Briefing Note

Mercer & Hole

SHARE INCENTIVE PLAN (SIP)

An SIP offers a tax-efficient route for companies to reward employees with free shares and acquire further shares if they so wish. The scheme does, however, need to be open to all employees of the company.

An SIP provides for three main types of shares to be made available:

Free shares

Employers can annually give each employee free shares worth up to £3,600.

Partnership shares

Employees can use up to £1,800 a year (or 10% of salary if lower) of gross, i.e. pre-tax and national insurance contributions (NIC) salary to buy shares.

Matching shares

Where employees acquire partnership shares, employers can give further shares at a ratio of up to 2:1 for each share acquired.

Free and matching shares must normally be held in trust for a period of 3-5 years. At the end of that time the employees can sell their shares if they wish.

Employers can also provide for cash dividends on shares held in the SIP to be reinvested, tax-free, in more shares. These 'dividend shares' must normally be held in the trust for a period of 3 years. At the end of that time, employees can sell the shares if they wish.

The SIP operates with a trust funded by the company, which will acquire and hold the shares in the SIP on behalf of the participants.

There are no restrictions on participation by reference to size of any existing shareholding.

What are the tax benefits?

For individuals:

- Income tax and NIC are not chargeable when shares are awarded to or acquired for participating employees.
- Employees who keep their shares in a SIP trust for a minimum of 5 years pay no income tax or NIC on those shares.
- Employees who take their shares out of the SIP trust before 5 but after 3 years will normally pay income tax and NIC on no more than the initial market value of those shares. Any increase in the value of their shares whilst in the plan will be free of income tax a

- Employees who take their shares out of the SIP trust within 5 years because they are leaving the company for a 'good leaver' reason will pay no income tax or NIC on their shares.
- Employees who sell their shares will be liable to capital gains tax (CGT) on any increase in the value of their shares after they have come out of the SIP trust. CGT is not chargeable on the increase in value of the shares whilst they remain in the SIP trust. Existing shareholders who want to sell their shares to a new SIP trust to be used for the benefit of employees may be able to benefit from a CGT rollover.

For the company:

- Employers will get corporation tax relief for the costs of setting up and running the SIP, including for the value of Free and Matching shares, and the cost of providing Partnership
- Shares to the extent that this exceeds contributions received from employees
- Employers will not pay employer's NIC where the shares are held in the plan for 5 years. NIC is not chargeable with respect to dividend shares

All Employees must participate on the same terms

According to HMRC, the purpose of the SIP must be "to provide benefits to employees in the form of shares in a company which give them a continuing stake in that company."

The plan must be open to all eligible employees who are UK tax resident.

An eligible employee is an employee of the establishing company or a member of its group who is not participating in another SIP.

Every employee who is invited to take part in a SIP must be invited to do so on the same terms and every employee who does take part must do so on the same terms.

The 'same terms' requirement does not prevent a company from varying the number of free shares awarded to employees in the ways permitted by the legislation e.g. by reference to an employee's remuneration, length of service, or hours worked.

Additionally, the 'same terms' requirement does not prevent a company from making the award of free shares to particular individuals, and/or the level of their award, conditional on a performance condition being met.

Market for shares

If the company wishes the employees to be able to sell shares, it will need to provide a market for them. This can be achieved using the SIP trust to buy shares and hold them for distribution as free or matching shares. However, this can be expensive, especially if the company is successful; a preferable route may be to require the shares to be held until employment ceases as a good leaver or in the event of a company exit.

Who can use a SIP?

Historically, SIPs have been most popular with larger companies.

However, the relaxation of rules on ownership limits in 2013 means that employees with significant shareholdings can also enjoy the benefits of participating in a SIP, making them potentially more attractive for SME's.

London
020 7236 2601
london@mercerhole.co.uk

St Albans
01727 869141
stalbans@mercerhole.co.uk

Rickmansworth
01923 771010
rickmansworth@mercerhole.co.uk

Milton Keynes
01908 605552
miltonkeynes@mercerhole.co.uk