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UK and US Equity Incentive Arrangements A comparison for US Companies

BRIEFING NOTE





UK and US Equity Incentive Arrangements: A comparison for US Companies

Many companies in both the US and the UK involve their employees in equity ownership, as both countries have provided tax breaks and other measures to promote this.

Although the type of plans operated in the US and UK have developed differently over the years, there are many common features. We at Abbiss Cadres are here to help you with the design, implementation and operation of equity based plans in the UK and beyond.

Tables A-C overleaf compare the key features of the main tax advantaged and non-tax advantaged equity based plans in the US and the UK. The tax advantaged plans are shown in two tables: table A for those plans which must be operated on an 'all-employee basis' and table B for those plans where companies may select the individuals who can participate. Table C shows non tax-advantaged plans.

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US Companies Operating an ESPP in the UK

ALL EMPLOYEE TAX ADVANTAGED EQUITY PLANS

US companies who wish to implement an all-employee stock purchase plan (ESPP) for their UK employees will need to decide whether to take advantage of either of the two tax advantaged structures available, the SAYE or the SIP.

Either of those plans can be used to replicate some of the features of an ESPP, and the tax advantages can be significant.

However, many US companies simply choose to implement an ESPP for UK employees in broadly the same way as it is operated in the US.

Dealing with the tax liabilities not only presents administrative challenges, but it also makes the ESPP more unattractive from an employee's perspective.

| | US – Section 423 Employee Stock Purchase Plan (ESPP) | UK – Savings Related Share Option Plan (SAYE) | UK – Share Incentive Plan |
|------------------------------------|---|--|--|
| Structure | Share purchases using monthly payroll deductions at up to 15% discount | Share purchases using monthly payroll deductions at up to 20% discount | Share purchases at market value using either monthly or one-off payroll deductions. Matching shares for shares purchased. Free shares. Dividends shares |
| Eligibility | Must be offered to all employees, but certain categories such as those with less than 2 years' service and part time or highly paid employees may be excluded | Company must satisfy certain legislative conditions. Must be offered to all employees, but may impose service requirement of up to 5 years | Must be offered to all employees but may impose service requirement of up to 18 months |
| Offering/ purchase period | Usually between 3 and 27 months. Shares may also be subject to a mandatory holding period | Either three or five year vesting period, no holding period | Purchase period of up to 12 months. Free, matching and dividend shares subject to a holding period of at least three years |
| Limits | No more than \$25,000 worth of stock may be purchased per year | Maximum monthly salary deduction of £500 (i.e. £6,000 per year) | Purchased shares limit of lower of £1,800 per year and 10% of salary. Maximum ratio of 2:1 matching shares to purchased shares. Free shares limit of £3,600 per year |
| Tax Treatment ¹ | Taxation at date of share purchase on difference between price paid and market value. Capital gains treatment on sale of the shares | No taxation on date of share purchase. Capital gains treatment only on sale of the shares. National Insurance savings for employer | No taxation on share acquisition. Deductions for purchased shares out of gross salary. Potentially no income tax or capital gains tax if shares held in plan for five years. National Insurance savings for employer |
| Other Features/ Requirements | N/A | Monthly deductions must be held in an account with a certified savings provider | All shares must be held in a UK resident trust |

¹ For UK resident employees

US Companies Granting Tax Advantaged Options in the UK

US companies wishing to implement a tax advantaged option plan in the UK for selected employees have a choice of either the CSOP or EMI plan. Although a UK specific appendix or schedule to its existing plan, and UK specific option grant documentation, would be required in order to reflect the statutory requirement, there would be relatively few changes to the option terms or the way the company operates the plan (particularly in respect of EMI options).

TAX ADVANTAGE SELECTIVE PLANS

| | US – Incentive Stock Options | UK – Company Share Option Plan (CSOP) | UK – Enterprise Management Incentive Options (EMI) |
|----------------------------|---|--|--|
| Structure | Exercise price must be equal to fair market value at grant | Exercise price must be equal to market value at grant | Exercise price may be at a discount to market value at grant |
| Eligibility | Employees owning more than 10% of the share capital may not be eligible to participate | Company must satisfy certain legislation conditions. Employees must not have a material interest (more than 30%) in the company | Only available for smaller companies (those with less than £30m gross assets and no more than 250 full-time equivalent employees) that also satisfy certain other legislation conditions. Employees must not have a material interest (more than 30%) in the company and satisfy working time requirement. |
| Limits | No more than \$100,000 worth of shares (measured at grant) may vest pursuant to ISOs held per employee in a calendar year | Limit of £60,000 worth of shares (measured at grant) per employee | Limit of £250,000 worth of shares (measured at grant) per employee. Overall limit of £3m worth |
| Tax Treatment ¹ | Taxed in the UK in the same way as a non-statutory stock option | No taxation if option exercised more than three years after grant or in certain 'good leaver' circumstances. Capital gains treatment only on sale of the shares. National Insurance savings for employer | No taxation on option exercise if market value exercise price. If discounted exercise price, income tax on exercise on discount at grant. Potential 10% capital gains tax rate. National Insurance savings for employer |

¹ For UK resident employees

US Companies Operating Non-Tax Advantaged Plans in the UK

NON-TAX ADVANTAGED EQUITY PLANS

US companies that are either ineligible or unwilling to operate a tax advantaged plan for their UK employees would usually choose to grant non-statutory stock options, restricted stock units, or restricted stock. These types of plan would usually be implemented in the UK with a UK specific appendix to the plan or the award agreement, which would include additional terms and conditions reflecting UK employment, data protection and tax laws.

| | US Plan Structure | UK Plan Structure | Differences/similarities between the US and the UK Plan Structures |
|------------------------|--|--|--|
| NSOs | NSOs are granted with an exercise price equal to fair market value, and are exercisable on a future date or dates | Usually called an unapproved or non-tax advantaged share option plan. | Non-tax advantaged stock option plans in the UK are similar in structure to those in the US. Graduated vesting is more often seen in the US than in the UK (where cliff vesting is more common) |
| Restricted Stock Units | RSUs give employees the right to receive a specified number of shares at a future date or dates. Where linked to performance, they may be called PRSUs | The equivalent plan structure in the UK is known by a number of terms, including Long Term Incentive Plan (LTIP), Deferred Share Plan, Performance Share Plan (where performance linked) or conditional share awards | Vesting schedules may differ (as above). Performance based awards becoming increasingly common in the US (they have been so in the UK for a number of years) |
| Restricted Stock | Stock acquired by employees on grant which is subject to restrictions on transfer and potential forfeiture until a future vesting date or dates | Restricted shares in the UK may be granted under a separate plan or as part of an omnibus plan that provides for other type of awards | Vesting schedules may differ (as above). Both the US and the UK has an election process whereby employees can choose to be taxed on the acquisition of restricted stock, rather than at vesting. |

¹ For UK resident employees

What can Abbiss Cadres do for you?

At Abbiss Cadres, our mission is simple: to help you make the most of your workforce. We provide a comprehensive range of human resources services via our unique multi-disciplinary team which includes lawyers specialising in immigration, tax, pensions, share plans and employment law, as well as payroll and HR consulting specialists. Specially licensed by the UK legal services regulator to provide a broad range of legal and non-legal services, we have the flexibility to organise around your needs, and are experienced in working alongside existing legal advisers.

Our clients include large multi-national companies as well as small and medium-sized enterprises.

Outside the UK, we work with the CELIA ALLIANCE to provide the same level of comprehensive support and expertise across a global network.

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Client testimonials

"The team at Abbiss Cadres possess expertise that is second to none in relation to complex remuneration structures and share-based incentives that has proven invaluable to us in the execution of both IPO's and corporate transactions."

Corporate Partner, AM Law 100 firm

"Abbiss Cadres assisted Abbott Risk Consulting (ARC) Ltd in the design and implementation of an employee share scheme based on Enterprise Management Incentives (EMI). Their support was invaluable and went beyond the simple mechanics of EMI schemes. They helped us focus on our business needs and ensure the scheme we put in place would help us attract and retain staff. The scheme did just that and we have just enjoyed one of our best year's performance ever with low staff turnover and a motivated workforce. Guy Abbiss is an expert in his field and is a pleasure to deal with. I have no hesitation in recommending him and Abbiss Cadres LLP."

John Abbott, Managing Director, ARC

Abbott Risk Consulting (ARC) Ltd is an independent consultancy leading the field in the provision of consulting services and technical recruitment to the defence, transportation, marine and energy sectors.

Contact us

For more information on how we can help you, visit our website at www.abbisscadres.com or contact our team.

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