

# Growth shares



Growth shares give private companies a flexible way for key employees to share in the company's success. Particularly useful for companies aiming for an exit, growth shares offer a tax efficient incentive and retention tool.

## What are growth shares?

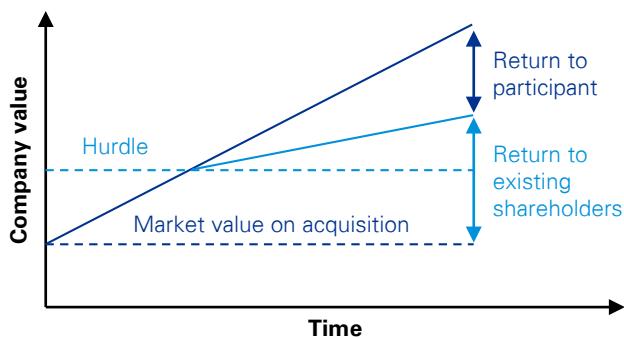
'Growth shares' are a special class of shares that allows employees to participate in the value of a company over and above a valuation hurdle.

This means that other shareholders' economic interests are diluted only if and when the value of the company exceeds the specified hurdle.

## How do growth shares work?

Employees acquire a class of shares with specially designed economic rights.

These rights typically have a limited value unless and until a valuation hurdle is exceeded. Once this happens, the rights attaching to the growth shares 'flower' and they are entitled to share in the company's value above that hurdle.



It is common for growth shares to be forfeited if the participant ceases employment other than in certain 'good leaver' situations. The employer can also impose performance or other conditions on the employee's retention of their growth shares.

Unlike an option plan, or other arrangement whereby employees acquire shares at a future date if vesting conditions are met, participants acquire growth shares on the date of award. This means that employees are exposed to the economic risks and rewards of share ownership from the outset.

However, growth shares are typically designed so that their initial value is relatively low.

This means that the price employees must pay to acquire their growth shares, or the value subject to income tax on receipt (see below) if the employee pays less than full value for their award, should be manageable. A low initial value of the growth shares means that the economic risk of share ownership for the employee is also limited.

## What is the tax treatment?

Growth shares can offer income tax and social security (NIC) efficiencies.

### Acquisition of the shares

Employees won't pay income tax or employee's NIC when they acquire their growth shares provided they pay full market value for them. In these circumstances, there will be no employer's NIC or Apprenticeship Levy charges for the employer to pay either.

A low initial valuation should mean that the cost of paying full market value for the shares should be manageable for the employee.

Where employees pay less than full market value for their growth shares, income tax, and potentially NIC and Apprenticeship Levy charges, will be due on the discount.

This will be a 'dry' tax charge, as the employee is unlikely to be able to sell any of their growth shares to fund the up-front liability on acquisition. However, again, this should be a manageable cost provided the initial valuation is low.

### Sale of the shares

Capital Gains Tax (CGT) may be payable on any growth in value of the employee's shares.

CGT is currently charged at standard rates of 10% and 20%, which apply depending on individual circumstances.

Employees could potentially qualify for Business Asset Disposal Relief (BADR) (formerly Entrepreneurs' Relief) on disposal of their growth shares, which can cut the top rate of CGT that applies to 10%.

Generally, gains realised on a disposal of growth shares will benefit from ER if the shares are sold at least two years after they were acquired and during that period they represented at least 5% of:

- The nominal value of the company's ordinary share capital; and
- The voting rights in the company.

In order to attract ER, the growth shares must also entitle the employee to at least 5% of value of the company's ordinary share on disposal.

Whilst these requirements can make it challenging for growth shares to qualify for ER in certain circumstances, the potential availability of ER should be borne in mind – particularly for 'exit based' growth share arrangements.

The CGT annual allowance (or other CGT reliefs) might reduce or eliminate any CGT charges.

No corporation tax relief will be available to the employer in respect of any growth in value of the employee's shares, but neither should any increase be subject to employer's NIC or Apprenticeship Levy charges.

### How can growth shares be used?

Growth shares are relatively flexible plans and can accommodate a wide range of commercial objectives.

As employees will often wish to realise some or all of the value in their growth shares once the valuation hurdle has been exceeded, growth shares often work best as exit based incentives.

However, they can also be acquired by executives tasked with growing the value of group subsidiaries, and be acquired by the parent company when the valuation hurdle has been exceeded.

As companies can choose who acquires growth shares, they can be used to grant awards to selected senior executives. But they can also be used for a wider employee population, and are much more flexible than tax advantaged 'all employee' plans.

However, the relatively complex structure, and potential investment risk borne by participants, is likely to mean that growth shares are most suitable for more senior employees and executives.

Growth shares can be acquired by employees under an Enterprise Management Incentive (EMI) plan. They can also be used as an alternative to EMI for companies that do not meet the EMI conditions, or which have granted EMI options up to the statutory limits.

For companies with a higher share value, growth shares can provide a tax efficient way for employees to participate in any future increase in value at a manageable initial cost and economic risk.

Growth shares can also operate alongside other employee share plans.

### What kind of shares can be used?

Growth shares form a separate class of shares. The rights and restrictions that attach to them must be carefully designed to ensure employees are incentivised to work towards achieving relevant corporate goals.

This means that growth shares issued by different companies, and potentially growth shares issued by the same company at different times, will be distinct.

Specific care is required if growth shares are to be implemented by companies that have issued, or expect to issue, shares to investors which are intended to be qualifying investments under a statutory venture capital scheme (e.g. the enterprise investment scheme).

### Which employees are eligible?

Employers set their own eligibility criteria for acquiring growth shares.

### Find out more about how growth shares can deliver for your business

Contact us to talk through how growth shares can help you engage and incentivise key employees and executives to build the value of your business.

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