Getting Over The Hurdle

Companies often use equity incentives to reward key members of their workforce and attract and retain the best talent. In the UK, companies have typically granted EMI options (a government-backed, tax-advantageous share option) or unapproved options. However, where a company is unable to grant EMI options (for example, because the company is not sufficiently 'independent', the company's gross assets exceed the relevant threshold when the option is to be granted or the individual is not an employee of the company) and it does not want to grant an unapproved option, then growth share schemes can be used as an alternative.

The principle behind growth shares is that they only participate in the growth of the company from the date they are issued and the right to receive a return on exit in respect of the shares is only triggered if the value of the business increases above a 'hurdle' threshold. Growth share schemes can be tax efficient and attractive for companies and individuals, if they are structured in the right way.

With regards to implementation, the company's articles of association will be amended to create a new class of growth shares, which are then issued to the individual. Key considerations for the company include what rights should attach to the shares (for example, whether the shares will have the right to vote and/or the right to receive dividends) and where the hurdle should be set (ideally, backed by a third party valuation). In many cases, an individual will sign a growth share subscription agreement with the company, containing details of the hurdle and bespoke vesting or leaver provisions.

Whilst such schemes do not need to be approved by the UK tax authority (HMRC), tax is still a key area to consider, for both the company and any holder of growth shares, including how they are taxed on issue and any tax that is payable at exit, such as an IPO where the growth shares would convert into ordinary shares. Tax and legal advice should therefore be sought before implementing any growth share scheme.