



Joint Share Ownership Plans (JSOPs) Utilising an Employee Benefit Trust



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Joint Share Ownership Plans (JSOPs)

Utilising an Employee Benefit Trust

1. Preliminary

This fact sheet describes a relatively new share incentive device which may be appropriate for companies whose shares do not qualify for tax-favoured Enterprise Management Incentive (or EMI schemes): see The Everyman Legal Fact Sheet on EMI schemes. It may also be appropriate if HMRC limits (£120,000 for an EMI Option or £30,000 for a CSOP) will be exceeded.

2. What is a JSOP?

The JSOP is a device to replicate the economic effect of a share option (namely a risk free participation by employees in the future growth of company shares) with the tax effectiveness of day one ownership (namely tax at 18% or 28% on the option gain).

3. Why is this useful?

The option gain on unapproved share options is taxed to income tax. This means tax at rates (including employee's NIC) of up to 52%. In addition, where shares are *readily* realisable (which they will be if the option is exercised on exit) employer's NIC which is currently at 13.8%, will also be payable.

4. How does the JSOP work?

The Company establishes a vehicle which it controls called an Employee Benefit Trust. This is a discretionary trust with company employees as beneficiaries and directors or a company subsidiary as trustee. The EBT will buy shares (either new issue or existing shares) using a loan from the company.

The EBT will then enter into a contract with the employee participant. In return for a small payment the EBT will agree with the employee that the future growth in the value of the share will accrue substantially to the employee. This is generally set at 95% of the growth, so the EBT retains 5% of the future growth.

5. Why does the EBT retain 5% of the growth?

The right to realise the capital growth in a share is the key benefit of holding shares in growth companies that do not pay dividends.

Splitting the future growth between the EBT and the employee participant provides a defence against arguments that might be advanced as to the day one benefit enjoyed by the employee.

6. Do these arrangements work?

The effectiveness of these arrangements was recently confirmed at a meeting between HM Revenue & Customs and an association of share scheme lawyers.

Practice differs on how to structure a JSOP. Some practitioners advocate the use of two EBTs: one to acquire the legal title to the shares and a second one to hold the beneficial interest in the shares jointly with the employee-participant on the 95/5% split. By doing so there is greater clarity (it is hoped) on the distinction between legal title and beneficial ownership. The danger that this double trust seeks to guard against is that the employee is a beneficiary interested in settled property as opposed to a person with a day one right to the shares.

The specific arrangements including as to performance conditions, vesting and lapsing, may leave arrangements open to challenge as *de facto* options or as settled property. The practice of HM Revenue & Customs may also change. Nonetheless with tax rates on unapproved options at such a high rate their popularity is bound to increase.

7. Are there alternatives?

The most obvious alternative which should not be overlooked is to allow employees to become direct shareholders. Such ownership can be combined with buy-back provisions including performance conditions to replicate in economic terms the effects of an option to acquire shares.

Particularly for early stage companies where shares are likely to have a low value these arrangements may be simpler if a traditional EMI Scheme is not available. The frequent obstacle to EMI options is where there is a controlling corporate shareholder. In such circumstances the buy-back arrangement can be in favour of that corporate shareholder.

Where such buy-back arrangements are put in place the Company and its advisers will almost invariably want to ensure that Restricted Securities Elections are made: see the Everyman Fact Sheet on Restricted Securities Elections. Failure to make such an election could leave the growth in value liable to income tax if HM Revenue & Customs could successfully argue that the restrictions had depressed the day one value.

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