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US - UK Equity Compensation – A Comparison

Equity Compensation

Employers in the U.S. and the UK face a fiercely competitive labor market to hire "tech talent." While there are a number of factors that sway prospective employees, the availability of equity grants to allow them to share in the company's success is often crucial.

Private companies typically leverage two key tools for incentive equity: **option grants** and **restricted stock**.

Option grants confer upon a recipient the right to purchase common stock/ordinary shares at a pre-determined exercise price and are typically subject to a vesting schedule. There are two main types of option grants used by private companies in each of the U.S. and UK: **incentive stock options** (ISO) and **non-qualified stock options** (NSO) in the U.S., and **enterprise management incentives** (EMI) and **non-tax favored options** in the UK.

Restricted stock are shares of company common stock/ordinary shares that are issued on award to a service provider. Although the recipient of a restricted stock grant receives shares outright, these shares are subject to restrictions that - similar to option grants - lapse in accordance with a vesting schedule.

The chart below summarizes the main types of equity grants that transatlantic technology companies utilize:

Features	EMI (UK)	"Non-tax favored" Options (UK)	ISO (U.S.)	NSO (U.S.)	Restricted Stock (U.S.)	Restricted Stock (UK)
Summary	Only for employees, tax favored treatment which gives a tax rate as low as 10 percent if disposal of the shares is more than two years after the date of grant of the option	No favorable treatment	Only for employees; more favorable tax treatment if held/exercised within specific timeframes	For any person providing services; fewer limits, but less favorable tax treatment	For any person providing services	For any person providing services

Recipient	Employees satisfying certain working time conditions	Employees, directors, and consultants	Only employees	Employees, directors, and consultants	Employees, directors, and consultants	Employees, directors, and consultants
Exercise price	Usually at actual market value (AMV) agreed with HMRC but can be at a discount to the AMV with the discount being taxable on exercise	Can be any value (including nil)	At least fair market value (FMV) (110 percent of FMV if optionee is > 10 percent shareholder)	Exercise price typically FMV, but may be greater or less (but subject to Section 409A if exercise price is less than FMV)	N/A	N/A
Taxation (grant)	None	None	None	None (assuming exercise price at least equal to FMV on the date of grant)	None unless election under IRC 83(b) is made; awardees are generally encouraged (or required) to file an election under IRC 83(b) to be taxed at grant in order to minimize the tax burden	Income tax on AMV of the shares as of the date of acquisition (less any amount paid for them). Awardee may also make a s.431 election to pay income tax on the UMV of the securities. Market practice is to require awardees to make a s.431 election. Tax treatment will vary if grant is to a non-employee.
Taxation (exercise)	None (assuming exercise price at least equal to the AMV of the underlying shares on the date of grant and no disqualifying events have	Taxable income equal to UMV of shares on exercise date minus exercise price (assuming a s.431 election has been signed). Taxable	Spread is AMT income unless shares sold in year of exercise.	Spread is compensation income to optionee and deductible expense to company; if optionee is an employee, tax withholding will be required	N/A	N/A

	occurred more than 90 days prior to exercise).	income may be subject to withholding on account of income tax and employee and employer NIC under PAYE, if, at exercise, there are arrangements in place for the shares to be transferred or sold. The employer NIC liability can be transferred to the optionee. Tax treatment may vary if granted to non-employees.		regardless of liquidity of underlying stock.		

The area of equity compensation is complex, and so the guidance of an equity compensation specialist is crucial in order to avoid adverse tax consequences for the company and/or your employees. For any questions on U.S. and/or UK equity compensation, contact the following individuals: Stacy Kim, Daniel Glazer, Sriram Krishnamurthy, or Fleur Benns.