Incentivise and Retain Staff with Share Options

With the help of loyal key members of staff, many company owners will have fought their way through the recession to find themselves in a much more comfortable position. As economic conditions look set to continue into a more prosperous phase, company directors and shareholders will be hopeful that their businesses will grow and rise in value.

However, as the job market improves and wages increase, employers will be faced with a new dilemma – how to retain and incentivise their key employees and reward them appropriately.

For many company owners, this will involve undertaking a balancing act. No business will want to be stretched beyond its means financially whilst the economic recovery continues. Conversely, as the job market becomes more buoyant, there is a real risk that if employers don't reward their staff members appropriately, they will be faced with losing key people who may be integral to future growth.

So, what can employers do to improve their position?

Share ownership by employees

This can take many forms. Larger companies are able to set up programmes to reward all staff members. A great example of this is the John Lewis Partnership, where employees are given the opportunity to buy shares and they truly do own the business they work for.

However, for many SMEs, this simply isn't feasible. Most will still require a typical pyramid ownership structure which rightly means that the owners who have built the business hold the majority of the shares.

Luckily, for these companies they are able to access the flexibility of other share plans, such as the HMRC approved Enterprise Management Incentives (EMI) scheme. Participation in an EMI scheme means that shareholders of SME companies can seek to reward their staff with share options, but the owners retain control.

How does an EMI Scheme work?

One or more employees of a qualifying company can be granted options within the scheme, up to a maximum value of £250,000 per employee. This is provided that certain qualifying criteria are met:

- The total number of EMI options granted must not exceed £3,000,000 at any one time by the company.
- Gross assets of the company must not exceed £30 million.

- The company must have fewer than 250 employees.
- Options must be granted to an 'eligible employee'.
- The employee must provide 'committed time' of at least 25 hours per week to the company, or 75% of their total working time must be for the company, if this is less than 25 hours per week.
- The employee must not already have beneficial ownership of, or the ability to control more than 30%, of the company.

What are the advantages of setting up an EMI scheme?

There are many advantages to setting up an EMI scheme:

- Ownership and control of the company, including voting and dividend rights, doesn't change on grant of the options. The employer is simply providing share options over a pre-determined proportion of the company's shares to their employee.
- Therefore, if an employee who has been granted share options leaves, the options typically lapse, with no implications.
- The EMI scheme rules allow for specific employees to benefit from participation. It is not the type of scheme which has to be offered to all employees. It can be offered to just one key staff member, if this is what the company owners wish to do.
- The scheme will provide the employee with an incentive to help grow the business. Ultimately, where the value of the company grows between grant of options, share exercise and ultimate sale, the employee will reap the benefits.

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What about the tax implications?

EMI options can be extremely tax efficient for all parties:

- No tax charge is payable on the grant of the options
- No income tax or NIC's will be payable by the employee or the company when the options are exercised. This is provided that the exercise price is set at the market value of the shares at the date of grant of the options. Therefore, the more the value of the company grows between the granting of options and the exercise into full shares, the more value the employee will receive.
- The shares will be subject to CGT when they are subsequently sold. For the employees, the good news is that provided that they have held the options for 1 year prior to any sale, the disposal of the shares should attract Entrepreneurs' Relief. This means that any gain made ought to be taxable at just 10%.
- Importantly, the company can achieve a corporation tax deduction on exercise of the options. This deduction is based on the uplift in value from the date of the grant of the options to the date of exercise. Again, the more the company value grows during this period, the better the benefit will be for the company.

What if an EMI scheme isn't appropriate?

An EMI scheme is perhaps one of the most flexible ways in which a qualifying company can reward key members of staff. However, due to strict qualifying criteria, it doesn't apply to all companies. There are other forms of share option planning which can be undertaken, which would be appropriate to specific circumstances. We would be happy to discuss with any interested parties in more depth.

For Further help and advice, please contact Kirsty MacDonald: kmacdonald@dtegroup.com or George Lovell: glovell@dtegroup.com or call 0161 767 1200.

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