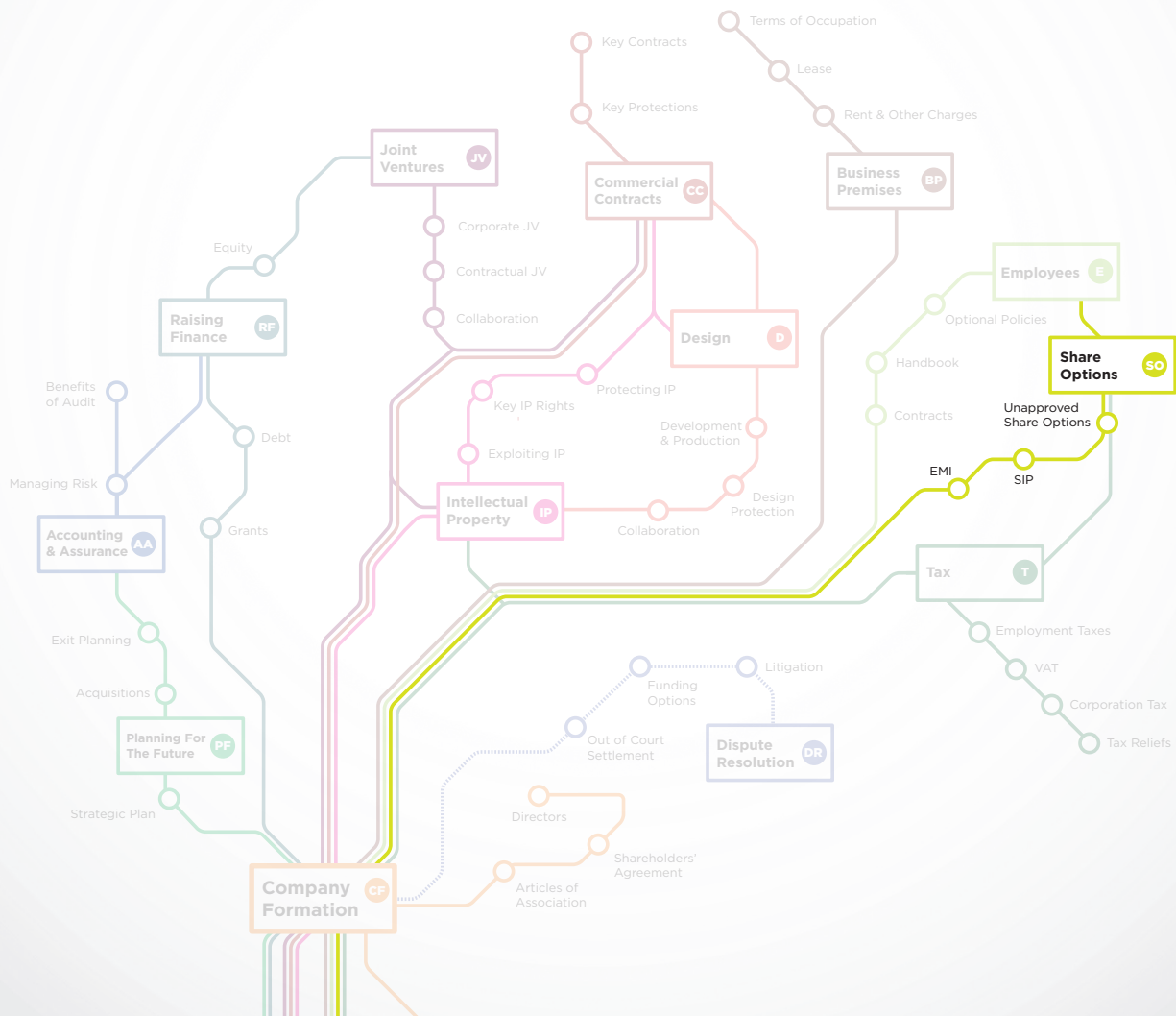




SHARE OPTIONS



SCINAPSE

Geldards
law firm



SHARE OPTIONS

Share options can be an effective tool for rewarding employees, particularly in the early days of a new business when cash may be in short supply. Share options can also be used to help recruit and retain key individuals who are required to build the business.

There are a variety of different types of share option, some of which benefit from tax breaks.

WHAT IS A SHARE OPTION?

A share option is a contractual entitlement to buy shares in the company at a future date and at a price set when the option is granted. The option may be granted over a fixed number of shares or over a variable number of shares depending on the satisfaction of performance conditions based on either individual employee performance or company wide performance over a fixed period of time. Assuming that the value of the shares will increase over time, the employee can expect, on exercising the share option, to realise a paper profit due to the shares by then being worth more than the option price. Full realisation of the paper profit would, of course, depend upon the ability of the employee to sell the shares in the future. If the company does less well than expected so that its shares become worth less than the option price, the option is said to be “under water” and the employee can simply decide not to exercise the option. A share option is therefore a low risk opportunity for the employee.

TYPES OF SHARE OPTION SCHEME

Share option schemes can be divided into two main types:

DISCRETIONARY SHARE OPTION SCHEMES

Under these schemes the company has a choice as to whom options are granted. The most popular discretionary share option scheme is the Enterprise Management Incentives or “EMI” scheme.

ALL EMPLOYEE SHARE OPTION SCHEMES

Under these schemes options must be offered to all qualifying employees. The Share Incentive Plan or “SIP” is an increasingly popular all employee scheme.

TAXATION OF SHARE OPTIONS

The EMI scheme and the SIP are known as HMRC approved schemes. They benefit from favourable tax treatment provided they satisfy all of the HMRC conditions to qualify for the scheme. The tax savings can be substantial, both for the company and its employees.

If a company either does not satisfy the HMRC conditions, or does not wish to adopt an approved scheme, it may adopt an unapproved share option scheme instead. Unapproved share options receive no preferential tax treatment and are usually taxed as if they were employment income. The difference in value between the option price and the market value of the shares at the time the option is exercised is subject to income tax. In certain circumstances the income tax liability must be collected under the PAYE system, whereupon a National Insurance liability for both the employer and employee (depending upon salary levels) will arise.

If it suits the circumstances of your company, you may want to operate an HMRC approved scheme and an unapproved share option scheme side by side, to be used selectively as best suits the circumstances of your company and the employee on each occasion.

WHAT ABOUT VALUING THE COMPANY SHARES?

Both approved and unapproved share plans generally require the company shares to be valued and for that value to be agreed with HMRC. This is because the share value can drive the amount subject to tax. In most cases there is a range of possible company share valuations and you may wish to agree a value at the lower end of the range in order to minimise tax charges. Share valuation is an art and not a science and significant experience is needed to agree an acceptable value with HMRC. Geldards will work with firms of accountants who can value the company shares and obtain agreement from HMRC.

WHY ADOPT A SHARE OPTION SCHEME?

There are a number of reasons why you may want to consider adopting a share option scheme, and there are potential benefits for both your company and its employees.

The benefits to employees can include:

- Obtaining a financial interest in the company.
- Feeling more a part of the company.
- Benefitting from any increase in the share price, which can be translated into a financial gain on an exit event such as a flotation or sale of the company.
- Tax advantages and tax savings on the grant and exercise of options under HMRC approved schemes.

The benefits to the employer can include:

- Aiding recruitment by differentiating the company from its competitors.
- Increasing

productivity and performance of employees through the use of performance conditions and their general willingness to work harder to obtain a financial reward for their efforts.

- Increasing growth and profitability of the company through the use of performance targets and benchmarking against competitors.
- Encouraging staff retention which will reduce staff turnover, training costs and recruitment costs over the long term.
- Share options can form part of the overall remuneration package and yet involve little cash outlay from the company. The issue of shares on exercise of share options will, however, dilute the

shareholdings of existing shareholders and this needs to be taken into consideration.

- Encouraging the adoption of a team environment and business culture.
- Obtaining a corporation tax deduction on the issue of shares to employees.

We can provide you with detailed notes on unapproved share options, EMI schemes and SIPs, and will be happy to discuss your requirements in relation to share options. Please contact a member of the *Scinapse** team at Geldards.

CHECKLIST

Consider your objectives and what you want to achieve.

Consider who should benefit from the options.

Consider how much you want them to receive.

Consider when employees can exercise the option: on exit only, immediately or after a period of time.

Consider what happens if an option holder leaves.

Consider what sort of performance conditions should apply.

Share Options

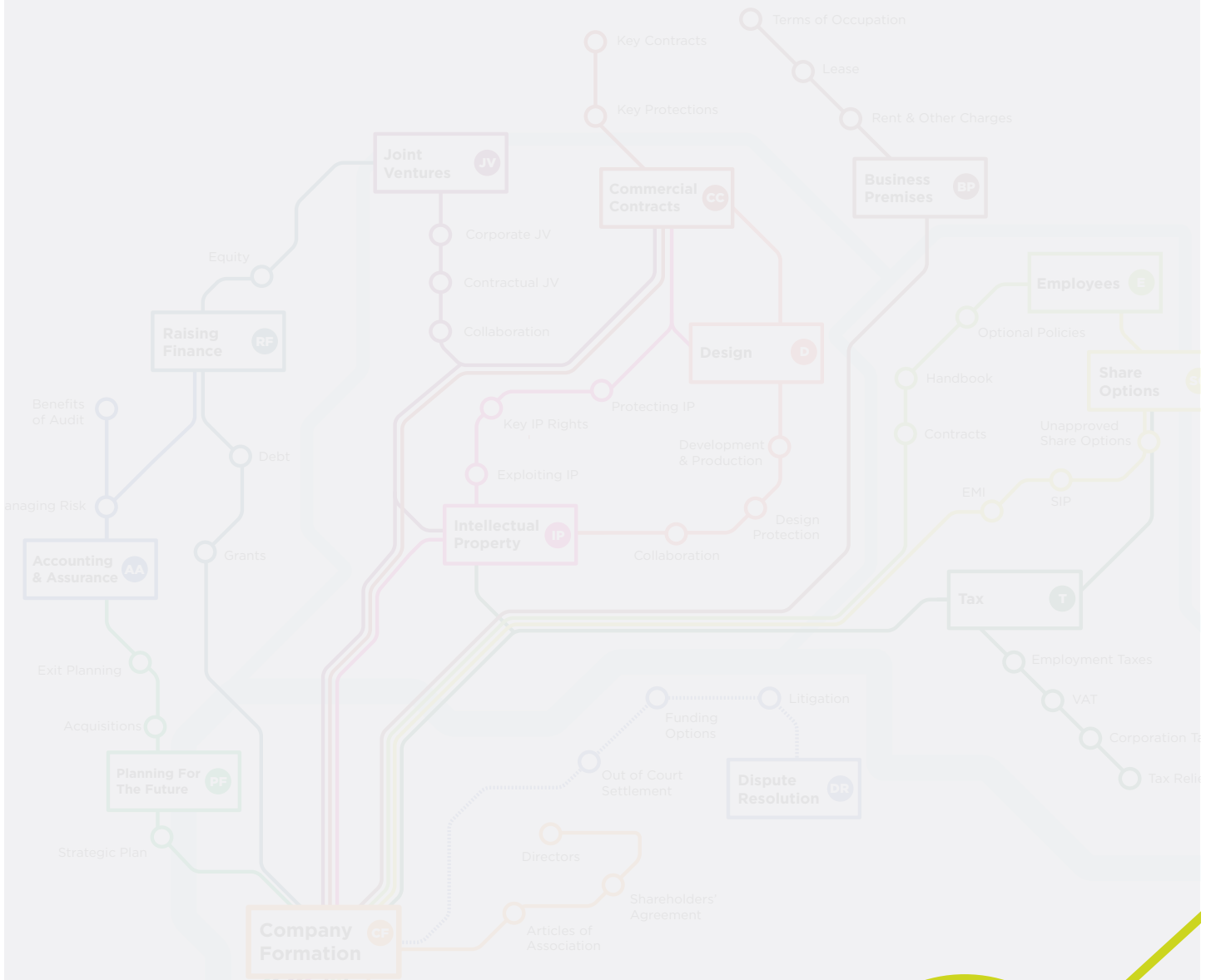
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Unapproved Share Options

SIP

EMI

SO



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