Share Incentive Plans

A guide for employees

This guidance explains the rules of Share Incentive Plans and the tax and National Insurance advantages that apply when you take part. It replaces booklet IR2002 which is no longer available.

What's in this guide

- What is a Share Incentive Plan?
- How does it work?
- Free shares
- Partnership shares
- Matching shares
- Dividend shares
- What are the advantages?
- Are there any disadvantages?
- Can I take part in my employer's plan?
- How many shares can I get?
- Will the shares be ordinary company shares?
- When can I take my shares out of the plan?
- Can I get shares under a SIP and under another Share Scheme or plan?
- What happens when I leave the company?
- What happens if the company is taken over?
- What if I move abroad?
- What happens if I die while I am still working for the company?
- Do I have to pay tax and NICs when I am awarded the shares?
- When will I have to pay income tax and NICs on my shares?
- How much income tax and NICs will I have to pay?
- What income tax and NICs do I have to pay on my shares?
- How do I pay the income tax or NICs I owe?
- What tax do I have to pay on dividend shares?
- What about Capital Gains Tax (CGT)?
- What if I keep the shares after I take them out of the plan and sell them later?
- Hope much CGT will I have to pay and when?
- How can taper relief reduce the CGT I pay?
- Is there any other tax I might have to pay?
- Can I put my shares into an Individual Savings Account (ISA)?
- Can I put my shares into a stakeholder pension?
- Can I transfer my shares to someone else?
- What records do I need to keep?
- Will I need to complete a tax return?

What is a Share Incentive Plan?

Share Incentive Plans were introduced in July 2000 to give employees tax and NICs advantages when they buy or are given shares in the company they work for.

How does it work?

If your company decides to set up a Share Incentive Plan, it can choose to offer you one or a combination of four types of plan shares. These are

- *free shares*
- *partnership shares*
- *matching shares*
- *dividend shares*

The plan works by keeping the shares in a trust for you until you either leave your job or decide to take the shares from the plan. The shares must be kept in the plan trust for a specified number of years to give you the full tax benefits.

The Share Incentive Plan rules described in this booklet act as the framework for plans set up by employers and provide them with some choices. You should check the details of your own employer's plan.

Free shares

Your employer can award you up to £3,000 worth of free shares in any tax year. A tax year runs from 6 April one year to 5 April the next.

An employer may link awards of shares to its employees' performance, for instance

- your individual performance, or
- the performance of your team, division or other work unit.

If the award is linked to performance, the company will set out clear targets in advance and tell you what those targets are.

Partnership shares

You can buy partnership shares using your gross pay. However, the limits on how much you can spend on partnership shares are the lower of:

- £1,500 per tax year, or
- 10% of your total salary for the tax year.

Your employer may specify whether all or only part of your salary is to be used when calculating the maximum percentage of salary to be spent on partnership shares. For example a scheme may exclude a particular description of earnings, such as overtime or bonus payments.

Buying shares using your gross pay means that you will not have to pay income tax or National Insurance contributions (NICs) on the money that you use to buy them. NICs savings may not affect you if you would not have paid NICs on the money because you earn below the employee earnings threshold. Tax savings may not affect you if you earn below the personal allowance.

Matching shares

If you buy partnership shares, your employer can **match** them by giving you up to two free shares for every partnership share you buy. You will need to check the details of your employer's plan to find out if your employer offers any matching shares.

Dividend shares

As a shareholder you may be paid **dividends** on your shares.

If you receive dividends on your free, partnership or matching shares, your employer may allow you to use those dividends to buy more shares to be held in the plan. These are dividend shares. You are allowed to use up to £1,500 of plan dividends in this way in any tax year. You will not have to pay income tax on these reinvested dividends as long as the shares you buy with your dividends are held in the plan for at least three years.

If you do not use your dividends to buy more shares in this way, they will be taxed in the same way as other dividends. If you are a higher rate taxpayer you will need to enter the details on your Self Assessment tax return.

What are the advantages?

If you receive free shares in the company you work for, you usually have to pay income tax and NICs on them because they are part of what you earn from your job. However, if you take part in a Share Incentive Plan, you will not have to pay income tax or NICs on the value of free or matching shares awarded to you. The longer you keep the shares in the plan, the less tax and NICs you will pay when you finally take them out.

Your plan shares are held in a trust for a holding period of at least three years. Your employer can increase this holding period to up to five years. You can take your partnership shares out of the plan at any time, but you will normally have to pay some tax and NICs on them if you take them out less than five years from the date that you bought them.

To get full income tax and NICs advantages, you will have to keep all the shares in the plan for at least five years (or three years for dividend shares). These time limits are explained in the table below.

If you keep your shares in the plan until you sell them, you will not have to pay Capital Gains Tax (CGT) on the gain you make, however much the shares grow in value.

Are there any disadvantages?

Buying partnership shares under the plan may affect your entitlement to contribution-based, earnings-related and means-tested state benefits, tax credits and work-related payments.

You will not have paid NICs on the pay that you used to buy the partnership shares. As a result, you may not have paid enough NICs to qualify for certain benefits. This will only affect a small number of people. Our leaflet IR177 - Share Incentive Plans and your entitlement to benefits - explains this in more detail.

Shares can go down in value as well as up. So, if you are thinking of buying partnership shares under the plan, you might want to consider whether you could afford to make a loss if the shares do not perform as well as you hope.

Can I take part in my employer's plan?

Share Incentive Plans are all-employee plans, so they cannot be restricted to particular groups or individuals. However, companies can exclude employees who have not worked for the company for a minimum period of time. Individual companies can set their own minimum limit, but it cannot be longer than 18 months.

Part-time employees have the same rights to join as full-time employees.
You can take part right up to retirement. Income tax and National Insurance advantages will remain in place if you take your shares out of the plan early because you retire at or after the age specified in the plan rules.

How many shares can I get?

Your employer can offer you

- **free shares** - worth up to £3,000 per year
- **partnership shares** - bought with up to £1,500 or 10% of your salary per tax year, whichever is lower
- **matching shares** - up to two matching shares for each partnership share you buy
- **dividend shares** - bought with up to £1,500 worth of dividends per year.

Your employer can set lower limits than these, which will be set out in the plan rules.

Your company's plan may link the award of free shares to your

- level of pay
- length of service
- hours worked, or
- performance.

The number of partnership shares you receive depends on how much of your income you contribute. The number of matching shares you may receive (if any) depends on the number of partnership shares you buy and the matching ratio set by your employer.

Will the shares be ordinary company shares?

Yes. The shares must be ordinary shares in the company. However, your employer can put certain conditions on them. For example, the shares may have limited or no voting rights.

You may have to give up your free and matching shares if you leave the company within three years of receiving them. You may also have to give up your matching shares if you withdraw partnership shares from the plan within three years.

When can I take my shares out of the plan?

You can take your partnership shares out of the plan at any time. But, if you take them out within three years of the award you may lose the matched shares that were awarded with them.

You cannot take free, matching or dividend shares out of the plan within the first three years.

Your employer can extend this period to up to five years for free and matching shares.

If you leave your employment, your shares must come out of the plan, whether the time limits have passed or not. Some employers will arrange for free and matching shares awarded to you to be forfeited if you leave within a period of up to three years after the award.

If you take your shares out of the plan within the first five years, you may have some tax and NICs to pay. There is a more detailed explanation of the tax charges and the time limits in the table below.

Can I get shares under Share Incentive Plans and under another share scheme or plan?

Yes. There are other schemes or plans that give you tax advantages for holding shares in the company you work for. You may already have shares or rights to acquire shares through them.

They are:

- Save As You Earn (SAYE) share option schemes, and
- Company Share Option Plans.

You can take part in a SAYE share option scheme or a Company Share Option Plan at the same time as you take part in a Share Incentive Plan.

What happens when I leave the company?

Your shares come out of the plan as soon as you leave your job. Depending on the rules of your employer's Articles of Association, you may have to sell your shares when you leave and you may have some tax and NICs to pay. There is a more detailed explanation of the tax position in the table below.

What happens if the company is taken over?

The old company's shares in the plan are usually exchanged for the new company's shares. Income tax reliefs continue to apply to the shares you have already been awarded, but tax charges will apply to any that you take out early following the normal rules. The trust set up to administer the plan for the old company shares stays in place at least until all of those plan shares have come out of that plan.

If the new company wishes to make awards of shares after the take over it will need to set up a new plan (if it does not already have an approved plan) - it cannot use the plan you have been participating in to award shares in the new company.

What if I move abroad?

If you are posted abroad, to work for the same company or a member company of the group, shares you already have can stay in the plan. When you are abroad, you may not be able to enjoy the tax advantages of the plan unless you are still subject to UK tax.

Your employer will still be able to offer you free, partnership, matching and dividend shares if he so wishes, but you may have to pay local overseas taxes and local social security contributions on their value. You should seek the advice of your employer or the Tax Office abroad.

What happens if I die while I am still working for the company?

Your shares have to come out of the plan. The company may require the shares to be sold back to them. If not, then the shares will become the property of your estate. There will be no income tax or NICs to pay on these shares. The personal representatives of your estate may have to pay Capital Gains Tax if they sell the shares for more than they were worth at the date of your death. See our leaflet CGT1 - Capital Gains Tax. An introduction - for more information.

Do I have to pay tax when I am awarded the shares?

No. There are no tax or NICs to pay when you are awarded shares under the plan.

When will I have to pay income tax and NICs on my shares?

There may be tax and NICs to pay if you leave the company or take your shares out of the plan within five years of joining it. This will depend on why you take the shares out, and how long they have been in the plan.

If your shares come out of the plan because you leave the company for any of the following reasons income tax or NICs will not be payable on their value

- injury or disability
- redundancy
- the company or part of the business you work for is sold out of the group
- retirement
- death.

If you take the shares out for any other reason, you may have to pay income tax or NICs.

How much income tax or NICs will I have to pay?

This depends on how long the shares have been in the plan. See the table below.

What income tax and National Insurance do I have to pay on my shares?

Type of share	**When you acquire the shares**	**When you take shares from the plan during the first 3 years***	**When you take shares from the plan during years 3 to 5***	**When you take shares from the plan after 5 years**
Free shares and matching shares	No income tax or NICs to pay on the value of the shares	Income tax payable on the market value of the shares when you take them out of the plan	Income tax payable on the lower of the market value of the shares at the time you: • acquired them, or • take them out of the plan	No income tax or NICs to pay
Partnership shares	No income tax or NICs to pay on the money you use to buy the shares	Income tax payable on the market value of the shares when you take them out of the plan	Income tax payable on the lower of: • the pay used to buy the shares, or • the market value of the shares when they are taken out of the plan	No income tax or NICs to pay
Dividend shares	No income tax or NICs to pay on dividends used to buy dividend shares	Dividends that you used to buy shares are taxed as a dividend in the year when you take the shares out of the plan	No income tax or NICs to pay	No income tax or NICs to pay

** You can take partnership shares out of the plan at any time. You cannot take free, matching or dividend shares out within the first 3 years. Your employer can extend this period to up to 5 years for free and matching shares. Your shares have to come out of the plan when you leave your employment so income tax charges may apply. This could be within 3 years, 3 to 5 years, of receiving them. The charges do not apply if the shares come out of the plan because you leave your job for one of the exempt reasons listed under 'When will I have to pay income tax and NICs on my shares?' above.*

How do I pay the income tax or NICs I owe?

Your employer will normally deduct the income tax and NICs under PAYE. If you leave the company and you are a higher rate taxpayer, you may have further income tax to pay if your employer only deducted basic rate tax. You should give details of your shares and the tax you have paid in your Self Assessment tax return.

If the shares can be readily converted into cash (for example, if they are listed on the Stock Exchange) then your employer will deduct the income tax under PAYE and you will have NICs to pay.

If they are not readily convertible assets, there will be no NICs to pay, but you may have to pay income tax and you will have to give details about the shares in your Self Assessment tax return. If you do not usually receive a tax return, you should contact your Tax Office to let them know about the shares by 5 October after the end of the tax year. They will arrange for any tax you may owe on the shares to be deducted through your tax code.

What tax do I have to pay on dividend shares?

You will not have to pay income tax on dividend shares if

- you take them out of the plan after three years, or
- you take them out because you leave your job for one of the reasons listed above.

If you take the shares out for any other reason less than three years after they went into the plan, you will be taxed on the value of the original dividend, but you will only have to pay more tax if you are a higher rate taxpayer. Your employer will give you the details that you will have to enter on your Self Assessment tax return.

Dividend shares are not subject to NICs.

What about Capital Gains Tax?

Capital Gains Tax (CGT) may be due if you make a gain when you dispose of your shares or other assets. You can make gains up to the annual exempt amount each tax year without having to pay CGT. The annual exempt amount for tax year 2004/05 is £8,200. You have an annual exempt amount for each tax year but you cannot carry it forward if you do not use it.

Share Incentive Plans give you a special CGT advantage: if you keep your shares in the plan until you sell them, you will not have to pay CGT on any gains you make, however large.

What if I keep the shares after I take them out of the plan and sell them later?

You calculate the gain on your shares by deducting from the sale price

- the exit value (their value on the date you took them out of the plan) plus
- costs of disposal, for example, stockbroker's commission.

Taper relief may reduce your gain for CGT purposes.

If your gain after taper relief (plus any other tapered capital gains you make in the same tax year) is no more than the annual exempt amount, you will not have to pay any CGT. Otherwise, you will have to pay CGT on the excess over the annual exempt amount.

If the sale price is less than the exit value, you will make a loss for CGT. You can set the loss against capital gains before taper relief of the same year and carry forward any excess to future years.

How much CGT will I have to pay and when?

This depends on the level of your income liable to income tax. You add the gains chargeable to CGT onto your income liable to income tax and pay CGT at the appropriate rates. For tax years 2003/04 and 2004/05, the rates are 10%, 20% and 40%, depending on your income tax band.

You pay CGT on 31 January after the end of the tax year in which you dispose of the shares.

How can taper relief reduce the CGT I pay?

Taper relief reduces the percentage of the gain that is chargeable to CGT according to the number of whole years you hold the shares after you take them out of the plan. The longer you hold your shares after you take them out of the plan (up to a maximum of ten whole years) the lower the effective rate of CGT you pay.

There are different rates for taper relief depending on whether the shares are business assets.

Broadly, while you are an employee of

- the company
- its subsidiary
- a qualifying joint venture company.

Your shares will be business assets. However, if you have an interest of more than 10% of the shares in a company, then the shares are only business assets if it is a trading company or the holding company of a trading group.

When you cease to be an employee then your shares become non-business assets.

The main exception is that your shares will remain business assets even when you leave the company if

- your shares are in an **unlisted** trading company or
- your shares are in an **unlisted** holding company of a trading group.

Taper relief reduces the percentage of the gain that is chargeable to CGT more rapidly for business assets than for non-business assets.

The relief reduces the gain in steps,

- by 75% down to the minimum of 25% over four whole years, if the shares are business assets
- by 40% down to the minimum of 60% over ten whole years, if the shares are non-business assets.

Our leaflet CGT1 - Capital Gains Tax. An introduction - tells you more about taper relief and sets out the full taper relief table.

Example *(using tax rates for the tax year 2004/05)*

Jo, a basic rate taxpayer employed by a listed trading company, is awarded £3,000 worth of shares under the plan. Five years later, she takes the shares out of the plan. By this time, they are worth £12,000 (the exit value). She keeps the shares for a further four years and then sells them for £25,000. She makes no other capital gains in the tax year that she sells them.

Jo pays no CGT on the £9,000 growth in the value of the shares while they were in the plan.

The gain is the difference between the exit value (£12,000) and the sale price (£25,000) = £13,000.

Jo has held her shares for four whole years after taking them out of the plan so taper relief reduces her gain by:

- 75%, if the shares are business assets
- 10%, if the shares are non-business assets.

(a) If Jo continues to work for the company until after she sells the shares, her shares are business assets

Gain	£13,000
Reduced by taper £13,000 x 75%	-£9,750
Tapered gain	**£3,250**

Her annual exempt amount is £8,200 and so Jo pays no CGT.

(b) If Jo leaves the company when she takes the shares out of the plan, her shares become non-business assets.

Gain	£13,000
Reduced by taper £13,000 x 10%	-£1,300
Tapered gain	**£11,700**
Her annual exempt amount is	£8,200
Gain chargeable to CGT = £11,700 - £8,200 =	**£3, 500**

Jo pays CGT at 20%, the rate for basic rate taxpayers. (This rate applies if the amount of the taxable gain does not take her income above the basic rate band.)

CGT payable = £3,500 x 20% =	**£700**

Is there any other tax I might have to pay?

While your shares are in the plan, you or the trustees of the plan may receive payments in cash or in kind in relation to your shares. For example, the receipts may follow a rights issue. These are capital receipts.

You pay income tax and NICs under PAYE on any capital receipts you receive within five years (three years for dividend shares) of the shares being awarded to you.

Can I put my shares into an Individual Savings Account (ISA)?

Yes. You can transfer your shares directly into the stocks and shares part of an ISA, as long as you do so within 90 days of taking them out of the plan. The transfer is free of CGT.

The market value of the shares at the date of the transfer counts as a subscription to your ISA. This means that this market value, together with any cash subscription you make during the same tax year, cannot exceed the ISA subscription limit.

Can I put my shares into a stakeholder pension?

Yes. You can transfer your shares directly into a stakeholder or personal pension, as long as you do so within 90 days of taking them out of the plan. Not all pension schemes will allow you to do this, so you should check with the scheme administrator first.

When you transfer your shares into a personal or stakeholder pension, HM Revenue & Customs will credit your pension account as if you had paid basic rate tax (22% for tax year 2005/06) on the shares. So, if you have shares worth £780 and transfer these into your pension, we will add a further £220. If you pay tax at the higher rate, you may also claim higher rate tax relief on your Self Assessment tax return.

Once transferred into a personal or stakeholder pension, the shares may only be used to provide benefits under the rules of the pension scheme. Please refer to our website at www.hmrc.gov.uk/pensionschemes/guidance.htm for more information about the conditions attached to pension contributions.

Can I transfer my shares to someone else?

Not while they are held in the plan. However, once the shares come out of the plan, and if your company allows it, you will be able to transfer the shares to someone else, such as your spouse. You will have to pay any income tax or NICs charges that you owe before you can make the transfer.

If you transfer the shares to someone else, apart from your spouse, you may have to pay CGT on any gain in the value of the shares after you took them out of the plan.

What records do I need to keep?

You must keep full records of your participation in a Share Incentive Plan. For example, you will need to keep a record of when you were awarded free or matching shares, and when you bought partnership shares. This is because you may have to pay income tax or NICs if you leave the company or take your shares out of the plan within five years.

Will I need to complete a tax return?

If you keep your shares in the plan until you sell them, it is unlikely that you will need to complete a tax return unless

- you are a higher rate taxpayer, or
- your employer did not deduct the full amount of the tax due under PAYE when you took the shares out of the plan.

If you do have to complete a tax return, remember to ask for the share schemes pages. There are also notes and Helpsheets to help you fill in the return.

If you keep your shares after you take them out of the plan and dispose of them later for more than they were worth when you took them out of the plan, you may have to pay CGT. If you have to pay CGT and you have not received a tax return, you should ask your Tax Office for one. Remember to ask for the Capital Gains pages and notes.