Nil Paid Shares

Created June 2015

What are nil paid shares?

Also known as nil-paid or part-paid shares, this plan allows employees to buy shares at market value but defer the cost of this purchase until a later time. The employee acquires the shares under an obligation to pay their market value as the subscription price, but they are not required to make any payment on being allocated the shares. This means that they are 'nil paid' and the amount due is left outstanding as 'unpaid calls' due to be paid at a future date, as agreed with the company. If the company wants the employee to pay something up-front, this is perfectly possible. The shares are then 'part-paid'.

Payment can in fact be left outstanding indefinitely until the shares come to be disposed of; at that time the employee will have the funds to pay the calls due and can collect the balance as the profit made on the shares.

These plans may include performance conditions and are often used to top up approved plans or EMI plans or where approved plans are not possible.

What rights do the shares have?

The voting, dividend and other rights are as set out in a company's articles of association, but leavers would normally be expected to sell their shares on ceasing employment. The amount which a leaver would receive in those circumstances can be freely determined, as can the amount which can be received on a sale.

Often, a company's articles and shareholders' agreement may have to be amended to provide for or disapply provisions for nil or partly-paid shares, but the mechanics of this should not be problematic.

It is also possible for the same dividends to be paid on the deferred shares as on the company's other ordinary shares providing that the employee pays at least the nominal value of the shares up front or depending on what the company's articles say.

The employee acquires the shares under an obligation to pay their market value as the subscription price, but they are not required to make any payment on being allocated the shares.

Share Plan Partners Limited. Registered in England No. 08791239. VAT Reg No. 798 1639 61.
T: +44 (0)7838 491 550 | E: ian.muphie@shareplanpartners.com | www.shareplanpartners.com

What are the advantages of these arrangements?

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.

What are the disadvantages of these arrangements?

The risk to participants is the key concern. The participant is almost always liable to pay up the subscription monies at some stage. If the company goes into winding up, the liquidator will be obliged to call for the amount due to be paid up on the shares. If the employee leaves he may have to pay up what he originally agreed to pay even though the shares may have fallen in value. If the shares fall in value below their value when the employee acquired them, he will still be required to pay up the unpaid call at some point even though this may be more than the shares' value at the time he pays the unpaid call.

Some schemes purport to waive payment obligations in certain cases. However, these (if set out up-front) are ineffective in law and so are unlikely to prevent a liquidator from claiming subscription monies either from the participant or the directors who issued the shares. Any amount waived at the time of ceasing employment is treated as additional employment income in most cases, even though the participant would not feel as if he has received a real benefit, and so the participant will at the very least probably have to pay some tax even if he is relieved of his obligation to pay up his monies to the company. With small numbers, the tax exposure may not be considerable and is still better for the individual than paying the whole amount.

If the choice is between these arrangements and paying in full up-front, the participant is still better off acquiring partly paid shares as he ends up paying later what he would have paid anyway. However, if the choice is between these arrangements and options (which are risk free but otherwise share many characteristics with these arrangements), options may be preferable.

Summary tax treatment

Because the shares are acquired for full price albeit that the full price won't be paid until a later time, there is no income tax or National Insurance Contribution charges on them at the time the employee acquires the shares.

Different rules apply if the shares are acquired in connection with tax avoidance arrangements, but HM Revenue & Customs has confirmed a straightforward issue of nil-paid/part-paid shares is not regarded as being caught by these rules.

A taxable benefit arises on the employee each year on the notional interest-free element of the amount outstanding. Interest is calculated at the Official Rate of 3.25% (at the moment) of the unpaid calls. However, there is no taxable benefit at all if the shares are in a close company (broadly one under the control of five or fewer shareholders) and if certain detailed conditions are satisfied (e.g. the shareholder works full time for the company in a managerial capacity).

Share Plan Partners Limited. Registered in England No. 08791239. VAT Reg No. 798 1639 61.
T: +44 (0)7838 491 550 | E: ian.muphie@shareplanpartners.com | www.shareplanpartners.com

The gain on the eventual sale of the shares should attract Capital Gains Tax (CGT) for the individual at 10% if the conditions for entrepreneur's relief are all met. The company will not get any corporation tax relief for any gain on the shares.

There should also be no 25% section 455, loan-to-a-participator charge on the company for an illegal loan to a participator, as the unpaid element should not count as a loan for the purposes of this section until the company makes a call. However, the plan needs to be carefully structured to achieve this.

Although these arrangements are becoming increasingly popular, their tax treatment is well established, and so they have not so far been seen as particularly aggressive.

We hope you found this useful, but if you would like further information about Nil Paid Shares or other share plans then please contact Share Plan Partners.

T: +44 (0)7838 491 550
E: ian.muphie@shareplanpartners.com