Briefing note

Smith & Williamson

Flowering shares

February 2019

What is a flowering share?

Flowering shares offer a tax-efficient means of incentivising employees to partake in the growth of the company.

The shares initially hold little value, but this increases (ie the shares 'flower') once the business achieves a predetermined level of growth.

How to set up a flowering share scheme

A scheme can be set up by creating a new class of share with restricted voting and capital rights. These shares have rights to a proportion of the future growth in value in excess of the pre-determined 'hurdle'.

Tax/NIC treatment at award and sale of flowering shares

The below table summarises the tax/NIC treatment on award and sale of flowering shares which do not qualify for any of the HMRC-approved tax-advantaged schemes.

Taxable event		Tax/NIC treatment
Award:	Income tax	Tax on the market value of shares less price paid*
	PAYE/Class 1 NIC	PAYE/Class 1 NIC on discount if market for shares exists
	Corporation tax	Tax deduction applicable on discount**
Sale:	Capital gains tax	Tax on sale proceeds less market value at award***

* The flowering share scheme can be structured so that the market value at award is low, thereby minimising the income tax and NIC arising on the award of the shares to the employee. By setting the hurdle higher than current market value, the value of the shares at the award date should be low.

**In certain cases, such as for subsidiary companies, a corporation tax deduction may not be applicable.

*** Entrepreneurs' relief, providing a capital gains tax rate of 10% (compared with the standard 20% rate), may be available if the employee holds at least 5% of the company's ordinary share capital and other requirements are met in respect of the shares held.

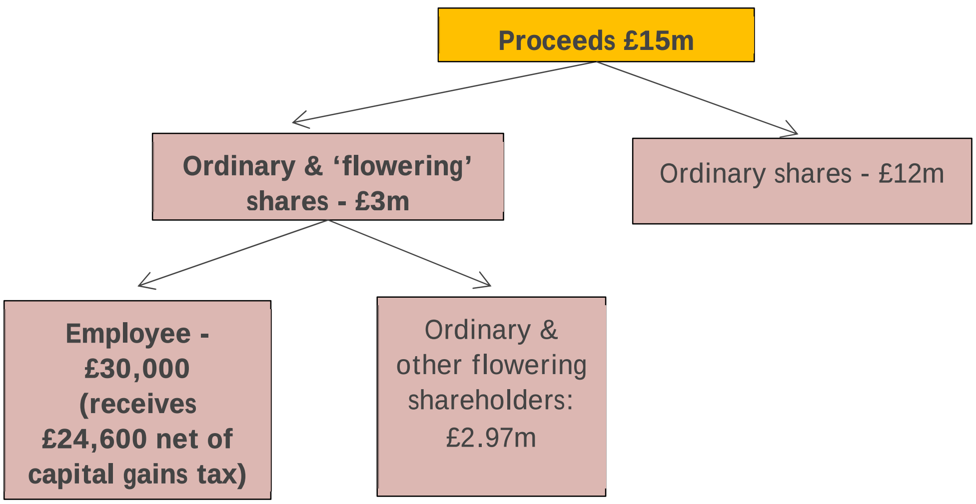
Example - XYZ Ltd

XYZ Ltd has one class of 90,000 ordinary shares with a current whole company value of £10 million. XYZ Ltd creates a new class of 10,000 flowering shares with no voting/dividend rights. The shares will receive a proportionate amount of the company's value over a £12 million 'hurdle'.

An employee of XYZ Ltd is awarded 1,000 flowering shares. The employee pays the full market value as consideration for the shares (valued in this case at £3,000, or £3 per share). No income tax/NIC is payable.

Two years later, the employee sells their 1,000 shares as part of an exit event when the company is sold for £15 million. The employee's shares receive a proportion (in this case 1%) of the £3 million excess above the £12 million hurdle ie £30,000 (£30 per share). The employee is required to pay capital gains tax at 20% on the £30,000 less the £3,000 base cost (entrepreneurs' relief is not applicable in this example).

The below flowchart depicts the flow of cash to each group of shareholder:



How we can help

- Advise on tax/NIC issues in relation to flowering share plans;
- design the flowering share plan;
- work with lawyers to facilitate amendments to Articles of Association;
- prepare supporting documentation including a tax memorandum and employee explanatory booklet;
- advise on the valuation of the shares at the award date; and
- deal with all HMRC elections and reporting requirements.

If you have any queries relating to flowering shares or any other equity-based incentive arrangements, please speak to your usual Smith & Williamson contact.

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Offices: London, Belfast, Birmingham, Bristol, Cheltenham, Dublin (City and Sandyford), Glasgow, Guildford, Jersey, Manchester, Salisbury and Southampton.

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