Bird & Bird

Share Incentive Plans ("SIP")

November 2024

Introduction

The SIP is a qualifying employee share ownership plan which must be operated on an all-employee basis.

The key features of the plan are:

- up to £3,600 of "**free shares**" can be awarded to employees tax free each year;
- employees can invest up to £1,800 a year of pre-tax and pre-NIC salary in "**partnership shares**";
- where an employee invests in partnership shares, the employer can provide additional tax-free shares on a matching basis in any ratio of up to 2:1 ("**matching shares**"); and
- participants may be permitted to use dividends paid on their free, matching and partnership shares to acquire further "**dividend shares**".

The shares can be withdrawn from the plan tax-free (including no capital gains tax) after 5 years or earlier in certain circumstances (such as dividend shares, which only need to be held in the plan for three years).

Eligible Participants

- All UK resident employees are eligible to participate in the plan. The company may impose a qualifying period of service. The period may be up to 18 months (or 6 months for partnership / matching shares where participants' savings are "accumulated" over a period of up to 12 months instead of being used to purchase partnership shares monthly).
- Every employee who is invited to participate must be invited to do so on similar terms (although there is an exception for the award of free shares on the basis of performance).

Special Purpose Trust

All shares acquired through the plan must normally be held in a special UK resident trust. In order for employees to benefit from the maximum tax advantages, they must leave shares in the trust for at least five years.

Plan Shares

Qualifying conditions

Broadly speaking, shares must be fully paid-up, not redeemable ordinary shares in a company:

- which is independent; or

- listed on a "**recognised stock exchange**" (which includes for these purposes the London Stock Exchange, New York Stock Exchange, NASDAQ, the Australian Stock Exchange, Euronext Paris etc., but not AIM); or
- which is under the control of a company whose shares are listed on a recognised stock exchange.

Shares may be subject to restrictions (subject to certain protections for partnership shares outlined below).

Free shares

A company can give up to £3,600 worth of free shares per year to employees. Performance conditions relating to whether or not shares are awarded (or as to the number that are awarded) may be imposed, essentially pre-grant performance criteria. The plan may provide that bad leavers forfeit free shares if they leave within the first three years. The plan may permit participants to withdraw free shares voluntarily between three and five years.

Partnership shares

Partnership shares may be acquired with a single lump sum deduction (e.g. from salary or bonuses) or by way of regular monthly deductions. Employees can deduct a maximum of £1,800 per year (equating to £150 per month) or 10% of salary (if lower). The partnership share money is held by the trust on behalf of the employee until it is used to purchase partnership shares.

Companies can allow deductions to be used to buy partnership shares monthly or the savings can be retained by the trustee over periods of up to 12 months (known as "**accumulation periods**") and used to buy shares at the end of the period. If an accumulation period is operated, the shares must be sold to participants at the market value of the shares at the beginning or end of the accumulation period (or the lower of the two) depending on which is specified in the partnership agreement.

Participants must be able to withdraw from the plan, in which case all money held on their behalf must be repaid. Participants may withdraw partnership shares from the plan at any time but there may be a tax charge if they do so. The plan rules may permit partnership shares to be forfeited on cessation of employment but in that case the shares must be purchased for an amount equal to the salary used to purchase the shares in the first place or, if lower, their market value at the time of forfeiture.

Matching shares

If the employer offers matching shares, they must be awarded on the same day as the partnership shares to all participants on the same basis. The partnership share agreement must specify the ratio of matching to partnership shares and the circumstances and manner in which the ratio may change. The ratio must not exceed 2 matching shares for every partnership share. The plan may permit participants to withdraw matching shares at any time after three years and it may require matching shares to be forfeited on the withdrawal or forfeiture of partnership shares in the first three years.

Dividend shares

Dividends received on shares held in the trust are passed on to participants by the plan trustee. The plan may, however, permit participants to use dividends to acquire further shares (known as "**Dividend shares**"). Dividend shares must be held in the plan for three years.

Tax Treatment

Income Tax and NIC

Employees can buy partnership shares out of pre-tax and pre-NIC salary. Matching, free and dividend shares are tax free when awarded. Employees who keep their shares in the plan for five years (or three years in the case of dividend shares) pay no income tax or NIC on the subsequent withdrawal of shares.

No income tax or NIC is due if shares are withdrawn from the plan early due to certain exit events.

Leavers are required to withdraw their shares from the plan. Good leavers are exempt from income tax and NIC in those circumstances. For these purposes, good leavers are employees who leave due to injury, disability, redundancy, retirement, death, a TUPE transfer or because their employing company ceases to be an associated company.

In other circumstances:

- If partnership shares are withdrawn from the plan after three years but before five years, the employee will pay income tax and NIC on the amount that was originally deducted from salary or, if less, the market value of the partnership shares at the time that they are withdrawn. Any increase in value of the shares during their time in the plan will, therefore, be free of tax and NIC.
- If free or matching shares are withdrawn after three years but before five years, the employee will pay income tax and NIC on the initial value of the shares at the time they were awarded or, if less, their value when withdrawn.
- If any partnership, matching or free shares are withdrawn within the first three years, the employee will pay income tax and NIC on the market value of the shares at the time they are withdrawn (which may be higher than their initial value).
- If any dividend shares are withdrawn within three years, the employees will be liable to income tax on the cash value of the dividends re-invested to acquire the dividend shares at investment tax rates.

Where salary deductions have been made to purchase partnership shares and surplus partnership share money is repaid to employees, it is subject to PAYE income tax and NIC.

Capital Gains Tax

Employees who keep their shares in the plan until they sell them will have no CGT to pay. The "base cost" of the shares is uplifted to market value on withdrawal so if shares are withdrawn and sold later, the employee will only be liable to CGT on any increase in the value of those shares after they are withdrawn from the plan.

Corporate Tax Deduction

Companies can obtain corporation tax relief for the costs they incur in providing shares for employees, to the extent that such costs exceed the employees contributions. Set-up and running costs are also deductible as is salary deducted to purchase partnership shares.

Stamp Duty

Any stamp duty due on the purchase of partnership shares must be borne by the employer, it cannot be recovered from employees

Self-Certification

Companies are required to self-certify that they comply with the legislation.

The documentation required to establish a plan consists of a special purpose trust deed, plan rules, ancillary documents, a partnership and/or free share agreement and an explanatory brochure.

The plan should be adopted by the board and the SIP trust deed should be executed by the establishing company and the trustee. SIPs should be registered with HMRC on or before 6 July following the tax year in which awards are first made. The registration should be accompanied by a declaration that the plan satisfies the relevant conditions. The declaration must confirm the conditions were met at the time the awards were made if it is made after the awards.

The plan may require prior shareholder approval. Companies listed on the full list of the London Stock Exchange are generally required to seek shareholder approval for employee share plans sourced using new shares and awards made to company directors must be in line with the approved directors' remuneration report of the main market listed company. AIM traded companies are not required to seek shareholder approval for employee share plans of any sort but companies may have made commitments to shareholders to do so.

Unlisted companies may be required to seek shareholder approval by, for example, shareholder agreements between investors and it may in any case be necessary to amend the company's articles of association to allow the plan to operate. Unlisted companies will also need to agree the value of their shares with HMRC for the purposes of the plan.

Advantages of the Plan

SIPs have the following advantages:

- the costs to the employer of funding the free and matching shares and establishing and operating the plan are tax-deductible;
- the plan allows for pre-tax investment in partnership shares by employees whether or not the employer wishes to provide any free or matching shares (this is the only UK employee share plan with this feature). Employers may take the view that, regardless of whether or not any free shares are provided, employee investment on a pre-tax basis should be encouraged;
- the plan is flexible by allowing performance conditions to apply to free shares and by allowing forfeiture conditions to apply to all shares awarded under the plan;
- there is a substantial tax incentive for employees to leave their shares in the trust for five years, since the shares are then released with no tax or NIC liabilities. Moreover, the base cost of the shares for CGT purposes is their market value when withdrawn from the plan;
- companies decide which types of shares are awarded so could offer only partnership shares to minimise costs.

SIPs in Practice

Listed Companies

Most listed companies that operate SIPs offer partnership shares. Typically, salary is deducted monthly and used to buy shares in the market monthly so as to minimise cash costs and market risk. A SIP operated in this way provides a tax efficient savings plan for employees at minimal cash cost to the employer and with no dilution for shareholders. Indeed, the NIC savings on salary used to purchase partnership shares can be cash positive. Partnership shares withdrawn within 5 years can, however, give rise to employers NIC charges (although it is possible to hedge the exposure).

Whilst is possible to offer other features such as matching shares and even free shares these tend to be less common as they involve either cash cost or dilution.

Unlisted Companies

In our experience most unlisted companies that operate SIPs also offer only partnership shares. Savings are typically accumulated over a six-month period and used to purchase shares in a "trading window". The purpose of the SIP, in these circumstances, is to create liquidity for an employee share market. It is possible to avoid cash costs by operating the SIP so the shares are purchased at a price equal to market value at the beginning of the accumulation period. A separate fact sheet is available on employee share markets.

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Chambers & Partners UK, 2022

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Thank you

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