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Tax-efficient share incentive scheme for management team

One of our audit clients is an engineering company, set up in 1986 and well-known in its area of business. In 2007 the directors decided it was time to put in place a new management team to lead the company through its next phase of growth.

This threw up a number of issues regarding shares, incentives and taxation. The board wanted to motivate the new team by giving them shares, if possible at no cost to the company or the individuals. However, the existing shares had a certain value – the company was successful – so giving them new ordinary shares would create a substantial benefit in kind, with the value being taxed as income.

Giving existing shares to a new shareholder would also dilute the equity value attributable to the existing shareholders, who were keen to preserve the value they had built up.

Our recommendations kept tax charges to a minimum

We suggested re-structuring the existing share capital to “capture” the value owned by the existing shareholders, and then create a new type of share, to which the increase in value going forward would be attributed. Consequently, the value attributable to the existing shareholders would not be diluted and would be preserved. The value of the new shares would therefore be par because at the time of issue they would only have nominal value. The new team could then be given new shares at nominal £1 value, which would not give rise to an income tax charge, and they would grow in value in line with the success of the business under their management.

We built a computer model illustrating the various permutations of value, number of shares and potential growth, and their effect on income, CGT and corporation tax liabilities for the company and individuals. This enabled all concerned to understand the overall impact of different scenarios and reach a fair agreement.

We arranged a post-transaction agreement with HMRC

The company chose a solution which resulted in £4m of accumulated share value being preserved for the benefit of the founding shareholders, within 10,000 “Founders” shares, a further 10,000 “A” shares that preserved another £6m of accumulated value, and the issue of 10,000 new shares to the new management team at a nominal cost. We arranged a post-transaction agreement to the exercise with HM Revenue & Customs to ensure that there would be no nasty tax surprises around the corner.

In these negotiations we acted for both the company and the new management team, as is often the case where our clients are keen to reach commercial agreements. This generally saves time and money, as we have a clear understanding of the business and the objectives of the parties involved and we act to reach an outcome that is fair and reasonable to all.



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