show that companies which gift shares to their employees outperform their competitors.

As well as being a reward for services or for continued loyalty, the share award strengthens the ties between employee and employer and acts as a motivational incentive for the worker who, being a shareholder, now has a vested interest in helping the company to grow its business.

For small and medium enterprises, evidence indicates that employee share ownership improves recruitment and retention as well as promoting growth.

The Government has done its bit in promoting wider employee share ownership by offering tax incentives in the form of “tax advantaged schemes” such as Share Incentive Plans (SIPs) or giving tax breaks on the grant and exercise of options in arrangements such as Company Share Option Plans (CSOPs) and Enterprise Management Incentives (EMIs).

However, these schemes are subject to rigid eligibility conditions, and SIPs and CSOPs in particular have relatively low reward ceilings which will rarely interest or excite the high-flyers and key executives.

For these people, share ownership can be facilitated by a simple gift of shares from their employer company. Such gifts are unlikely to have any tax breaks; we used to call them “unapproved” schemes, but they are now known as “non-tax advantaged” schemes which is a more accurate description.

How to make the share gifts

The company has two choices:

1. It could issue new shares; or
2. It could ask shareholders with existing shares to transfer some of these to the employees.

The second option will trigger a disposal by the existing shareholder for CGT purposes.

For many, this will open up the possibility of a business asset disposal relief (BADR) claim, so a 10% tax rate will soften the blow. But not all disposals will qualify for BADR and the reduction in the lifetime gains ceiling from £10m to £1m doesn't help. Ultimately the viability of a transfer from an existing shareholder will be heavily influenced by the CGT cost.

Issuing new shares avoids any CGT issues for the existing shareholder(s). It could, however, have the effect of diluting the percentage holdings of the existing shareholder(s) which they may object to.

The company could, of course, issue new shares to existing shareholders at the same time which may avoid any loss of control issues, but this isn't an ideal solution and could also create a potential income tax charge in the hands of the existing director-shareholders if the shares are deemed to have been obtained by reason of their employment.

A simpler solution would be to issue shares of a different class (carrying less favourable dividend and voting rights for example) with perhaps a right to convert these to full equity shares at a future date once either retention periods have been satisfied and/or performance targets met.

If new shares are issued, ensure that the legal formalities are properly adhered to. Before issuing shares, check the articles of association to make sure that the company is entitled to issue new shares. Issuing extra shares will then require a resolution to be passed by a general meeting of the shareholders.

Taxation implications of non-tax advantaged share gifts

UK resident employees are chargeable to income tax on the value of the share award as this constitutes earnings by reason of the employment.

The employee will then have “share-related employment income” equal to the market value of the shares at the date they are awarded, less any payments made by the employee to acquire the shares (which is normally nil).

Market value means the price the shares could be sold for to a willing and unconnected third-party buyer and may accordingly be affected by any restrictions attaching to the shares. [If so, the restricted securities rules will need to be googled as a further charge may be triggered when the restrictions are lifted.]

Where the market value of the shares cannot be established with reference to a third party (such as on a sale to an unconnected party or the sale on a recognised exchange), the employer is required to use its best estimate of the value.

Compliance issues

The compliance treatment is driven by whether the shares awarded are “readily convertible assets” (RCA).

If the shares are RCA, both income tax and Class 1 employer’s and employee’s NIC are collected via PAYE on the share-related income.

An RCA is either:

- a) An asset capable of being sold or otherwise realised on a recognised share or investment exchange (UK or non-UK); or
- b) Unlisted shares where “trading arrangements” are in existence or are likely to come into existence (covering situations where the employer is either assisting with, enabling or facilitating a sale of the shares by the employee).

If the shares are RCAs, the employee is receiving “PAYE income” and the value of the award must be put through payroll.

If the shares are not RCAs – for example, the company issuing the shares is unlisted and no arrangements have been or will be put in place to enable the employee to convert the shares into cash – then no PAYE needs to be applied. Instead, the employee will pay income tax through the self-assessment system. The employee will then report the award as “share-related employment income” on the employment income supplementary pages. HMRC Helpsheet HS305 is worth looking at should you need to.

If the payment goes through PAYE, the value of the award will be reflected in the form P60 figure, so no separate employee reporting is needed.

Payroll mechanics for RCAs

Where a share award is made by way of an RCA, both income tax and Class 1 NIC (employees' and employers') are due on the value of the shares.

The employing company must account for these payments under PAYE by including the taxable value of the share award as gross pay. In reality, this is a 'notional payment' as the employee does not actually receive the value of the addition in their gross pay; this is just a mechanism to ensure the correct amount of income tax and Class 1 NIC is deducted.

The tax must then be paid over to HMRC by the usual monthly PAYE payment date. Note that the 50% overriding limit for deductions via PAYE does not apply here.

Many employees will not have enough salary in the pay period to cover the extra income tax and NIC on the notional payment. This is very common when employees are paid in RCAs.

In this situation the net pay for the month is reduced to zero. It is important to make the employee aware of this in advance (as bills will need to be paid and children will need to be fed).

The employer must fund the difference to HMRC. The employee must then reimburse the employer for the excess deduction no later than 90 days after the end of the tax year in which the notional payment is made (being 4 July 2021 for share awards in 2020/21). This is typically done by the employee selling enough shares to cover the tax debt. This may need to be pre-planned so that funds are available in good time.

Some employers have 'sell to cover' withholding arrangements whereby the employee acquires beneficial ownership of all of the shares subject to the award, but immediately sells some of them to raise cash to reimburse the PAYE & NIC.

Where the employee does not reimburse the employer by the time limit, the PAYE paid on behalf of the employee is treated as a taxable benefit and reported as such on the P11D. In this case the value of the benefit is recorded in Section B of the P11D under "payments made on behalf of the employee".

This makes things more expensive because Class 1 NIC (employee and employer) is then payable rather than employer-only Class 1A. For NIC purposes, the benefit arises when the deadline is missed (being the tax year in which the 91st day falls).

If the employer decides to meet the extra income tax and NIC liability for the employee, it should do so by making a grossed-up payment to the employee via payroll.

Alternatively, the employer may decide to advance a loan to the employee to enable them to pay the tax. This would normally be linked with a repayment plan from post-tax pay. Assuming the loan exceeds £10,000, the notional interest on the loan should be reported as a P11D benefit.

A popular solution is for the employee to find all but £10,000 of the tax and leave the rest to be funded by employer loan which then gives rise to a zero taxable benefit.

If the loan route is to be pursued, sensible advice is for the company to make it clear to the employee (via a formal loan offer or at least by more informal e-mail) that the excess tax is being

loaned and to specify the terms of that loan. HMRC do not look favourably on employers who retrospectively treat the non-reimbursed tax as a loan once the deadline has passed.

Compliance reporting for non-RCAs

If the share award is not disclosed via the PAYE system, it must be reported by the employer to HMRC no later than 6 July following the tax year in which the shares were awarded. There are (inevitably) penalties for late filing of returns.

Notification is made via HMRC's registration portal for Employment Related Securities. This can be accessed through the employer's PAYE online account.

NIC

As already mentioned, if the shares are RCAs, Class 1 NIC (employer and employee) must be accounted for via payroll.

If the shares are not RCAs, there is no NIC. Note that Class 1A NIC will not apply here because the share-related income is not reported as a benefit via the P11D.

The NIC legislation imports the same definition of RCAs as for income tax.

CGT

One of the benefits of employee share ownership is that any growth in value of the shares after the initial award will normally be chargeable to CGT. [There are exceptions for restricted securities where the growth in value between the award and the lifting of the restriction can be chargeable to income tax.]

CGT will be payable at a maximum of 20% (or 10% if BADR applies). The lower CGT rate equates to a higher profit retention when the shares are eventually turned into cash.

The CGT base cost for the employee is the amount chargeable to income tax plus any amounts contributed by the employee for the acquisition of the shares. In most cases this will equate to the value of the shares at the date of the award (but may be different if some of the subsequent growth is chargeable to income tax as it may be for restricted securities).

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