

Driving Facts

TAX NEWS

Employee Share Option Schemes

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As we now have a number of clients who have either put in place or are actively putting in place Employee Share Option Schemes, we thought that it was time that we did a short introductory article on this subject.

By far the most popular form of scheme is the Enterprise Management Incentives (EMI) Scheme. It combines the maximum flexibility, with the least degree of regulation and some very attractive tax benefits.

The important point to note right from the start is that an EMI Scheme uses options over shares, not shares. What this means in practice is that you are not giving away part of a company on Day 1 but are promising to provide the employee with a right to acquire shares at some stage in the future. Typically the employee has to do something for the benefit of the company before he can gain the right to the shares. As far as the conditions to be performed are concerned, the only requirement is that these conditions can be articulated in the scheme rules and success or failure measured. Typical conditions include increasing the turnover of the business by 50% in three years or ensuring the overdraft is reduced from £X to £Y.

Putting a qualifying condition into the exercise of the option means that as an existing shareholder you are not merely giving away part of your company but are giving away part of your company in exchange for growth in its value, thus you are in a win situation. From the recipient or employee's point of view they know that if they fulfill the performance criteria they will get an equity stake in the company. In other words they will share in the growth of the value of the company in a way over and above their normal salary and bonus package, a win situation for them.

The legislation starts off by stating that a qualified share option must be granted for a commercial reason in order to recruit or retain an employee. In many instances schemes are introduced to lock in key workers, form part of a strategy for management to acquire a more significant shareholding in the company or to help meet the salary expectations of key workers where cash flow does not enable a cash salary to be paid. From the employees point of view the options start to acquire Business Asset Taper Relief from the date the options, rather than when the shares, are acquired. This is important as many option holders only exercise the options, and acquire the shares, when a sale is in the offing.

From the company's perspective a Corporation Tax deduction is obtained for the commercial cost of the shares; in other words the difference between the price paid by the employee for the shares and the value of the shares at the date of exercise. The price paid by the employee for the shares can be market value or market value plus or minus although the norm is market value. If market value there are no further income tax or NIC consequences for the employee.

Share options can be a valuable tool in recruiting and retaining the best employees and if used sensibly can represent a win, win position for both the existing shareholders and key employees.

A Place in the Sun

The last few years have seen a large increase in the number of UK individuals purchasing property abroad, usually in the guise of a holiday home that is available to let out when not occupied privately. Although it is tempting to simply concentrate on your choice of location for such property it is important not to ignore the tax implications.

Property in Personal Ownership

If the transaction is carried out by a UK resident and domiciled individual, the tax treatment is that the rental income less non private expenses will give the profit to be taxed in the UK. Tax is usually also payable in the country where the property is located and relief for this is obtained as a credit against the UK tax charge.

Property Owned via a Foreign Company

Sometimes it is not always legally possible, or indeed advisable, to purchase overseas property as a UK individual. The common alternative is to set up a company in the country where the property is located and use it to purchase the property and manage the rental income. This would be subject to the equivalent of corporation tax in that country and potentially subject to UK corporation tax, and also raises the spectre of the associated companies' rules.

Companies are treated as associated for UK corporation tax purposes if they are carrying on a business and are under common control ie the same individual and their associates or group of individuals control more than 50% of the share capital. The corporation tax rate bandings are divided by the number of associated companies and this can therefore increase the amount of tax payable as compared to stand alone companies.

If the foreign company is simply holding the property as a nominee for the individual then there is usually no problem, however, it is likely that by renting out a property it would be seen as carrying on a business and would therefore be treated as associated to other companies you own. This means that owning a holiday home in this manner could involve the hidden cost of an increase in the corporation tax paid by your existing motor trade company.

Legal issues permitting, the purchase and running of the property could be structured in a way that sidesteps the associated companies' rules, but with added red tape and cost, this is not always a workable solution and if you wanted to pursue this option detailed professional advice would be needed.

Benefits in kind and the 2007 Budget Announcement

Prior to the 2007 Budget, HMRC seemed determined to try and assess a benefit in kind charge on the individual using a corporate structure to own a holiday home, whether or not they actively managed the company. This clearly disadvantaged many people and as a response to this, it was announced that legislation would be included in Finance Act 2008 that would eliminate any benefit in kind charge provided certain conditions are met, such as it is not funded by a connected company, and would apply retrospectively. Although this announcement is very welcome, the associated companies issue is not addressed and thus tax as well as legal advice is essential before embarking on a venture of this sort.

VAT and Tax Allowances

In VAT News we often discuss how much VAT can be reclaimed on fixed assets but have you ever thought about how this interacts with the tax allowances your business receives? What is the correct amount of expenditure that qualifies for capital or industrial buildings allowances?

Normal Assets

The first situation to consider is where all the input tax incurred on a new asset is fully recoverable. In this case, it is the VAT exclusive cost of the asset that should be used to calculate the allowances due.

If however, there is an element of input VAT that is not reclaimable, for example if there is private use of a car that was not purchased as stock in trade, the allowances are calculated on the net cost of the asset plus any input VAT you were unable to reclaim.

If you have any queries on any of the subjects covered in this newsletter or on any tax or company secretarial matters please email us at

taxteam@trevorjones.uk.com or call our helpline on 0161 475 4700.

These articles are of a general nature and specific advice should be obtained before they are acted upon.

Capital Goods Scheme Assets

A more complicated situation arises in the case of assets that are subject to the VAT Capital Goods Scheme. The detailed workings of this scheme are outside the scope of this article but broadly speaking it involves monitoring the use of certain assets over a set period and comparing the extent they are used to produce VATable supplies in later years to the assets' original usage.

The amount of input VAT claimed at the time of purchase is revisited each year and there can be an upwards or a downwards adjustment to the amount of reclaimable VAT. Following on from the rules outlined above regarding irrecoverable VAT, this effectively means that the amount of expenditure that qualifies for allowances could change with each adjustment period.

Treatment of Adjustments Arising

The way the adjustments are treated for tax allowances purposes depends on the type of allowances claimed. If the expenditure qualifies for capital allowances and more VAT is recoverable as a result of the annual adjustment, the adjustment is treated like disposal proceeds, if the adjustment involves an additional payment of VAT to Customs; it is treated as an addition for capital allowances purposes.

Treatment is similar for industrial buildings allowances but the tax written down value of the asset is amended at the time of the adjustment and this revised value spread over the remaining life of the asset.

When we calculate the allowances that are due to your business, our starting point is the fixed asset register and for this reason it is important that this reflects any adjustment to the real cost of the assets to your business in the form of irrecoverable VAT. You must make us aware of any adjustments made so that we can ensure claims for tax allowances are maximised and tax payable is minimised.

Fraud Warning

It has come to light that some Companies House customers have been targeted by someone claiming to be from Companies House, asking for verification of their Web Filing Authentication Codes. Companies House has advised that they will never contact you by telephone to verify your Web Filing Authentication Codes. If you are contacted by someone under these circumstances obtain a return telephone number if possible and contact Companies House.