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## Incentivising employees through share schemes

**According to new figures released by the British Chambers of Commerce, recruitment struggles remain high with more than three quarters of firms (76%) reporting recruitment difficulties, a figure which dropped by only two percentage points from the previous quarter. Against this backdrop of challenge, and in a post-pandemic economy, employers are being forced to rethink their benefits packages, and to find different ways of attracting new talent and incentivising existing employees.**

**What is a share scheme?**

A share scheme is a way of sharing company ownership with employees. A company grants contractual rights to employees to acquire a specified number of shares in the company at a future date, for a specified price (sometimes at discount to market value). While almost all publicly-listed companies in the UK offer some form of share incentive, private companies, including early stage companies and scale-ups, may also opt to use a share scheme as a means to recruit and retain their workforce as well as encouraging colleagues to align with the vision and success of the company.

A share scheme incentive could differentiate a company from its competitors, allowing for a more attractive payment package to employees joining the company. Similarly, the benefits for employee retention are 'baked in' as there is often a minimum period before an employee can acquire the shares and benefit from the rewards, with private companies often opting to align the vesting of the share options with an exit event, such as an acquisition.

**Why introduce a share scheme?**

There are several types of share schemes available, each with their own characteristics and advantages. The favourable tax treatments on offer through schemes such as Company Share Option Plans, Save As You Earn, Share Incentive Plans and Enterprise Management Incentive schemes can bring significant financial benefits to both the company and its employees, while increased motivation and morale can have a positive impact on workers' well-being. In addition, there is no risk to the employee, who is not obliged to exercise the option and pay for the shares.

In short, share schemes can be advantageous to both employee and business alike. While companies should seek tailored advice on which type of scheme is the most suitable for their business structure, smaller, higher risk trading companies in particular, should look first to the benefits of the tax-advantaged EMI scheme.

## Enterprise Management Incentive Schemes (EMIs)

EMI schemes are the most flexible of the four tax-advantaged schemes referred to above and one of the most generous. They are intended to be used by small and medium-sized companies to encourage the recruitment, motivation and retention of skilled employees by inviting them to take a stake in the company and share in the risks and rewards while also providing a performance incentive.

- **What are the advantages?**

One of the biggest advantages of EMI options is the tax treatment for a UK tax resident employee. As long as the exercise price is at least equal to the market value of the company's shares at the date of grant, the exercise of the option will not usually give rise to any income tax or national insurance contributions. Instead, those employees will pay capital gains tax on any gain that they make when the shares are ultimately sold.
The following table illustrates the benefit of operating an EMI scheme over operating an 'unapproved' (non-tax advantaged) scheme or providing cash bonuses.

| | **Cash** | **Unapproved option**(1) | **EMI**(1) |
|---|---|---|---|
| Gross gain on exercise | £740,000 | £740,000 | £740,000 |
| Income tax and National Insurance Contributions (NIC) on exercise(2) | (£347,800) | (£347,800) | 0(3) |
| Capital gains tax payable on disposal | 0 | 0 | (£72,770)(4) |
| Net proceeds for employee | £392,200 | £392,200 | £667,230 |
| Cash cost to employer of providing benefit | £740,000 | (£10,000)(5) | (£10,000)(5) |
| Employer's NIC charge(6) | £102,120 | £102,120 | 0 |
| Overall cash cost to employer(7) | £842,120 | £92,120 | (£10,000)(8) |

1. Illustration based on option granted over 100,000 shares with an exercise price of 10p per share (equal to the actual market value of grant) and option exercised and all shares immediately sold 5 years later at £7.50 per share.
2. Income tax at 45% and NICs at 2% (with effect from 6 November 2022). Note: different rates for Scottish taxpayers.
3. Assumes EMI option granted with an exercise price no lower than the actual market value of a share at the date of grant, no disqualifying event takes place between grant and exercise and the other EMI conditions are satisfied.
4. CGT charge calculated after application of annual CGT allowance of £12,300 and assumes option exercise shares qualify for Business Asset Disposal Relief.
5. The aggregate exercise price received by the company from the option holder.
6. Employer's NIC charge of 13.8% (with effect from 6 November 2022). Note: excludes the impact of apprenticeship levy.
7. Ignores impact of Corporation Tax deductions that may be available.
8. This shows an overall cash benefit rather than cost of providing the EMI shares since the company will receive the exercise price, but not have to pay any employer's NICs.

EMI schemes also offer more flexibility when compared to other tax-advantaged schemes in relation to the limit on the value of outstanding unexercised EMI options granted to employees and the terms of the EMI options such as the exercise price, meaning companies have increased scope to tailor options to meet their commercial needs.

- **What are the qualifications?**

Statutory rules govern which companies will qualify to grant EMI options, which employees they can be granted to and the types of shares that can be granted under the EMI scheme. An independent trading company, even if incorporated outside the UK, can grant EMI options over its shares provided it meets the qualifying criteria set out in the legislation, which include criteria relating to the size of the company, control structures, subsidiaries and the type of trade carried out.

To be granted EMI options, an individual must be an 'eligible employee' under statutory requirements relating to working time and shareholding. Note that non-executive directors are not treated as employees for the purposes of EMI options, and so are not eligible under that scheme.

Lastly, the EMI options must also meet certain conditions over the types of shares to be granted and the structure and terms of any option agreement between the employee and the company. Companies self-certify that they meet the relevant criteria when they register an EMI scheme with HMRC, and when notifying HMRC of EMI option grants.

**Seek professional advice**

There are many issues to consider around establishing and running an employee share scheme, not least with regard to the regulatory and tax implications, and a company should always seek advice before introducing a scheme. However, with the correct advice, all companies, particularly smaller, private companies, can tap into the wealth of recruitment and retention benefits that are offered by establishing a share scheme; benefits which many larger, publicly-listed companies are already enjoying.

Shepherd and Wedderburn's employee share incentive practice has advised many clients on the design, implementation and administration of EMI schemes and is considered by Chambers and Partners to be the leading practice in Scotland, with clients based all over the UK.

For more information on EMI schemes or other types of share schemes, contact Rodger Cairns, Partner in Shepherd and Wedderburn's share schemes team, at rodger.cairns@shepwedd.com.