

The Complete Guide to Setting Up a Company Share Scheme

Everything UK-based
SMEs need to know



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Introduction

There are so many great reasons to [set up a company share scheme](#). Distributing equity is a fantastic motivator for your team, and helps underpin a strong company culture.

The problem is that it is such a complicated area. It should be simple, but questions around the different options, tax and protecting the business make the whole process cumbersome and costly.

We wanted to do something about this, so we launched Vestd, the UK's first and only FCA-regulated equity management platform. It is easy to use and trusted by thousands of people.

But let's not get ahead of ourselves... you will have lots of questions about the ins and outs of share schemes. This guide will help you filter out the noise and answer the key questions in plain English.

We also provide [a free equity consultation](#) to UK SMEs, so if you'd like some fast answers for your business then please book in a call.

Anyway, I hope you find this helpful. Do get in touch if you have any questions about equity.

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Founder & CEO of [Vestd](#)



Which share scheme should I use?

The vast majority of SMEs distribute shares to employees in one of four ways: EMI share options, CSOPs options, unapproved options, or growth shares.

Fundamentally, you can give people [actual shares](#) now, or choose to issue [options](#) that can be exercised at some point in the future. We will outline the pros and cons of shares vs options to help you decide which is the best fit for you.

There are a few other schemes to consider but they tend to be adopted by much larger companies.

01. EMI share options

If you're sharing ownership with your employees, the **Enterprise Management Incentive** (EMI) scheme **makes the most sense** because of its tax efficiency.

This scheme not only allows you to reward your employees with share options with massive tax advantages but also allows you to offset both the cost of the scheme and the tax benefits achieved by your employees against your company's tax liability.



02. CSOPs options

Following EMI, the Company Share Option Plan (CSOP) is the next best, tax-friendly scheme and (unlike EMI) is open to almost any business regardless of size.

Providing CSOP option holders don't exercise their options for at least three years (but within 10 years) of the grant date - they won't pay any Income Tax or National Insurance when they exercise (become shares), regardless of their value at that time.

03. Unapproved options

Unapproved options are flexible and can be given to employees, contractors, advisors, and consultants.

These options don't require any formal valuation but they need to be included in an annual report to HMRC if they have been given to UK employees or directors.

There is however no tax benefit for the recipient, who is liable for Income Tax on the difference between the exercise price and the market value of the shares at the time they are exercised.

An employee may also be liable to pay National Insurance on this sum if the shares are readily convertible to cash at the point of exercise (in a sale scenario, for example).



04. Growth shares

This provides employees with a share in the capital growth of the business from the point at which they are issued.

For example, if they are issued at a 'hurdle' of £1 per share, they will only share in any eventual net sale proceeds that are over and above £1 per share. As such, existing shareholders are only value diluted for growth from that point, rather than the existing worth of the company.

As long as the hurdle value is comfortably above the market value at the point of issue, the shares have no value when issued, therefore, there's no income tax to pay on receipt (only **Capital Gains Tax** on sale).

Let's now take a look at the pros and cons of each of these schemes.

EMI share options

[EMI](#) is a government-backed, tax advantageous, share options scheme for employees that is used by more than 14,000 SMEs in the UK.

Pros

- The scheme is relatively flexible, in terms of the conditionality and timeframes that can be set as part of its terms to the employee.
- Income Tax is only payable on exercise, and then only if the exercise price is below the value agreed with HMRC at award.
- Recipients will have to pay CGT when they sell their shares, but at a lower rate than normal. This is because you can get Business Asset Disposal Relief (BADR) with EMI share options which means you only pay tax at 10% rather than the usual 20%, so long as you hold the options and/or shares for 24 months from the date of award.
- Likely to be the most tax efficient scheme for employees (people who spend more than 75% of their time at your business).
- You can set conditions for recipients, such as achieving milestones, or staying with the company for an agreed period of time.
- The company can offset the costs of the scheme, as well as the tax benefit achieved by the employee between issuance and exercise against their own profits as a corporation tax relief.



Cons

- There are a [number of criteria](#) that must be met for the company and the employees to be eligible, and a number of processes that must be followed to ensure that they remain so. It is important to make sure that your company is eligible.
- You cannot award EMI share options to non-UK based employees.



Links

[Download our EMI scheme guide](#)

[Set up an EMI scheme](#)

CSOP options

[CSOPs](#) are tax-advantaged share option schemes for businesses of all shapes and sizes based in the UK. You can reward both employees and directors under the scheme.

Pros

- Unlike other share option setups such as EMI, your company doesn't need to be in a specific business to qualify.
- There are no size restrictions with CSOP, so companies that outgrow EMI can set up a CSOP.
- CSOPs are great for employees; they don't have to pay income tax or NICs when they exercise the option (conditions apply).
- Your company could enjoy Corporation Tax relief for any gains to employees.
- Recent relaxations in legislative requirements make CSOP accessible to more companies.
- The exercise price has to be set at the current market value in order to qualify as a CSOP so a HMRC valuation approval will provide certainty for everyone involved.



Cons

CSOPs are so versatile there are few downsides. But there are a couple of things worth noting:

- Each employee can only be granted up to £60,000 worth of options.
- HMRC have strict rules regarding the exercise price of CSOP options. This is the price at which the employee will be able to buy the company's shares in the future.

HMRC mandates that this price must be set at the fair market value of the shares on the date the options are granted. This value is commonly called the "UMV" on the HMRC valuation.

This is the difference between it being a CSOP or not. If it's not, the options aren't eligible for special tax treatment.



Links

[Download our CSOP guide](#)

[Launch your CSOP](#)

Unapproved options

[Unapproved options](#) can be really useful if you need an extremely flexible scheme that can be issued to employees, contractors, advisors or consultants, whether based in the UK or abroad.

Pros

- There are no limits to the number of options that can be given in total or to an individual.
- Options do not require any formal valuation they need to be included in an annual report to HMRC via ERS if they have been given to UK employees or directors.
- You can set conditions for recipients, such as achieving milestones, or staying with the company for an agreed period of time.

Cons

- There is no automatic BADR, so the normal rate of CGT will need to be paid once sold.
- Employees have to pay Income Tax (and also N.I. if they can be immediately sold) based on the value of the shares, less what they pay for them, on exercise.

Growth shares

[Growth shares](#) are particularly good for non-employees, or for companies that are not eligible for EMI, though this scheme can be complex to create (if done manually).

Pros

- By using growth shares you can limit the risk of the recipient having to pay Income Tax on receipt of the shares.
- Growth shares are designed so that recipients only share in the capital growth of the business from the point that the shares were issued.
- Minimises dilution on existing shareholders.
- You can set conditions for recipients, such as achieving milestones, or staying with the company for an agreed period of time, so long as your Articles of Association have been drafted to enable this.
- Shares are issued immediately.
- An interesting alternative to EMI options for businesses that have no intention of selling in the medium term.



Cons

- Unless the voting shareholding exceeds 5% at the point of exit, there is no automatic BADR, so the normal rate of CGT will apply once they have been cashed in.
- The hurdle needs to be set at a small premium to the value of the business today, to minimise the risk of income tax for recipients, so growth shares only make sense if there is significant upside possible.

Share scheme comparison chart

We've mapped out all of the different share schemes so you can see how they compare...

	EMI Options	CSOPs	Unapproved Options	Growth Shares
Tax efficient for employees	✓	✓	✗ (not typically)	✓
Tax efficient for non-employees	✗ (not available)	✗ (not available)	✗ (not typically)	✓
No tax on grant	✓	✓	✓ (Only in certain circumstances)	✓
No tax on exercise	✓ (Only if the exercise price is below value agreed with HMRC on award)	✓ (Providing three years have passed since the option grant date)	✗ (Income Tax based on exercise value)	n/a
No income tax on sale	✓ (CGT, but at a lower rate)	✓ (CGT)	✓ (CGT)	✓ (CGT)
Benefits from BADR, even if below 5% equity	✓ (if shares/options held for 24 months)	✗	✗	✗
Shares issued immediately	✗	✗	✗	✓
Options*	✓	✓	✓	✗
Conditional shares**	✓	✓	✓	✓
Typically used when exchanging equity for cash	✗	✗	✗	✗

* Shares issued at a later date, at a pre-agreed price.

** Ability to set specific requirements that must be met to complete share ownership.

Tax

Different share schemes have different tax implications, as shown in the comparison chart above.

For UK employees, there are three points at which tax can be due:

- On award (only affects ordinary shares)
- On exercise (only affects options)
- On sale (always due on all shares)

Then there are two different types of tax that generally apply, with an extra bonus for qualifying entrepreneurs:

- **Income Tax**
Typically between 20–45% (based on the recipient's current tax rate) and is due at the point that the option is exercised, or in some cases, on sale.
- **Capital Gains Tax (CGT)**
Normally 20% once your capital allowance is used up, and is due on sale of the shares and applied to the gain in value of your shares from the point they were given. Or in the case of options, on any gain in value over the price paid on exercise.
- **Business Asset Disposal Relief (BADR)**
Currently, 10% paid on all capital gains.

Shares vs options

As already mentioned, you can give people actual shares now, or choose to issue options that can be exercised at some point in the future.

Let's quickly summarise shares vs options to help you figure out which is best for you.

Real shares

Ordinary shares are real share in the business (rather than an option to buy at a later date) and can be given to anyone. They are typically the shares business owners and investors will hold. So long as they are issued for investment that reflects the current value of the business there is no tax to be paid.

Growth shares are just like ordinary shares but are issued at a 'hurdle price' that represents a small premium to the value of the company at that time. As such, the recipient only shares in the businesses growth in value from that point on.

Key takeaways

- Shares only incur CGT so long as they are issued for a price that reflects their current value.
- Gives people real ownership, immediately.
- Shares are issued in the recipient's name.
- Recipients can benefit from dividends.
- Recipients can receive voting rights.

Options

Options allow recipients to buy shares at a later date, at a pre-approved price. If you want to set up a tax efficient share scheme for employees (as opposed to non-employees), then in almost all cases an **EMI option scheme** is the best way to go.

Your company, and the employees, will need to meet some **qualifying criteria** to be able to benefit.

Key takeaways

- Options can be granted to anyone.
- EMI options can only be granted to employees working more than 75% of their time, or 25 hours per week, at the business.
- Companies need to qualify to be able to issue EMI options.
- Options are not real shares until exercised.
- Option holders do not get any benefits of being a shareholder (e.g. dividends, or voting rights).
- Options can incur a tax liability when exercised.
- The exercise price must be paid to exercise options, which some employees may struggle to afford. EMI options also have a limited exercise window (which may not give recipients enough time to find the cash to purchase them as shares).
- Vestd agreements allow for what is known as a ‘cashless’ exercise for exit-based schemes - so instead of paying the cost to exercise upfront, the cost is deducted from the total profit when sold.
- If the business isn’t gearing up for exit they may incentivise the wrong behaviour and attitude.
- Ideal for high growth businesses with an exit on the horizon.

Setting conditions

What if somebody leaves the business, or doesn't perform as expected?

This is a big worry for business owners, who don't want to give out equity to people who don't deliver. Thankfully it is very easy to protect yourself: you just have to **put some conditions in place**.

By attaching conditions to shares and options you can be sure that you only distribute equity to those who have fully deserved it.

For example, if you hire someone you might specify that in return for the shares they will **work for a specific minimum period** and/or help **reach certain milestones**. These conditions form part of the contract.

Therefore, if the recipient doesn't deliver on what they promised they simply don't get the shares.

With options, this is known as a 'vesting period' or 'vesting conditions', and with shares you can have a 'conditional vesting period' (so long as your Articles of Association have been drafted to enable this), during which the shares can be deferred to worthless shares if conditions are not met.

As a business owner you have plenty of protection in the event that an individual leaves or doesn't deliver. However, it's important for the equity to create the desired impact and incentive. That means **the recipient also needs to feel that the criteria is fair**.



Key conditions / criteria to determine include...

- Number of shares - how many will they receive?
- Time horizon (or vesting/conditional period) - when will they receive the shares?
- Performance conditions - what they must do before the shares are fully theirs? This might include things like staying with the business for a minimum period, and/or the deliverables you'd expect from the person in that role.
- What is the exercise price and in what circumstances can they be exercised?
- What happens if someone leaves the business?



For more ideas, download our free [Conditional Equity Milestones](#) Guide

Agile Partnerships

This is a framework devised by Vestd to provide founders with maximum flexibility, from the inception of the business right through to exit.

An [Agile Partnership](#) can include multiple types of share schemes (e.g. EMI + Growth Shares), so employees and non-employees can participate.

This approach helps startup founders share ownership with key people in a way that is **fair**, and which protects the business (and all shareholders).

Your Agile Partnership will be based on a **pre-agreed set of deliverables**. Everybody will be clear on what they need to bring to the party, and the equity rewards that will follow if they do what they promised.

How does it work?

If someone delivers 100% of what they said they'd contribute, then 100% of the agreed equity will be released.

If they don't then they get a proportion of what was agreed. You set the conditions and everyone knows what is expected of them.



The beauty of Agile Partnerships is that **they can be launched at any stage of a company's journey.**

- They are ideal if your company is in its infancy and you want to [get agreements in place with your co-founders](#) and early hires.
- They can also be used to remotivate an existing team.
- They can also help shareholders to transition out of a business on good terms.

We believe that Agile Partnerships are the future of equity-based agreements, so do get in touch if you'd like to explore setting one up.



[Schedule a call to find out more](#)

Valuations for share schemes

Share schemes sometimes require a valuation to be placed on the business prior to issuing shares.

Here's a quick overview...

Action	EMI Options	CSOPs	Unapproved Options	Growth Shares
Valuation needed to start distributing shares	✓	✓	✗*	✓
Valuation needs to be approved by HMRC	✓	✓	✗	✗
Premium recommended on company valuation	✗	✗	✗	✓ (Typically add 10-40%)

*While unapproved options don't have any statutory requirements for a valuation - there are some instances where recipients of the options need a valuation for tax purposes. [Learn more](#).

Timetable for creating a share scheme

It's really important to understand the timelines involved, especially when it comes to executing and filing documents with HMRC.

Many professionals believe that 50% of the EMIs set up won't qualify when it comes to exit because they didn't meet the criteria.

You need to be fully prepared if you want to qualify.

Here's how to stay compliant...

Details	Period	Note
Preparation of valuation	1-4 weeks (this depends on the time it takes for you to pull the information together)	Vestd's valuation support is included on most of our plans, and follows a well structured process. We provide both the Valuation Report, and even fill in the HMRC form for you (VAL231).
HMRC approved valuation (EMI & CSOP)	3-6 weeks to get approval, which is then valid for 90 days	Getting a valuation agreed by HMRC will typically take 3-6 weeks from the date of submission and will be valid for 90 days from the date of agreement. This cannot be extended.



Details	Period	Note
Preparing share scheme documentation for recipients	Minutes - months	If you are digitally generating your documents using Vestd this is as simple as a click of a button . If you are going a more traditional route of manually preparing your documents with a lawyer we typically see these taking between 3 weeks and 3 months to prepare.
Executing share scheme	Hours - weeks	If you are digitally executing your documents using Vestd everything is automated and digitally accepted including the option pool creation and board resolutions and can be completed in under an hour if everyone is available. If you are going a more traditional route of printing, posting, chasing, signing, processing we'd advise you leave a minimum of 2-3 weeks to complete this process.
Annual return	The end of the tax year and within the 92 days that follow	An annual return must be submitted by the company before the end of the tax year concerning the tax year prior. With Vestd, you are reminded to do this, guided through it and given a file for simple upload.

Common pitfalls

There are five issues that we regularly see when setting up share schemes for SMEs.

These are all easy to resolve... just contact us if you need help.

01. I've set up my company with too few shares

A company can have any number of shares , but most companies are incorporated with either 1, 10, 100 or 1,000 shares.

It doesn't really matter how many shares a company is incorporated with, as they can be relatively **easily subdivided** at a later date. The reason people do this is so that their equity is split into enough pieces to be a "liquid currency" so that small percentages (or fractions thereof) can be given to people.

You do this by passing a board and members resolution and then submitting a form (SH02) to Companies House. This is a completely automated and digitised process on Vestd. Having said that, it's much easier just to set up your company with enough shares so that it's flexible moving forward.



02. The only thing I want to use my equity for is to sell it to investors in return for cash

At the beginning of a company's journey this is probably the road you're going to want to go down. You need cash for things like overheads, to feed and clothe yourself and your general survival.

But there are other options for your equity, such as **employee retention**. Share schemes reward team members for their loyalty and are a great motivator to encourage people to perform, as well as significantly enhancing team retention and commercial alignment.

03. I haven't kept track of my different share types and classes

Ordinary shares are what most people have. At their simplest, they give the holder of each share the same rights to dividends, capital and voting in the company. Most companies are founded with (and issue only) ordinary shares.

Preferred shares ('prefs') typically give their holders rights to specific dividends ahead of all ordinary shareholders, and may also give them rights to a specific amount of the capital at a winding up of the company ahead of any ordinary shareholders.

Then there are **growth shares**, which are issued at a 'hurdle price' that represents a small premium to the value of the company at that time, and only share in the capital appreciation in the business from that point on.

The standard approach is that all shares have equal **voting rights**, it's very common that certain classes of shares don't. This may be to ensure that voting control sits with a certain section of the shareholders or maybe to limit the administrative burden of dealing with numerous shareholders in a particular class.



Similarly, all shares usually have equal **dividend rights**, but sometimes each class has specific rights to dividends as defined from time to time.

Although the rights of the shares are usually set out in the Articles of Association, they can be changed by a Shareholder Resolution, if the Articles allow it.

As a standard part of onboarding with Vestd we go through this with you to make sure it is correctly represented.

04. I've ended up with the original founders having the wrong number of shares each

As part of the incorporation process the company has to decide how the shares are split between the founders of the company.

The problem is that it is very difficult to know in the very early days what the eventual contribution of each founder will be. A way around this is to set up the company from the beginning as an **Agile Partnership**, so that equity flexes over time depending on the contribution of each individual.

05. I keep putting the management of my equity at the bottom of my priority list

Many business owners are understandably put off by the sheer hassle of equity management and setting up a share scheme. Traditionally, it would take weeks of time spent with your accountant or lawyer to figure out what to do (and their time is money).

It would then take more weeks for you to talk to your board members and existing shareholders, followed by the agony of printing documents, signing them, posting them and waiting for them to be signed and posted back.

Sorting all this out is sometimes just another piece of admin that gets lost by the wayside. By the time you get around to it a valued team member has left. The advisor you really wanted to collaborate with for equity has had other offers.

Vestd solves this problem for business owners. Our platform was specifically built to remove the pain of setting up share schemes and creating equity-based agreements.

Book a free equity consultation

We speak to SMEs of all shapes and sizes every single day to help them with their equity, and we'd love to speak with you too.

A quick equity consultation with one of our experts will quickly help you to figure out your options. No pun intended.

It will be time well spent. You will...

- Discover the best scheme type

- Understand the process

- Figure out the costs

- Learn how - and why - to stay compliant

- See how digitising your share scheme makes life easier

- Be able to ask us anything about sharing ownership

There's absolutely no obligation to use Vestd afterwards, though naturally we hope you will.

[Just choose a time that suits you best](#) and let's talk equity!

Vestd is the platform of choice for UK SMEs issuing shares and options. We help businesses create, execute and manage shares & options schemes simply and affordably.

Vestd Ltd is authorised and regulated by the Financial Conduct Authority (685992).

All information correct at the time of publishing.
See a mistake? **Give us a shout**, we'll sort it.