BARKER & JENNINGS
CHARTERED ACCOUNTANTS

Knowledge

Should you give your employees shares in your company?

There is a lot being written about employee share schemes (ESS) right now. And rightly so. Reforms before Parliament will make these schemes more attractive with a common sense approach to how they are taxed and special incentives for start up companies to share the rewards of growth with the people who help create that growth.

As the reforms apply to shares and options issued from 1 July 2015, it's important that employers do not issue new shares or options prior to this date if they want the new rules to apply to those shares or options. If the shares or options are issued prior to this date they will be caught under the current, more onerous rules.

What does an employee share scheme do?

Employee share schemes are a way for businesses operating through company structures to provide employees with an ownership stake and share in the growth of the company or its parent. The main purpose of employee share schemes is to align the interests of employers and employees as both parties will be working towards a common goal.

Under an ESS, employers issue shares (an ownership stake) and/or options (a right to acquire shares at a later date) to their employees at a discount to the market value of the shares or rights.

A range of conditions generally applies to determine when and how the employee can access those shares. For example, in many cases employees will not have full access to the shares until they have been employed by the company for a certain number of years or certain performance targets have been satisfied. These conditions can lead to reduced staff turnover and higher levels of productivity. This is because the employee would generally forfeit the shares if the conditions are not met.

A shareholders agreement may also be put in place to control when, how and who the shares can be sold to once the employee is able to exercise the rights.

The reforms before Parliament address how and when employees are taxed on those shares and the regulation of share schemes.

How will the new rules work?

At a very high level, when an employee receives shares or rights under an employee share scheme they are taxed on the discount they have received.

The discount is taxed much in the same way as salary or wages. The discount is generally taken to be the difference between the market value of the share or right and any amount paid by the employee to acquire the share or right Depending on the way the scheme has been structured, the employee may be able to defer the taxing point until a later point in time (many years later in some cases) and concessions may also be available to reduce the amount that is subject to tax.

As with the current rules, it will still be necessary to work through a number of conditions to determine whether an employee is able to defer the taxation of the shares or rights they have received. If these conditions are met and the employee has been provided with shares, the taxing point will be the earlier of:

- When the employee leaves the employer;
- 15 years after the shares were acquired; or
- The point where the employee can sell the shares without restriction.

If the conditions are met and the employee has been provided with options to acquire shares then the taxing point will be the earlier of the following:

- The employee leaving the employer;
- 15 years after the right was acquired;
- The point where the employee can sell the rights without restriction; or
- The right is exercised and there is no real risk of the employee forfeiting the resulting shares and there are no restrictions on the employee selling the shares.

In general, the new rules enable the taxing point to be deferred for a longer period of time until the point at which it becomes clear that the employee will actually derive some economic benefit

Quote of the month

"Experience is simply the name we give our mistakes."
Oscar Wilde

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