ESOP centre

Analysis of the HMRC statistics on employee share schemes 2012

ESOP Centre

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The Employee Share Ownership Centre

Spreading the Wages of Capital

ALL-EMPLOYEE SHARE SCHEMES IN DECLINE DESPITE GOVERNMENT ADVOCACY

The number of companies offering an all-employee share scheme has fallen for the fourth consecutive year according to the ESOP Centre's annual analysis of HMRC's most recent statistics.

The ESOP Centre is the leading members organisation which lobbies on behalf of the employee share ownership industry. Our members are drawn from companies which have employee share plans, professional advisers in the area, academics, politicians and other interested parties.

The figures for 2010-11 show that 1,180 companies now offer either a Save as You Earn (SAYE), a Share Incentive Plan (SIP) or both to employees down from 1,530 at its peak in 2006-07.

Most of the decrease can be attributed to SAYE which has suffered from competition with the SIP since its introduction in 2001. At its peak 1,110 companies operated a SAYE scheme compared with just 510 in 2010-11.

EMI, the scheme developed for smaller, fast-growing companies has bucked the trend, with an additional 410 companies having implemented one in 2010-11. Because of this, the overall number of companies operating one of the four tax-advantaged share schemes has risen from 8,710 to 8,910, masking the decline of the other three schemes.*

Reacting to the disappointing figures, ESOP Centre chairman, Malcolm Hurlston, said: "The sleep-walking decline of all-employee share schemes cannot continue. It should be a priority of any government to ensure that people can gain access to productive capital wealth and build their savings for the future. These share schemes are the only route available for many, many employees to achieve this aim.

Over the last two years, employee share ownership has been the subject of review by the Office of Tax Simplification, the Department for Business, Innovation and Skills and HM Treasury.

"The government has been very active, but needs to consider why, despite the associated benefits to motivation and productivity, these schemes are not as widely used as they used to be.

"The statistics suggest that bold action needs to be taken today to reinvigorate the share schemes market. The future payoffs are doubly beneficial to the government and society through increased productivity and through reduced reliance on the state where employees build a nest-egg of savings through such schemes."

"An opt-out system similar to the one being introduced for pensions would encourage a mid-term savings culture and reduce many employees' reliance on credit."

Save as You Earn

The traditionally popular Sharesave has suffered in recent years. The number of companies operating an SAYE scheme fell 15 percent according to this year's statistics from 600 in 2009-10 to 510 in 2010-11. The number of employees benefiting from the scheme also fell from 480,000 to 420,000.

Sharesave is a share option scheme linked to a savings contract so that when the time comes employees have enough money to buy the shares. Under a Sharesave the company offers an option price which can be discounted by up to 20 percent of the market value at the date of grant. Participants decide at the outset to contribute from £5 to £250 each month over the course of a savings contract for either three or five years (decided by the company).

At the end of that period, the accumulated savings (plus a tax free bonus at a level set by HMRC – currently zero) are then be used to exercise options and purchase of shares. All gains realised at this point will be free of Income Tax and NIC liabilities, and subject instead to CGT when shares are sold. For most people the annual CGT allowance (£10,600) is enough and they pay no tax. Alternatively, the participants can withdraw their savings and bonus and allow the option to lapse which is what people do if the share price is below the option price.

ESOP Centre chairman, Malcolm Hurlston said: "It's a great shame to see the number of companies offering Sharesave schemes decreasing.

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"Sharesave schemes present an opportunity to companies in allowing employees to build a nest-egg, meaning they are less stressed about their finances at work. Share schemes also have a positive impact on retention, motivation and productivity. Yes, they can be expensive to run, but it should never be simply a 'bottom line' decision for companies. Providing a share plan should be part of any company's corporate responsibility plan.

"For employees Sharesave schemes are low-risk. If the share price is below the option price you get all of your savings returned."

Some of the fall in the use of Sharesave can be attributed to falling bonus rates which currently stand at zero for all contracts.

"When the bonus rates were high, the deal was a little bit sweeter. Some have called on HMRC to review these rates, but to be fair to them, the bonus rates are linked to the equivalent swap rates (sterling bid rates) published in the Financial Times. The mechanism was agreed with the industry when interest rates were high so that savings providers could continue to offer the savings contracts at a time when they were beginning to look prohibitively expensive."

Share Incentive Plan

Commenting on the statistics for the other all-employee scheme, the Share Incentive Plan (SIP), Hurlston said: "The number of companies offering SIP schemes has fallen by much less than Sharesave. A number of companies who have had both a Sharesave and a SIP historically are now choosing between the two, and SIP is coming out on top."

"The SIP has more generous tax-reliefs attached to it than Sharesave, but more generally share option schemes, like Sharesave, seem to be out of fashion at the moment, with share purchase schemes, like SIP, getting the nod."

"However, share purchase schemes expose employees to real risk whereas share options schemes do not. We should take care not to exclude the risk averse, often the worst paid from employee share ownership."

The number of companies offering a SIP fell, with 20 fewer including one in their remuneration package in 2010-11 compared with the previous year – 820 versus 840.

"Both of the all-employee schemes could do with a boost from the Treasury. If the Government is serious about spreading employee share ownership to a wide employee base, these two all-employee schemes are the most obvious choice for the vast majority of companies."

Company Share Option Plan (CSOP)

The CSOP faced a difficult year after the OTS review reported that it was unclear of the policy rationale behind the scheme, saying the limit of £30,000 was too low for executives but too high for other employees.

Following this, HMRC issued a consultation further investigating the use of the CSOP to ascertain whether the scheme as currently used has a positive effect on productivity and economic growth and supports government objectives in a cost efficient and targeted way. The government's response to this consultation resolved that the CSOP would remain on the statute books.

The most recent HMRC statistics, however, presented further bad news for the beleaguered scheme with 210 fewer companies operating a CSOP in 2010-11 than in 2009-10, falling from 1,490 to 1,280.

Use of the CSOP has been in decline since the introduction of EMI which (for those companies which qualify) presents a more generous and flexible offer. The introduction of IFRS2 has further adversely affected the use of share option schemes.

Mr Hurlston said, "CSOP plays a vital role as a simple scheme which can be used on an all-employee basis for companies which would find the operation and administration of the other two all-employee schemes prohibitively complex."

"As employees do not have to contribute regular sums of money to participate in a CSOP, it is the most suitable scheme for the lowest paid."

There was some encouraging news for the scheme, with an increase in the number of employees to whom options were granted from 35,000 in 2009-10 to 40,000 in 2010-11. However, this is still a mere fraction of the 415,000 employees who participated in a CSOP in 2000-01.

Enterprise Management Incentives

The fall in the number of companies using share schemes is masked by the fantastic success of Enterprise Management Incentives, which have proven recession-proof. This year the number of companies operating such a scheme rose from 6,780 to 7,190.

“Wherever companies expect rapid growth over the coming years, EMI should without hesitation be introduced,” said Mr Hurlston, “it is testament to the optimism of our entrepreneurs that the number of EMI schemes increases year after year.”

In 2010-11 2,280 companies granted options to key staff using EMI.

The ESOP Centre has called on the government to put a halt to the decline in the number of companies using employee share schemes by actively promoting their use and benefits. A whole range of simplifications to the legislation and rules was recently announced by HMRC in response to the Office of Tax Simplifcation’s review. It is now hoped that more companies will be encouraged to implement a share plan.

For additional information, please contact:
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The Employee Share Ownership Centre is an independent not-for-profit membership organization, established by Malcolm Hurlston in 1988 to inform, lobby and research in the interest of employee share ownership. Its subscription-based membership includes consultants, professional advisers, trustees, banks and companies who have either introduced employee share schemes or intend to do so shortly.

The HMRC statistics on share schemes are available here:
http://www.hmrc.gov.uk/stats/emp_share_schemes/menu.htm

Notes:

The statistics this year underwent a review to check the data validation processes and as a result some historic data was revised.

***The four HMRC tax-advantaged schemes: the Share Incentive Plan, Save as You Earn, Company Share Option Plan and Enterprise Management Incentives** are summarised below.

Share Incentive Plan ("SIP"): The SIP is an HMRC approved tax-efficient, all-employee plan. There are 4 main elements to the SIP. Companies can choose to use one or more of the following modules: Free Shares; Partnership Shares; Matching Shares; and Dividend Shares.

Under a SIP companies may gift up to £3,000 of shares to each employee (Free Shares) each tax year. Employees can also be given the opportunity to buy shares with up to £1,500 of pre-tax salary in each tax year (Partnership Shares). Where one Partnership Share is purchased companies can award a maximum of two shares for free in return (Matching Shares). Dividends paid on SIP shares can be used to buy up to £1,500 worth of additional shares in each tax year (Dividend Shares). Shares in the SIP must be held in trust.

Save As You Earn ("SAYE")/Sharesave: The SAYE is an HMRC approved plan that allows employees to enter into a savings contract for three or five years. The accumulated savings (plus a tax free bonus at a level set by HMRC) can then be used to fund an exercise of options and purchase of shares. Employees who decide to participate in a company's SAYE plan are granted an option to buy shares at a later date as prescribed by the company. The option vesting period can be 3, 5, or 7 years.

The options can be granted at a discount of up to 20% of the market value of the shares at the date of grant. Participants decide at the outset to contribute up to £250 each month.

Participants who want to exercise their option to buy shares use the accumulated savings plus bonus. All gains realised at this point will be free of Income Tax and NIC liabilities, and subject instead to CGT when shares are sold. For a high proportion of participants the annual CGT allowance is enough and they pay no tax. Alternatively, the participants can withdraw their savings and bonus and allow the option to lapse (sensible if there is no gain…)

Company Share Option Plan ("CSOP"): The CSOP requires formal HMRC approval prior to implementation. It allows qualifying companies to grant employees, and officers working more than 25 hours a week, options to acquire shares up to a value of £30,000 (calculated at the date of grant). The CSOP is often used by companies which do not qualify for EMI and also by companies which wish to offer participation to part-time and low-wage employees.

The option cannot, under normal circumstances, be exercised before the third anniversary of the date of grant, and any gain on exercise is not subject to Income Tax or NICs. Gains are, instead, subject to CGT after the employee's annual exemption.

Enterprise Management Incentive ("EMI"): The EMI is a tax favoured plan aimed at younger and smaller companies who want to attract, reward, and retain skilled staff. It allows companies with gross assets of less than £30 million and fewer than 250 full time (or equivalent) employees to grant options over shares up to a value of £120,000 per employee (valued at the date of grant). The EMI does not require formal HMRC approval prior to implementation of the plan.

As long as the exercise price is set at the market value of the shares at the time the option is granted, there will be no Income Tax or NICs charge when the employee exercises the option (provided the exercise takes place within 10 years of the grant). Gains will be subject to CGT after using the employee's annual exemption.