Flowering shares

Flowering share plans are versatile, tax efficient schemes which can allow employees to acquire low value shares where Revenue approved plans are not required.

What is a flowering share plan?

Flowering shares are a new class of ordinary shares issued by a company, which entitle the holder to capital generated by the future growth of the business above its current value. In order to both reduce the initial cost of acquiring the shares and to create an incentive for the employee(s), the flowering shares will include a requirement that the company reaches an agreed level of future growth (known as the "**hurdle**"). Shares are issued at day one value. Once the hurdle has been met, the shares will have an agreed value. This amount can either be variable (based on a suitable percentage) or a fixed and hardwired amount.

Structure of flowering share schemes

Some companies create new share classes that offer little or no present day value to their holders, but provide the ability to benefit in future increases in share value. However, when they are disposed of (e.g., when the startup is acquired), the rise in share value is taxed as a capital gain. Capital Gains Tax (CGT) is payable at a rate of 33%.

Entrepreneurs' relief may be available on the disposal of these shares, subject to meeting the requisite conditions. Finance Bill 2015 introduced entrepreneurs' relief. The new regime provides for a reduced rate of CGT of 20% on chargeable gains on the disposal of chargeable business assets (e.g. shares acquired under a flowering share scheme) made by an individual on or after 1 January 2016 up to a lifetime limit of €1m. To avail of this relief, the shareholder must hold at least 5% of the share capital. Furthermore, the chargeable assets must have been owned for a minimum period of three years prior to the disposal (other conditions must also be satisfied).

Benefits of proposed structure:

- flowering shares can deliver business growth and retain key talent as shares only deliver value if the employees remain with the company and help it achieve its growth target;
- any proceeds ultimately received by the participants from the sale of the flowering shares should be taxed only at CGT rates (currently at 33%), rather than being subject to income tax, (up to 52%/55%);
- the shares are owned by the participants from day one, which will assist in aligning the participants' interests with those of the owners. There is no limit on the number of shares that can be awarded under the flowering share plan;
- the shares should normally be available for purchase at a nominal or small amount, meaning only minimal outlay by the employees at the outset. The low initial value is driven by the fact that the shares may be structured such that they do not carry votes or dividends and, crucially, only shares in the future growth of the company. However, if commercially required, it would be possible to require the employees to pay a higher amount in order to acquire the shares;
- the company should not have any future exposure to employers' PRSI on the award (currently at 10.75%), as long as the price paid to acquire the shares is not less than the tax market value of those shares; and
- good and bad "**leaver provisions**" can be built into the rights attaching to the flowering shares. This will prevent ex-participants retaining an interest in the company.

Other considerations:

- in order to avoid a tax charge on a purchase at an undervalue, the participants must pay the full, unrestricted market value for the shares they acquire. Accordingly, a valuation exercise will be required to establish this current tax market value;
- the inclusion of the hurdle creates a natural target within the structure. Where this is not met, even if only by a small margin, the existing shareholders will still have the benefit from the increased growth in the business due to the new shares having no value;
- typically, flowering shares will be used where there is an overall exit planned from the business by the shareholders. Where an exit is not envisaged but it is intended that the flowering shares should be sold in order to realise an amount of money for the holders, the other shareholders will need to consider how to create a "**market**" for this sale; and
- a flowering share scheme does not require Revenue authorisation. Although Revenue may not have reviewed the plan, there is a window of four years generally in which the valuation of the shares at day one can be challenged.

Key questions:

- Do you want to grow your business to maximise its value at exit?
- Would you like to incentivise key employees by awarding shares to them in a tax efficient manner?
- Would you like to award low value shares and lock in the value of the shares held by existing shareholders?

Contact

Flowering share plans are flexible and can be adopted to a variety of situations. At Grant Thornton, we can meet with you to discuss the key elements of operating a flowering share scheme in your business. Please do not hesitate to call a member of the Grant Thornton team to discuss further.

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