

## **Share Incentive Plan Fact Sheet**

### **Background**

The Share Incentive Plan (SIP) was introduced in 2000. There are currently 960 plans in place costing the Government £300m in tax relief (Source: HMRC June 2008).

### **General Features**

An on-shore trust must be used to hold employees assets (cash/shares).

Companies are able to choose between a flexible combination of three modules:

### **Partnership Shares**

Employees can buy shares from their pre-tax weekly or monthly salary subject to a limit of the lower of £1500 per annum or 10% of salary. Again, these shares are free of income tax and NICs. Alternatively, employees may invest up to £1,500 in a lump sum.

Employee contributions to partnership shares will not affect their ability to contribute to retirement benefit schemes, retirement annuity schemes and personal pension plans. In order to protect employees' rights HMRC has stated that salary allocated to partnership shares will not limit payments for pension contribution purposes.

### **Matching Shares**

Employers can give employees up to two matching shares for each partnership share the employee buys.

### **Free Shares**

Employers can give up to £3,000 worth of free shares per annum to employees free of income tax and National Insurance (NICs). The legislation also provides two alternatives for awarding shares on the basis of performance (individual, team, divisional or corporate):

- Firstly, up to 80% of the shares awarded can be linked to performance. The highest performance award to any employee cannot be more than four times greater than the highest award made to an employee on the 'similar terms' basis.
- Secondly, all shares may be awarded by reference to performance as long as awards made to the employees in each performance unit are made on similar terms to the other employees in that unit.

### **Eligibility**

Companies must offer all employees whose remuneration is within Case 1 Schedule E the opportunity to participate in the plan whether they work full or part time. Companies can require employees to have completed a minimum qualifying period of employment

before they can participate, but that period must not be more than 18 months (6 months in the case of an annual accumulation period for partnership shares).

### Holding Period

Free Shares	Partnership Shares	Matching Shares	Dividend Shares
At least 3 years from the award of shares (this can be up to 5 years if the Company chooses).	None.	At least 3 years from the award of shares (this can be up to 5 years if the Company chooses).	3 years from acquisition.

Where an employee leaves the company, their shares must be transferred to them. A tax charge may then arise, which is explained under the Tax Treatment for Employees Section below.

### Limits

Free Shares	Partnership Shares	Matching Shares	Dividend Shares
Up to £3000 per tax year	Up to £1,500 per tax year, capped at 10% of salary.	Up to two matching shares for each partnership share bought.	Dividends from the shares from the plan can be reinvested - up to £1,500 per year.

### Tax Treatment for Employees

#### Partnership Shares

##### Within 3 years of the award

Where the partnership shares have been held in the plan for less than three years, employees will pay income tax and NICs on an amount equal to the market value of the partnership shares at the time they are removed from the plan.

##### Between 3 and 5 years of the date of the award

Where the partnership shares have been held in the plan for at least three years but less than five years, employees will pay income tax and NICs on the lesser of the salary used to buy the shares and the market value of the shares at the time they are removed from the plan.

#### Free & Matching Shares

##### Within 3 years of the award

Withdrawal within 3 years of the date of the award (or the relevant holding period if longer) is not possible whilst still employed by the company.

### **Between 3 and 5 years of the date of the award**

If the shares are withdrawn between three years (or the relevant holding period if longer) and five years after they have been awarded, the employee will have to pay income tax and NICs on the lesser of the market value of the shares when they were first awarded or the market value of the shares at the time they are removed from the plan.

### **Partnership, Free & Matching Shares**

#### **After 5 years**

Employees become entitled to all shares unconditionally on the fifth anniversary of the award (third anniversary in the case of dividend shares). They can choose to leave them in the plan or take them out and hold them elsewhere or sell them. Employees not wanting to pay income tax or NICs on the shares must keep them in the plan for five years.

No Capital Gains Tax is payable when shares are taken out of the plan. Employees who sell their shares directly from the plan will have no CGT liability. Employees may choose to keep shares when they come out of a plan and sell them later. If they do this, they will be liable to CGT only to the extent that the shares have increased in value since they were withdrawn from the plan.

#### **Leavers**

The trust must transfer plan shares to those employees who leave employment irrespective of the reason for leaving. However, if the shares have been held in the plan for at least five years, there is no income tax or NICs to pay.

Where employment ends before the shares have been held for three years, the employees will have to pay income tax and NICs on the market value of the shares at the date of leaving. Where shares have been held for three years but less than five years the employee will pay income tax and NIC on the lesser of the market value of the shares when they were awarded or the market value at the date of leaving. If the employee leaves for one of the specified reasons (such as disability, redundancy, retirement or death), all of the shares can be withdrawn tax-free.

### **Tax Treatment for Employers**

#### **Corporation tax relief**

Employers operating the Share Incentive Plan will be entitled to corporation tax relief, as a deduction in computing their taxable trading profits or as expenses of management, for:

- The costs of setting up and administering the plan.
- The costs they incur in providing shares for employees to buy to the extent such costs exceed the employees' contributions.
- The market value of free and matching shares at the time they have been acquired by the trustees. The deduction is given in the accounting period when the shares are appropriated to the employees.

The new plan allows trustees to borrow money in order to acquire shares in the employing company. Where this happens and the company meets the trustees' costs, it may deduct any payment of interest made by the trustees, in computing its corporation tax profits.

It will also be possible for shares to be transferred into a plan from another trust. A corporation tax deduction will be available for free and matching shares acquired from another trust to the extent that no corporation tax deduction has already been given for the acquisition of those shares by the other trust.

### **PAYE and NICs**

An employer will have to operate PAYE and account for NICs where a Schedule E income tax charge arises under the terms of the plan and the plan shares can be readily converted into cash.

### **Tax Treatment for Trustees**

There are also important tax reliefs in respect of the trustees of a plan:

- There is no charge to income tax on any dividends arising on unallocated shares held in the plan provided the shares are awarded to employees under the terms of the plan within two years of their acquisition.
- If the shares are not capable of being readily converted into cash this period is extended to five years after their date of acquisition, or within two years of the date on which they become convertible if that is earlier.

For these purposes forfeited shares are treated as being acquired by the trustees on the date that they are forfeited. Provided shares are awarded to employees as described above, the trustees will not have any CGT on the disposal of the shares to employees.

### **Forfeiture of Shares**

Companies may, if they wish, provide in the plan rules that during the first three years free shares and/or matching shares will be forfeit if the employee leaves the relevant employment other than for a specified reason such as disability or redundancy. Matching shares can also be subject to forfeiture if the corresponding partnership shares are

withdrawn within three years of purchase. However, partnership shares themselves cannot be subject to forfeiture.

## **Dividends**

The plan also allows employers to offer dividend reinvestment for employees with shares in a plan. Employers can choose whether to provide:

- For the dividend to be paid out to employees, in which case it will be taxable in the normal way.
- For the dividends in respect of shares in a plan to be reinvestment in 'dividend shares' within specified limits (up to £1,500 per year); any balance is paid to the employee and taxed in the normal way.

The dividends received by trustees must be reinvested in plan shares on behalf of employees within 30 days of the dividend being paid.

Dividend shares will be subject to a holding period of three years during which employees will not be permitted to sell them, unless they leave the relevant employment. Where employees leave the relevant employment during the holding period their dividend shares will be transferred out of the plan and income tax will be payable on the original dividend as if it had been received in the normal way but in the year employment ceased.

Once the three-year holding period has expired the dividend shares can be withdrawn tax free, and if they are sold immediately there will be no CGT. Alternatively, these can be held in the plan until the participant's employment ceases.

## **Qualifying Shares**

The shares used in a plan must be either:

- In a company listed on a recognised stock exchange or in its subsidiary, or
- Shares in a company that is not controlled by another company.

The shares in a plan must also be:

- Fully paid up ordinary shares
- Not redeemable

These rules are the same as for the existing HMRC approved schemes, however, there are some differences from the existing rules for shares that qualify for the existing approved schemes:

- It is possible to have a special class of shares for employees.
- Free and matching shares held by employees may be subject to forfeiture.