

## Partly Paid Share Plan

A partly paid share arrangement allows executives to become shareholders for a small upfront cost (typically the nominal value of the shares but this could be zero). The awards, however, are subject to the condition that the recipient employees must pay full initial market value at some later date. If nothing is paid up-front the shares are normally termed “nil paid”; if something less than the full subscription price is paid, the shares are termed “partly paid”. To avoid any up front tax charges, the amount ultimately payable by the participant should be the market value of the shares at the time they are acquired.

For most plans of this kind, participants share the same risks and returns as the other owners of the business and, therefore, are incentivised to both maintain and improve company performance. However some plans are structured so that the participants do not receive any dividend income on their shares until they have been fully paid up.

The scheme is not HMRC approved as such but any gain made on the eventual sale of the shares by a participant is taxed as a capital gain.

Participants are able to acquire shares up-front from an existing EBT, but do not pay the full acquisition price until the shares are sold or other agreed circumstances arise. Such circumstances would typically include a cessation of employment in the Group (good and bad leaver provisions may apply), a takeover or IPO of the Group, or in the unlikely event of a winding up. Most plans would also typically have a “long stop” date by which the participant would be required to pay up the unpaid balance on the shares and this would typically be five years (i.e. less than the typical ten year period that one would see in a standard share option scheme).

The legal documentation comprises a partly (or nil paid) share purchase agreement between the participant and the trustee which would set out the rules under which the arrangement would work i.e. what happens if the participant ceases his employment in the Group, what happens if the Company is taken over, what is the long stop date and whether dividends are payable on the shares during the partly paid period.

The agreement could include a requirement that the participant would have to offer his shares back to the EBT for sale on a cessation of employment. This could be structured with a “penalty clause” such that if the participant is a “bad” leaver he would be required to offer his shares back to the EBT at the lower of cost and market value at the time.

Some plans envisage that the requirement to pay the unpaid balance will be waived if performance warrants it (thus making the arrangement work like a performance share plan).

### *Advantages*

Aside from the tax benefits (see below) the main benefit is cash flow. An employee does not have to provide cash up-front and this can indeed lead to him receiving a larger number of shares than he would otherwise be able to afford. In company law terms, leaving monies outstanding in this way is not a loan.



## *Disadvantages*

The risk to participants is the key concern. The participant will always be liable to pay up the unpaid balance at some stage. If he leaves he will have to pay up what he originally agreed to pay even though the shares may have fallen in value.

## *Tax considerations of partly paid shares*

- For UK income tax purposes, that proportion of the market price of the shares left outstanding is treated as a notional employment related loan, the benefit of which is taxable in the hands of the executive.
- However, there would be no income tax charge where interest relief exemptions apply. These are aimed at allowing senior employees who acquire shares in their employing company using loan finance to claim a deduction for the interest cost incurred from their annual taxable income. The interest relief provisions apply if the company is a close company and at the time that the shares are acquired by the participant, he is involved in the actual management of the company (or has an interest in more than 5% of the share capital).
- If interest relief would not be available (because the participant is not deemed to be senior enough) the annual taxable benefit would be calculated based on the "Official Rate" of interest, which is currently 4.75%. The Official Rate is published from time to time by HMRC and fluctuates with interest rate changes as announced by the Bank of England (although the changes tend to lag the Bank of England announcements).
- For example, if the executive purchases 100,000 shares having a market value, at the time of acquisition, of 102p each for 2p per share, the annual benefit in kind income tax and NIC charge for a high earner (at prospective rates) would be:

$$(100,000 \times (102p - 2p)) \times 4.75\% \times 51.5\% = \text{£}2,446.25$$

- If the requirement to pay up the outstanding balance is waived, the amount waived is treated as a taxable benefit for the year in which the waiver takes place. For example, if the executive is not required to pay up any of the outstanding balance (because performance conditions have been fulfilled) the amount of income tax and NICs would be calculated (at prospective rates) as follows:

$$100,000 \times (102p - 2p) \times 51.5\% = \text{£}51,500$$

- On a sale of the shares, any gain made by the executive is subject to capital gains tax, currently, at 18%. If the shares double in value, the amount on which the executive would be charged to CGT is calculated (ignoring the annual CGT exemption) as follows (assuming a sale price of 200p per share):

$$100,000 \times (204p - 102p) \times 18\% = \text{£}18,360$$

- UK employer's NICs (current rate 12.8% but increasing to 13.3% from April 2010) are payable in respect of benefits which are subject to income tax in the executive's hands. Thus if the participant did not qualify for interest relief employer NICs would be payable on the annual beneficial loan benefit.



- The employer should qualify for corporation tax relief in respect of:
  - the annual benefit in kind subject to income tax in connection with the notional loan , together with the associated employer's NIC and
  - any amount chargeable to income tax in the event that the requirement to repay the outstanding balance is waived, together with the associated employer's NIC charges.

For further information please contact:

[ian.murphie@mm-k.com](mailto:ian.murphie@mm-k.com)

[michael.landon@mm-k.com](mailto:michael.landon@mm-k.com)

[paul.norris@mm-k.com](mailto:paul.norris@mm-k.com)

[nigel.mills@mm-k.com](mailto:nigel.mills@mm-k.com)



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