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A SHARE OF THE TAX BREAKS

The government's share incentive plan, SIP, launched in 2000, is witnessing a high rate of take-up by UK businesses with 45% of FTSE-350 companies expecting to be offering the scheme by the end of the current tax year next April, according to research by New Bridge Street Consultants.

The government has set what NBSC regards as an "ambitious" target of having two million employees participating in the scheme, but the indications are that at least 750,000 will be signed up by April 2003. Most businesses appear to be using SIPs alongside the save-as-you-earn scheme, SAYE.

The scheme allows employees to acquire shares in their employer organisations on tax-favourable terms in four different ways, provided the Inland Revenue approves the structure of the plan:

- Free shares
- Partnership shares
- Matching shares
- Dividend shares

There are clawback provisions if the shares are not held for a sufficiently long period. The following notes are based on guidance provided by NBCS.

Free shares

Up to £3,000-worth of free shares can be given to employees in a tax year, without incurring PAYE income tax or national insurance charges. But, while the current profit sharing scheme allows a different number of shares to be allocated to employees on the basis of factors such as length of service and salary, the new SIPs also allows variation according to results achieved by different "performance units" – business units, subsidiaries, and so on – provided the performance criteria are objective.

There are two ways that shares can be awarded to employees.

Under Method 1, some shares can be given according to performance with the rest given on a "same terms" basis, so that all may participate. On this basis, up to 80% may be performance-linked – and the conditions may vary within the business unit, right down to the level of individual performance.

Under Method 2, all shares can be awarded according to performance, but the criteria must not vary within the performance unit.

The distinction between these two methods ensures that either everyone gets at least some shares (Method 1) or that everyone is awarded shares on exactly the same basis (Method 2) – ie, no individual performance differences by which some employees will get shares and some won't.

Shares given freely may be forfeited if an employee leaves the company within three years of the award being made.

Partnership shares

A company may allow employees to buy £125-worth of shares per month (or an amount equal to 10% of salary, if lower) – equal to £1,500 per year. Deductions are made from employees' payslips, so the amounts contributed are not subject to income tax or VAT.

The actual purchase of shares may be made shortly after the end of the month or rolled up for up to a year to reduce the administrative burden. Unlike free shares, which have been given to employees, partnership shares cannot be forfeited as they have been purchased with the employees' own funds – but there are tax penalties for early withdrawal from the Plan.

Matching shares

For every partnership share that employees buy the company may offer up to two matching shares (though any such match may equally be less than one-for-one). The company must use the same ratio for everyone and, as with free shares, may be forfeited if not held for between three and five years, and there are tax penalties for taking matching shares out of the Plan too soon.

Dividend shares

The company's SIP may allow for dividends to be paid in cash to employees or reinvested in additional shares. Dividend shares will, as ever, be awarded on a tax-free basis (though there will be no tax credit) with similar retention rules.

Other issues

If a company decides to operate an SIP, then all employees with approximately 18 months' service must be allowed to participate. It's not necessary for all companies within a group to offer an SIP just because one or more does, but it isn't allowable to select participating companies in a way that favours better-paid employees.

The shares acquired by employees may be either new shares or existing shares bought on the market. The company must meet all relevant costs. The market value of free and matching shares awarded by the company are tax deductible, as are other costs associated with setting up and running the SIP, and employer NICs are not payable on allocated shares.

If an employee removes shares from the plan within three years of being allocated, they will have to pay tax and NICs on their then value. If removed between three and five years of being awarded, then in broad terms tax is payable on the value when the shares were first awarded or their value when removed from the plan, whichever is lower. So if the value of the shares has risen over the period, the employee will simply pay tax on the original value.

Capital gains tax will be payable on the sale of such shares, but the usual reliefs and allowances apply.

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www.financialdirector.co.uk/briefing

Useful links

- **New Bridge Street Consultants at www.nbsc.co.uk**
- **Inland Revenue guidance notes can be found at www.inlandrevenue.gov.uk/shareschemes/share_incentive**