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The tax benefits of "flowering" shares in a non-trading company

Q: I am a director and shareholder in a property investment company. I understand that as my company is not "trading" per HMRC I can't use EMI options to incentivise my employees and my shares will be subject to inheritance tax if I leave them to my children in my will. Are there any tax efficient alternatives out there for my company?

A: You are correct that the type of business you operate will exclude your company from participating in the tax efficient EMI (Enterprise Management Incentive) scheme to motivate your employees and that Business Property Relief will not be available to exempt your shares from inheritance tax. "Flowering shares" could be useful in helping to reduce the tax burdens here.

Flowering shares are shares which do not initially have rights to participate fully in the value of a company until a target has been met – commonly growth in the company's value or increased sales.

The level of uncertainty in meeting the target will influence the degree to which the value of flowering share is lower than that of an ordinary share when it is first issued.

Flowering shares to motivate employees

Say a share in Company A is currently worth £10,000. If a flowering share is created which "flowers" when the company value increases by 20% - this share is likely to be valued below £10,000 now due to the uncertainty in meeting the target - perhaps it might be just £4,000. Giving an employee a flowering share rather than ordinary share would see them save income tax on £6,000 in this example **and** they would be motivated to boost the company value by 20% to ensure that they get their full share rights.

Flowering shares for inheritance tax planning

An inheritance tax liability can arise where shares are gifted and the transferor dies within 7 years of the date of the gift, or are left in a will. Gifting shares sooner rather than later could take them out of inheritance tax but you may not wish to give away control and ownership of your company too early or suffer capital gains tax.

Flowering shares can be useful here as they could created with a target date for flowering some years into the future, and then gifted to your children. The gift would be subject to a lower capital gains tax charge and subject only to inheritance tax (on the flowering shares' lesser market value) if you die within 7 years of the gift. In this way, you can pass to your children the **future** rights of ownership of the company at some point in the future whilst reducing your potential inheritance tax exposure.

How can we help?

Flowering shares must be created correctly to secure the tax and valuation benefits. If you feel these could be useful in your situation we would highly recommend you seek advice – we would welcome the opportunity to discuss this with you.