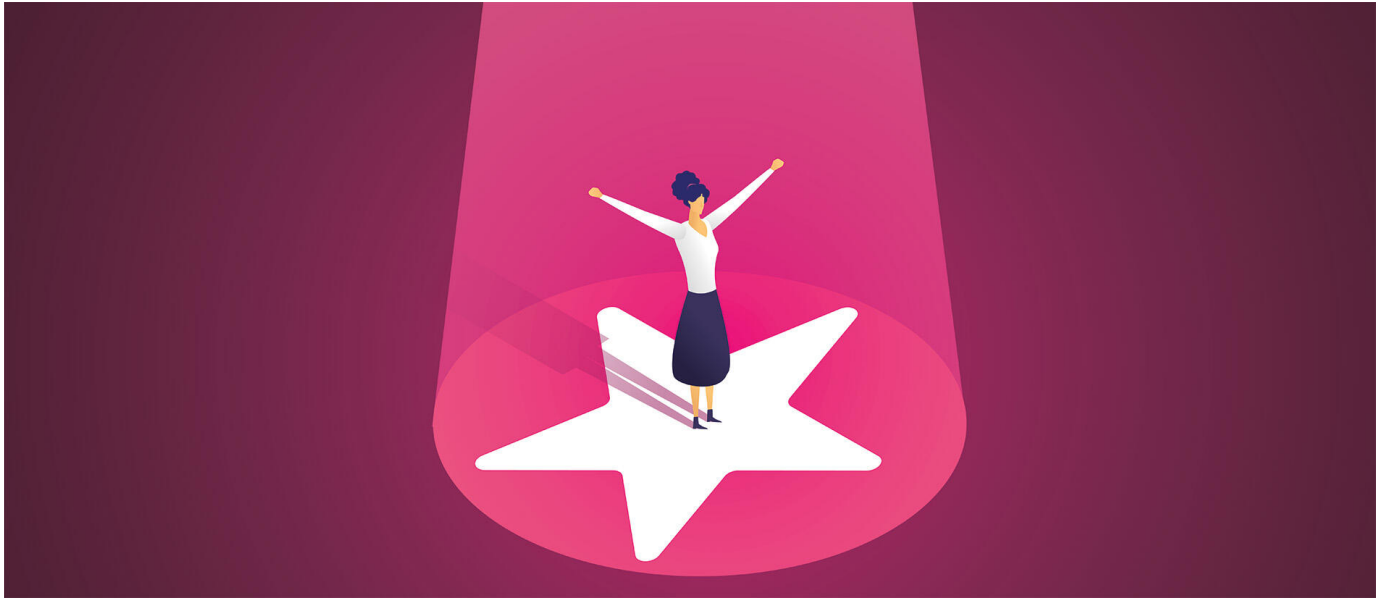


Management incentive planning: the options available to OMBs

OMB



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The introduction of a long-term incentive plan as a complementary option could lead to enhanced staff loyalty, accelerated business growth and reduced payroll costs.

Key Points

What is the issue?

When devising a remuneration plan, it is important for elements of both a traditional scheme (i.e. salary, bonus and/or benefits) and an unconventional scheme (i.e. a share plan) to be considered in order to achieve a cost efficient incentive plan which enhances staff attraction and retention while also boosting the company's financial performance.

What does it mean to me?

Advisers need to be able to guide on the implementation of a tailored compensation package which enhances staff productivity and boosts growth, while considering each company's specific circumstances and commercial objectives.

What can I take away?

Choosing the appropriate remuneration strategy to attract and retain key staff can be a complex decision which depends on many factors. Tailored advice and guidance should be sought.

In the Autumn Budget, the Chancellor of the Exchequer announced a wide range of fiscal measures, most of which are likely to have a detrimental effect on businesses and individuals alike. In relation to employers, from 6 April 2025, the rates of Class 1, Class 1A and Class 1B employer NICs have increased from 13.8% to 15%, while the NICs secondary threshold (i.e. the amount from which an employer will start making NIC payments in respect of an employee) has reduced from £9,100 to £5,000. Employers will be entitled to a £10,500 employment allowance, which may mean that for the smallest businesses the changes have only a modest impact.

These measures will likely lead to increased payroll costs and reduced profitability, which mean lower funds are available to attract and incentivise staff, especially key employees. Many employers are struggling to find suitably skilled workers and, when found, businesses face fierce competition. It is more important than ever for businesses to reconsider the compensation packages offered and, if necessary, to devise alternative ways of attracting and retaining key senior employees that could drive the business forward.

Traditional remuneration

Traditionally, an executive's remuneration package is usually structured to include a fixed level of reward (i.e. salary), as well as a discretionary remuneration element (i.e. bonus), payable once various performance related targets have been reached by the individual and/or the employer. A senior employee's compensation package also tends to include benefits such as a company car, fuel, company phone, healthcare and dental insurance.

However, it is becoming increasingly costly for businesses to keep improving an executive's remuneration package to attract and keep them motivated. On the payment of a salary and/or a bonus, a senior employee will personally be liable to income tax and NICs at a combined rate of up to 47%, while the employer will also be liable to make Class 1 NICs at a rate of 15% on the amount exceeding the updated threshold of £5,000.

Similarly, on the receipt of various benefits which are non-cash convertible, the 'cash equivalent' value of those benefits will be subject to income tax at a rate of up to 45% in the hands of the employee and at a rate of 15% by the employer. Any benefits which can be converted into cash (such as vouchers) would be taxed as a salary or a bonus.

The employer will, however, be able to claim corporation tax relief on the actual value of any salary, bonus and cash convertible benefit provided, and the 'cash equivalent' value of any non-cash convertible benefit, as well as on any employer NICs due on the provision of these rewards.

Alternative remuneration

Considering the recent increase in employment costs and the need for businesses to constantly stand out from competition regarding talent acquisition and retention, an alternative remuneration option which could operate alongside a traditional remuneration package is a share plan.

In essence, a share scheme allows the owner(s) of a business to give away some of the equity as a way of attracting and incentivising key staff and aligning their interests with those of the shareholder(s). The release of equity occurs only once the pre-determined conditions, which are normally set at the outset and include performance related targets, have been satisfied. The introduction of a share plan generally increases staff loyalty and motivation and leads to improved business productivity.

A non-tax advantaged share plan can be suitable where a tax advantaged scheme would not be feasible or provide the necessary flexibility around participating employees or the value of share awards. However, a tax advantaged share plan would generally be preferable, achieving the same commercial benefits but also generating significant tax savings.

Specifically, the award of shares at undervalue under a non-tax advantaged share plan will almost always give rise to an income tax liability to the participating employee and possibly a NIC charge to both the individual and the employer, if the shares awarded qualify as a 'readily convertible asset'. Such an award under a tax advantaged share plan can be undertaken at a significantly lower cost to both parties, where various conditions are met and the scheme is correctly structured.

Non-tax advantaged share plans: the growth share plan

One of the most popular non-tax advantaged share schemes is a growth share plan. Under this discretionary arrangement, a new class of shares is created with limited or no rights to income and generally no voting rights. The growth shares have capital rights which entitle their holder to participate in sharing the economic value of a company once a pre-determined valuation (i.e. hurdle) is reached. This means that the other shareholders' economic interests are diluted only if the set hurdle in relation to the economic value of the company is achieved and exceeded.

The issue of growth shares will not generally give rise to any income tax and/or NICs liabilities, provided that the shares are acquired at market value. As the initial market value of the growth shares is depressed by their limited rights and by the hurdle being set at an aspirational level, the employee's cost of acquiring the growth shares is usually manageable.

As growth shares lack voting rights, their future disposal is unlikely to attract the lower capital gains tax rate of 14% (for disposals occurring up to and including 5 April 2026) or 18% (for disposals occurring on or after 6 April 2026) available under business asset disposal relief. Therefore, the entire capital gain realised will be subject to capital gains tax at a rate of up to 24%, once the annual exempt amount and any available capital losses have been considered.

A growth share plan can be perceived as a 'high reward, low risk' reward strategy by the current equity holders, since any ownership will only be surrendered once the economic value of a company reaches a specific target. However, its implementation is a complex process from both a tax and a legal perspective. As such, professional advice should always be sought.

Tax advantaged share plans

There are four types of tax advantaged share option plans:

- a share incentive plan;
- a Save As You Earn (SAYE) option scheme;
- a company share option plan (CSOP); and
- an enterprise management incentive (EMI) plan.

Whilst a share incentive plan can only be implemented by large, listed companies which do not form the subject of this article, the other three plans can be successfully implemented by owner managed businesses. As such, a brief overview of each of these three schemes is provided below. In all cases, professional advice is recommended in view of the requirements of each type of scheme.

Save As You Earn option scheme

Under a SAYE plan, employees are granted options that permit them to acquire shares in the employing company after three or five years. The price at which options are granted over company shares can be discounted by up to 20% of the market value of the shares at the date of grant.

The SAYE scheme must be operated on an 'all-employee' basis, which means that all employees must be invited to participate. Each employee must enter into a savings arrangement for the same period as the length of the option under which monthly savings of up to £500 are made from post-tax salary.

The grant of the options under a SAYE plan will not give rise to any income tax or NICs implications. If the employee decides to exercise the options, the shares are also acquired free of any income tax or NICs charges irrespective of the value of the asset acquired at that date. (The individual can also let the options lapse and withdraw their savings at the end of the savings period.)

On the sale of the shares acquired under a SAYE plan, the lower capital gains tax rates available under business asset disposal relief are unlikely to apply since the employee will probably have less than 5% ownership in the employing entity. Therefore, any resulting capital gain will be subject to the standard capital gains tax rates of up to 24% once the annual exempt amount and any available capital losses have been considered.

The implementation of a SAYE scheme can improve staff retention, there is a wait time of between three and five years before the employee can acquire the shares. The successful implementation of this plan relies upon the satisfaction of various conditions and practical considerations.

Enterprise management incentive plan

Considering their flexibility and the significant tax benefits offered, it is not surprising that EMI schemes represent 89% of the total employee share schemes implemented, according to HMRC statistics (see tinyurl.com/27bj6vjz). Whereas SAYE plans are implemented by a smaller number of larger, listed organisations, EMI share plans are widely popular with a higher number of smaller, unquoted entities. Among other requirements, EMI schemes are generally available to UK trading companies with gross assets below £30 million and fewer than 250 full time employees.

Under this discretionary arrangement, qualifying employees can be granted options that allow them to acquire shares in the company upon satisfaction of various conditions. These requirements can be flexibly set around an employee's length of service and performance, as well as the occurrence of specific future events (for example, a future sale of the company). However, in order to preserve their tax benefits, EMI options must be capable of being exercised within ten years from the date of grant.

The grant of options will not give rise to any income tax or NICs implications. However, compared to a SAYE plan, the exercise price must equal the market value of the shares under option at the date of grant in order to ensure an income tax and NIC free award of the shares. Once any annual exempt amount and capital losses have been considered, a capital gain arising on the sale of shares acquired under an EMI scheme will be subject to capital gains tax at the standard rates of up to 24%, unless the lower 14% rate (or 18% for disposals occurring on or after 6 April 2026) is available for the first £1 million of the capital gain under business asset disposal relief.

Despite an EMI plan being more flexible and having the potential to deliver much higher rewards than other share plans, its successful introduction and operation hinges on the satisfaction of multiple detailed conditions.

Following the implementation, a constant awareness of the factors that could count as 'disqualifying events' and lead to a loss of the various tax benefits would also be required.

Company share option plan

A CSOP operates similarly to an EMI plan in the sense that it allows eligible employees to receive options that for a cost could be exchanged for shares in the company, subject to various conditions being met.

However, important distinctions exist between a CSOP and an EMI plan. A CSOP is less restrictive since there are no specific requirements concerning the trading status of the employing entity and the working requirement regarding the participating employees is relaxed. It is also less generous, however, as the maximum value of shares over which an employee can hold options is £60,000 (compared to the £250,000 limit available under an EMI plan). Additionally, to ensure a charge free award of shares, the options available under a CSOP must be exercised after a minimum period of three years but within ten years from the date of grant.

Whilst not as rewarding as an EMI scheme, a CSOP is still a highly beneficial option, especially for entities that do not qualify for EMI and want to introduce a share-based incentive programme.

Corporation tax deduction

Provided certain conditions are met, a corporation tax deduction would be available to the employing company in the period in which an employee acquires shares under both a non-tax advantaged and an advantaged share plan. The deduction available equals the amount on which the employee either is or would have been subject to income tax (if not for the benefits of a tax advantaged share scheme).

Reporting requirements

The above share schemes have strict reporting requirements that need to be followed in relation to each event consisting of a grant of options, exercise of options/award of shares and sale of shares respectively. Failing to adequately report these events to HMRC might invalidate a share plan and result in adverse tax

implications.

In conclusion

Considering that traditional remuneration plans are becoming costlier to implement, share-based plans are becoming an increasingly popular way to attract and incentivise key employees in a tax efficient way which can be aligned with the company's key commercial objectives.

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