Field Fisher Waterhouse

Save As You Earn (or Sharesave) plans

August 2009

Contents

Introduction

The HM Revenue & Customs (HMRC) Save As You Earn option plan (SAYE) is a popular and long established method of providing tax efficient share options to employees. SAYE plans are often referred to as “Sharesave” or “Savings related” plans. The main features of SAYE are:

- Companies offer their employees the option to buy shares in the company at a future date.
- All eligible employees must be offered the opportunity to participate in the plan.
- The option may be granted at market value (taken at the date of grant) or at a 20% discount to the market value.
- Employees save between £5 and £250 per month out of taxed pay on a fixed savings contract.
- When the contract matures, employees receive a tax-free bonus (based on a fixed interest rate) and decide at that time whether to use the proceeds to buy the shares or take the cash and the bonus.
- The exercise of the option (in most circumstances) is tax free for employees.
- The SAYE helps solve the employer’s national insurance contributions (NICs) problem on exercise of the option.
- Companies of all sizes and whatever their business can establish an SAYE.

BUT

- Some companies cannot establish an SAYE because of their ownership structure.

How SAYE works

In outline, SAYE works as follows (with reference to typical documentation):

- A company establishes the plan (plan rules) and obtains HMRC approval of it.
- In the case of an unquoted company or one listed on the AIM Market of London Stock Exchange plc, the market value of the plan shares is agreed with HMRC before an option is granted.
- The board invites all eligible employees to participate (letter of invitation).
- The employees who want to be part of the plan agree to participate (application form).
- The employees are granted options to acquire shares in the company within, usually, a ten year option period (option certificate).
- The employees enter into a savings contract with a savings provider such as a bank or building society. The contract can last three or five years.
- When the savings contract matures the option holders either use the proceeds to exercise their options and acquire shares or allow the options to lapse and take the bonus and the proceeds of the savings in cash (notice of exercise of option). The bonus or interest earned on these savings is tax free.
- Employees who choose a five year contract can decide whether to take the proceeds after the fifth anniversary or leave the savings for another two years to earn an additional bonus.
- Any shares received on exercise of an option belong to the employee absolutely.

The benefits of SAYE

SAYE provides a tax efficient way for employees to acquire shares in their employer. It involves a cost to the participants (the exercise price) but an employee will not exercise the option unless the value of the shares under option at the time of exercise is higher than the exercise price.

If the value of the shares is less than the exercise price at the time the savings contract matures or at the time there is a takeover of the company then employees can simply take the savings they have accumulated from monthly salary deductions and the fixed rate bonus tax free.

In summary the employee does not generally pay income tax or National Insurance Contributions on:

- the grant of options
- the bonus or interest received under the SAYE savings contract
- the benefit from being able to acquire shares at a discount to their market value
- any increase in the market value of the shares from the date the option is granted to when it is exercised.

Capital gains tax may be payable by the employee if shares acquired are later sold for a gain.

Approval conditions

Framework

The SAYE plan framework is as follows:

- Participation must be available to every eligible person of the company (or participating company if there is a group).
- Eligible persons are those who: (1) are either employees or full-time directors of the company and have been so for a qualifying period of up to five years, and (2) are subject to UK income tax, and (3) do not already own or control a certain level of equity or assets in the company implementing the SAYE plan.
- All employees who take part must do so on similar terms.
- The option exercise price can be equal to or up to twenty per cent **less** than the market value of the company's shares at the time of the grant of the option.
- The option rights must not be transferable (except on death).
- If an option is exercised three years or more after its grant then the exercise is tax free for the participant.

BUT

- Options exercised within six months of an option holder's employment ending for injury, disability, retirement or redundancy are not taxable regardless of the time period between the grant and exercise of the option.

Plan shares

The scheme shares have to meet certain qualifying conditions. They must be:

- ordinary shares,
- fully paid up, and non-redeemable,
- in a company which is not controlled by another company (unless, for example, it is a subsidiary of a company listed on the Main Market of London Stock Exchange plc or the New York Stock Exchange), and
- not subject to any restrictions other than restrictions attaching to all shares of the same class or certain employee pre-emption restrictions.

Other conditions

There are other approval conditions to meet. If there is more than one class of share the scheme shares must satisfy additional conditions. If the company is a close company (generally if it is controlled by less than five persons) then a 25% or more shareholder (including options) cannot participate.

Prior approval of the SAYE plan rules from HMRC is required before options can be granted to eligible employees.

Once an SAYE plan is established changes to key features of it must be approved in advance by the HMRC.

There is an annual return which must be submitted to HMRC by 6 July each year containing details of options granted and exercised in the previous tax year.

Important tax advantages for the employer

As well as tax advantages to participants, there are two very important tax advantages for employers.

1. In the case of an unapproved option, the employing company will usually face an employer's NICs charge when an option is exercised. This charge is currently 12.8% (without limit) of the difference between the exercise price and the market value of the shares acquired *at the time of exercise*. This liability is unquantifiable and is a major concern for many companies.

   In contrast, under SAYE there is an exemption from NICs when shares are acquired *even if income tax is payable by the employee (for example because there is a company takeover within three years from the date the option was granted).*

2. A corporation tax deduction is normally (subject to certain conditions) available as a statutory right in respect of the acquisition of shares through SAYE. This is a potentially valuable relief and is available even if the employee pays no income tax on acquisition of the shares (as is generally the case). Further details of this relief are available from the Equity Incentives team.

The SIP alternative

If you are considering setting up an SAYE plan, you should also think about whether a Share Incentive Plan (SIP) is appropriate for your company's circumstances.

A SIP is another form of HMRC approved all-employee share plan. A SIP has the following key features:

- employers can give each employee up to £3,000 worth of shares each year
- each employee can buy up to £1,500 worth of shares out of pre-tax and National Insurance earnings
- employers can give up to two free shares for each share bought by an employee
- dividends on SIP shares of up to £1,500 per year can be reinvested by an employee in more SIP shares

SIP shares are held in trust on behalf of employees and generally the receipt of them by an employee is income tax free with any gains made while in trust, free of capital gains tax.

This is a very brief summary of the SIP. Further details are available from the Equity Incentives team.

How we can help you

- We can advise whether or not a SAYE plan is possible for your company.
- We can help you decide whether or not it is worthwhile establishing a SAYE or whether another form of equity incentive plan is better suited to your company's circumstances.
- We can assist in the design, implementation and operation of the plan.
- We can prepare all the plan documentation and deal with the approvals procedure with HMRC.
- We can assist with granting options under the plan.
- We can provide easy-to-read employee communication guides to enable employees to understand how the plan affects them.
- We can provide ongoing assistance in the administration of the plan.

Contacts

For further information, please call the Equity Incentives team on +44 (0)20 7861 4717 or contact:

Graeme Nuttall
e: graeme.nuttall@ffw.com

Mark Gearing
e: mark.gearing@ffw.com

Stephen Wright
e: stephen.wright@ffw.com

Field Fisher Waterhouse LLP 35 Vine Street London EC3N 2AA
t. +44 (0)20 7861 4000 f. +44 (0)20 7488 0084 info@ffw.com www.ffw.com