

Share Incentive Plans

A Share Incentive Plan (SIP) is a HM Revenue & Customs approved plan, which offers tax and national insurance contribution (NIC) advantages. It can enable an employer to provide shares worth up to £7,500 (plus up to £1,500 from reinvested dividends) to each employee each year, potentially free of all tax and NIC, while increasing their after-tax profits.

Three main types of shares may be used:

- free shares - each employee may receive free shares worth up to £3,000 each year
- partnership shares - employees can use up to £1,500 per year (or 10% of salary if lower) out of pre-tax and pre-NIC pay to buy partnership shares
- matching shares - the employer can give up to two matching shares for each partnership share bought by the employee. The maximum value of matching shares is therefore £3,000 per year.

The company can exclude employees with insufficient length of service and is permitted to specify a period of up to 18 months for this purpose. Otherwise, all qualifying employees in the company must participate on equal terms (though free shares may be awarded by reference to length of service, rate of pay, and hours of work, or by reference to company or departmental performance targets).

Various combinations of types of plan share can be used, for example, free shares only, or partnership with or without matching shares, or another combination to suit the business needs of the company. It is permissible for partnership shares to be purchased from monthly savings through the payroll, or by giving up a single payment of, say, a bonus, of up to £1,500 (or, if lower, 10% of the employee's salary), per year. All shares awarded or purchased for a particular year may therefore be dealt with in a single transaction once a year.

Companies can also allow an employee to use up to £1,500 of dividends from his or her plan shares each year to buy further shares in the company through the plan. These are called dividend shares.

Employers can include other optional features, such as:

- forfeiture - companies can make employees give up some or all of their free or matching shares if they leave, for certain reasons, within three years of the award date
- holding periods - the employer can require free and matching shares to be held in the plan for any period between three and five years (for dividend shares this period must be three years), unless the employee leaves early.

The tax advantages for participants

Awards of free and matching shares are free of PAYE/NIC. The employee purchases partnership shares out of salary before PAYE/NIC is calculated. There is normally no tax charge on dividends paid on plan shares used to buy further plan shares that remain in it for at least three years. The tax treatment is summarised over the page.

Employee takes shares out of plan					
	Less than three years after award	Three years or more but less than five after award	Five years or more after award	Disposal of shares during holding period (if applicable)	Cessation of employment as involuntary leaver
Free and matching shares	PAYE/NIC on market value (MV) of shares at date of removal from the plan	PAYE/NIC on lesser of MV at date of award and MV at date of removal from plan	No PAYE or NIC	PAYE/NIC on MV at date of disposal	No PAYE/NIC
Partnership share	PAYE/NIC on MV of shares at date of removal from the plan	PAYE/NIC on lesser of salary used to buy the shares and MV at date of removal from the plan	No PAYE or NIC	Not applicable	No PAYE/NIC
Dividend shares	Not applicable	Not applicable	Not applicable	Not applicable	No PAYE/NIC

Note: The table assumes that the shares are 'readily convertible assets' for PAYE/NIC purposes.

The shares may grow in value free of capital gains tax within the plan. The employee's base cost for future disposals is the market value of the shares at the time they leave the plan. Further, from 6 April 2006, an employee who transfers shares from a SIP into a registered pension scheme obtains further tax relief for the value of the shares transferred.

Tax benefits to an employer for providing a Share Incentive Plan

An employer can normally claim relief against corporation tax (CT) for the value of shares provided under a Share Incentive Plan, and is not liable for employer's NICs on shares given to, or purchased by, employees through the Plan. Also, the costs of setting up the Plan are normally deductible to the employer for CT purposes.

Administration

Once having established the Plan the employer must make arrangements for the administration of the Plan for the future. Administration may be minimised by including a holding period in the Plan so as to limit the extent of employees withdrawing shares early and giving rise to PAYE and NIC charges. Further, a number of companies offer Share Incentive Plan administration services which substantially ease the burden otherwise falling on the employer.

Careful attention must be paid to the risk factors set out below.

- The tax legislation, rates and reliefs referred to herein are those for 2009/10. Tax rules change and the value of a relief from taxation depends on the circumstances of the taxpayer
- The value of an investment and the income from it can fall as well as rise as a result of market and currency fluctuations and changes in tax legislation and you may not get back the amount originally invested
- If there is no recognised market for the shares involved it may be difficult to deal in the investment or to obtain reliable information about the value of the investment or the risks that may be involved.

For further information on share schemes, please visit www.bakertilly.co.uk/ecg

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