withy king

The Bigger Picture

we need to talk about...

Incentivising staff by giving them a stake in your firm

With many businesses now focused on growth, retaining key staff in an increasingly competitive jobs market is more important than ever. Every employee will be incentivised by different factors but having a stake in the business they work in, can be a powerful motivational force. Katharine Mortimer, a partner in the corporate team at Withy King, explains how businesses of any size can incentivise employees through share options

If an employee is not already a trusted and valued member of the team, you may understandably be cautious about giving them a stake in the business. Fortunately, a share option scheme enables you to give an employee a contractual right to a fixed number of shares while not actually issuing the shares until any pre-agreed conditions have been met. If the conditions are not met or the employee leaves, the option falls away and you do not have to worry about getting the shares back. A further benefit of a share option scheme is that it will not normally give an employee additional rights in a redundancy situation. It is only when the employee exercises their option that he becomes a shareholder and acquires the rights of a shareholder, for example to attend shareholder meetings, vote and share in profits.

The most commonly used share option structure for owner managed businesses is the Enterprise Management Incentive (EMI) Scheme. Under an EMI Scheme, employees may be granted the right over a fixed or maximum number of shares at a price commonly set at market value at the date of the grant. The employee is then allowed to exercise the option on the terms set out in his personal offer letter. It is only when he exercises his option that he is required to pay the option price.

EMI Schemes are extremely flexible and allow options to be exercised according to an agreed timescale, subject to company or individual performance, on a sliding scale or only on an exit. This can be different for each employee.

If the main aim is for an employee to have a share in the ultimate sale price, without necessarily being entitled to dividends in the meantime, there is arguably no real benefit in holding shares until a sale is imminent. An EMI Scheme is often used in this context as it avoids the admin of having additional shareholders in the medium term while still giving the employee the guarantee of a share in the sale price on an exit. Once the sale is agreed, the employee gives notice to the company of his wish to exercise his option and pays the option price to the company. He then immediately sells on to the third party purchaser at which point he becomes entitled to his share in the sale price.

EMI Schemes offer a number of tax breaks. The grant of the option is tax free. If the option price is set at market value at the date of grant, there is normally no tax or NI for the employee when the option is exercised. Any profit made on an ultimate sale is then subject to capital gains tax rather than income tax. A key benefit of acquiring shares via an EMI Scheme is that the individual may benefit from entrepreneur's relief despite not holding a five per cent stake in the company. The period for which the option is held also counts towards the 12 months period of ownership required to qualify for entrepreneur's relief.

> **“To win in the marketplace you must first win in the workplace – Doug Conant, CEO, Campbell's Soup”**

Katharine Mortimer's experience as a corporate partner at Withy King is wide reaching and she has particular expertise in advising on all aspects of employee share option schemes. Katharine, pictured right, has strong relationships with a select group of accountants who she works closely with to advise clients on the most tax-efficient ways of structuring employee incentives. For further information or advice, please contact Katharine on 01225 730100 or email katharine.mortimer@withyking.co.uk

Three reasons to issue shares to employees

- **To reward and incentivise them through regular dividends paid on the basis of company performance**
- **To encourage them to help grow the company with a view to a sale or other exit by offering them a slice of the ultimate sale price**
- **To develop the next generation of leaders in the business**

THE FIRST FOUR QUESTIONS YOU SHOULD CONSIDER IF...

you are thinking of adopting an EMI Scheme

Does your company qualify?

There is a list of qualifying criteria for companies looking to establish an EMI share scheme. For example, the company must be independent and carry on a qualifying trade and the employee must work at least 25 hours per week (or 75% of his working time) and not have a material interest in the company.

Should exercise of the share option be subject to any conditions?

These can be linked to individual or company performance targets, length of service or the ultimate sale of the business.

What class of share would you like to issue?

Options can be granted over a different class of employee share which means that when exercised, a dividend can be paid on the employee's shares on a different basis to any dividend payable on those of other shareholders.

Have you updated the company's articles of association?

Adoption of any share option scheme should include a review of the company's articles of association. This is to ensure that any shares can be reacquired if an employee leaves, dividends can be paid separately on different classes of share and, in the event of a company sale, no individual employee shareholder is able to frustrate the sales process by holding out for a higher price.