

Growth Share schemes

An employer's guide



THE MILL CONSULTANCY

THE MILL CONSULTANCY

The Mill,
Christow,
Exeter,
EX6 7LX

PHONE

01392 432654

WEB

www.millconsultancy.co.uk

Growth Shares can be a good solution for companies who wish to incentivise and retain key employees using equity in a situation where an EMI share option scheme is prohibited due to legislative restrictions. Growth shares can still provide significant tax advantages to those employees.

Introduction

While an EMI share option scheme is a popular model in many growing companies, certain types of business activities are disqualified, such as leasing, financial activities and property development. A Growth Share scheme can be the substitute incentive.

The essence of a Growth Share scheme is that a **new class of shares is created** for the scheme, but they do not share in any of the value of the company that was created prior to their issue; the scheme preserves all the built-up value for the existing shareholders. The Growth Shares then share in the **future growth in value** from the date of issue.

Let's say the company is valued at £2 million today. The Growth Shares would have a restriction that states that when the company is sold, they only share in exit proceeds exceeding £2 million, i.e. the first £2m goes to today's existing shareholders. Thus, the new Growth Shares have nil value to start with. The actual scheme structure is up to the company e.g. the proceeds 'hurdle' could be more than £2

million if you wanted. The Growth Shares can also be non-voting, non-dividend, and subject to buyback etc

Tax

Because the Growth Shares have (effectively) zero value attached to them when issued, they can be issued to employees at a nominal price, so they are both **affordable and should be free of any tax liability**.

Let's contrast that with a situation where the company issues 10% of existing ordinary shares to employees. In the example above, they would be worth some £200,000. If they were gifted to the employees, they would pay income tax on the discount, incurring a tax bill of up to £90,000.

When the company is sold (an 'exit event'), the employees holding Growth Shares will pay capital gains tax at 20% on their proceeds and benefit from the annual CGT allowance.

Note on the changes in the October 2024 Budget

The rates of Capital Gains Tax (CGT) have increased as follows:

- *The normal rate on the sale of shares has increased from 20% to 24%*
- *Business asset disposal ('entrepreneurs') relief - available from two years from the date of grant of EMI options, and up to the first £1m of capital gains - the rate increases from 10% to 14% in April 2025 and to 18% in April 2026*
- *Although the CGT rates have increased, employees are still far better off using EMI options – without EMI they could pay around 60% PAYE/NI.*

Company valuation

An accountant's **valuation** of the company is done as at the issue date of the shares. It's not formally approved by HMRC as with an EMI scheme, but a record of the valuation is kept for the records, so that it can be shown to HMRC when shareholder tax

liabilities are assessed after an exit event. This could be a few years later so it's important to be able to demonstrate that the valuation was properly executed and was reasonable. Typically, the valuation has to be more in depth and forward looking than for other share and option schemes, and we would require financial projections.

Legal matters

Shares v Options: under a Growth Share scheme, the shares are issued to employees upfront, whereas under an option scheme they do not become shareholders until they can exercise their options, either after a specified date, or often only when the company is sold.

In case any employee shareholder leaves the business prior to an exit event, the company will be protected under a Growth Share scheme because the Articles provide that the board can force a **buyback of their shares**.

There are no legislative limits on the volume of Growth Shares that may be issued, but of course the company's existing shareholders would have to approve the creation of the new share class, and the expansion in share numbers.

Legal documents required to set up the scheme:

- New Articles of Association

- Board minutes
- Shareholder resolutions
- Employee share subscription agreement
- Scheme Rules
- Companies House filings

Other points

The design of the structure which defines the share of proceeds or value in which the Growth Shares participate is very flexible and up to the board. In the earlier example, the company is worth £2 million at issue date and employees are issued 10% of the equity. The board could set the proceeds hurdle at the £2 million level or higher, say £3 million. You could also have a ratchet mechanism, such that if the proceeds exceed a further hurdle, the Growth Shares benefit even more e.g. between £3m and £6m proceeds, they receive their proportionate 10% share, but if the company sells for over £6 million, they get 15% of the excess over that. This encourages the employees to add as much value as possible.

SEIS/EIS – any companies that have raised funding from investors using these schemes must be very careful not to disqualify the investors' tax relief by issuing new shares that effectively give the investors a preferential return.

Note that tax legislation may change and negatively impact Growth Shares.

Growth Shares will be classed as 'employment related securities' and this will require an annual return to update HMRC after each tax year.

EMI - if your company is in fact eligible for EMI, note that Growth Shares can be used in combination with EMI if you would like a proceeds hurdle as part of the scheme.

How we can help

We can set up your Growth Share scheme and undertake the valuation of the business. We are able to offer realistic fee rates that suit growing entrepreneurial companies. Typically, we can deal with the documentation by phone, post and email but if you would like a 'full service' basis, which would include face-to-face meetings (which can encompass presentations to staff for example) we are very happy to undertake this too.

We take care of all the scheme documents you need and your share valuation: in other words, you get a turnkey service. Fees – a fixed fee of £4,495 + VAT.

To discuss your requirements please call or email Jerry Davison: 01392-432654 or jerry@millconsultancy.co.uk

'Jerry set up our EMI scheme and I can't recommend him highly enough, Jerry provided us with all the advice, documentation and dealt with HMRC to get us heavily discounted options.' – Paul Thomas, Cupris Software

'We chose the Mill Consultancy to create our share scheme based on the all-inclusive package (i.e. including the company valuation and having no hidden extras) and the price which was extremely competitive. We were very happy with our decision. Jerry at Mill Consultancy was fast and effective whilst always maintaining great communication and being happy to help with any questions we had. What to a small company had seemed a daunting task turned out to be a very smooth procedure indeed and all thanks to Jerry for that. It is very easy to recommend the Mill Consultancy to you for your EMI share scheme.' - Rodney Higgins - CEO - VSR2 Limited

Pricing matrix – fixed fees

Growth Share scheme - £4,495

- Advice on design and structure
- Share Valuation
- New Articles of Association

- Board minutes
- Shareholder resolutions
- Employee share subscription agreement
- Scheme Rules
- Companies House filings
- A briefing document for employees

All fees are plus VAT

