Share Incentive Plan (SIP)

Created June 2015

What is a Share Incentive Plan (SIP)?

A share incentive plan (SIP) is an HMRC approved all-employee share scheme with four key elements: partnership shares, matching shares, free shares and dividend shares. A SIP offers companies a flexible way to incentivise employees through share ownership in a tax efficient way. Whilst it is possible to offer matching shares and free shares, a company is not obliged to do so, many choosing to just offer partnership shares to avoid the cash cost or dilution effect.

Partnership shares	Matching shares	Free shares	Dividend shares
Shares which a participant of a SIP can purchase out of pre-tax earnings up to a maximum of £1,800 per annum (or £150 a month), or 10% of their annual salary (whichever is lower).	Shares given to the participant by the company in a ratio not to exceed 2:1 to partnership shares. This is not a compulsory element to include.	A free allocation of shares to participating employees by the company up to a maximum of £3,600 per annum. Performance conditions can be attached. This is not a compulsory element to include.	Participants are beneficial shareholders if they hold shares in a SIP so are entitled to dividends. These can be given in the form of additional shares if the scheme allows it.

The SIP was introduced in 2000 and there are now almost 1,000 schemes in operation. According to HMRC (June 2014) these are estimated to generate £140m Income Tax Relief and £110m in NIC Relief. There are also more than one million individual employees currently participating in a SIP according to the latest ifs ProShare Annual Survey (July 2014).

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

Additional key features of a SIP:

- SIP must be offered to all full-time and part-time UK resident employees.
- Minimum employment service requirements may be set, but these must not exceed 18 months.
- As a SIP is an HMRC tax-approved plan it must follow their requirements.
- All deductions from salary are taken from the gross amount.
- If a minimum employee contribution is specified, it must not be greater than £10.
- The employer can require free and matching shares to be held in the scheme for any 'holding period' between three and five years (dividend shares must be held for three years), unless the employee leaves early.
- There is no minimum holding time for partnership shares, participants can access these at any time, but it may result in the forfeiture of associated matching shares if the minimum holding period has not been satisfied.
- If a participant voluntarily leaves the company within three years of the award of free or matching shares, the company can build into the scheme rules that the shares can be forfeited.
- For maximum tax advantages participants must leave shares in the trust for at least five years.
- Special forfeiture exemptions apply for involuntary leavers who leave within three years.
- Any performance conditions for free shares must be based on company targets and not specific to each participant.
- Matching and free shares must be offered on the same terms to all employees.
- When participants leave employment all their shares must come out of the scheme.
- A SIP scheme may require shareholder approval.
- The company's articles of association may need altering to allow the scheme to operate.
- Unlisted companies will also need to agree the value of their shares with HMRC for the purposes of the plan.

Tax implications

For Employees:

- Employees can buy partnership shares out of gross salary (pre-tax and NICs)
- Matching, free and dividend shares are tax free when awarded.
- Employees who keep their shares in the plan for five years pay no income tax or NICs on the shares.
- Tax and NICs for employees broadly works as follows:

Type of share	When you acquire the shares	Removing shares from the SIP during the first 3 years	Removing shares from the SIP during years 3 to 5	Removing shares from the SIP after 5 years
Free shares and matching shares	No income tax or NICs to pay on the value of the shares	Income tax and NICs payable on the market value of the shares when you take them out of the plan	Income tax and NICs payable on the lower of the market value of the shares at the date of award or the market value on the date of removal	No income tax or NICs

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

Type of share	When you acquire the shares	Removing shares from the SIP during the first 3 years	Removing shares from the SIP during years 3 to 5	Removing shares from the SIP after 5 years
Partnership shares	No income tax or NICs to pay on the money you use to buy the shares	Income tax and NICs payable on the market value of the shares when taken out of the plan	Income tax and NICs payable on the lower of the salary used to buy the shares, or the market value of the shares on the date of removal	No income tax or NICs
Dividend shares	No income tax or NICs to pay on dividends used to buy dividend shares	Taxed as dividends	No income tax or NICs	No income tax or NICs

If an employee leaves as a 'good leaver' then they are exempt from income tax and NICs. A good leaver status is applied to those who leave due to injury, disability, redundancy, retirement, death, a TUPE transfer or because their employing company ceases to be an associated company.

Employees who keep their shares in the plan until they sell them will have no CGT to pay. The 'base cost' of the shares is fixed to the market value upon withdrawal from the scheme. This means that if shares are withdrawn and sold at a later date then the participant will only be liable to CGT on any increase in the value of those shares above this base cost.

Shares released from a SIP can be transferred into an ISA or a pension provided this is done within 90 days of removing the shares from the scheme.

For Employers:

Companies can claim corporation tax relief for their costs in setting up and running a SIP, to the extent that such costs exceed the employee contributions. There is also further tax relief on partnership shares purchased by employees equal to the value of the gross salary deduction. The costs to the employer of funding the free and matching shares are also tax deductible.

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

Example:

Partnership shares purchased	
Monthly contribution for Partnership Shares	**£100**
Share price at date of purchase	**£4.50**
Partnership shares purchased	**22**
Cost to a lower rate tax payer (as an example, if you pay tax at 20% and NI at 12%)	**£68**
Cost to a high rate tax payer (as an example, if you pay tax at 40% and NI at 2%)	**£58**
Matching shares awarded on a 1:1 basis	
Matching shares awarded	**22**
Total SIP shares acquired	**44**
Notional value at award based on a share price of £4.50 per share	**£198**
Tax free value at release from the scheme after five years based on a share price of £6.50	**£286**

Note: The above example is for illustrative purposes only. Based on income tax and NICs rates for the 2015/16 tax year and assumes that the shares are retained within the SIP for 5 years (not subject to tax).

Employees need to be made aware that they become shareholders in the company through SIP and that the share price can fall as well as rise. There is common confusion with this if a company operates a SIP alongside an SAYE plan whereby they only become a shareholder at the end if they choose to exercise their option.

Share Plan Partners can advise and help you establish a SIP, which will require the design of plan rules, HMRC registration/declaration and the setting up of a trust to hold the shares. Please contact us for more information.

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

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