OPTIONS TO ATTRACT AND RETAIN KEY STAFF

NO	OPTION	PROS	CONS	COMPLEXITY	SUITABLE FOR	TAX	ADVISORY COSTS
1.	Increase salary/ benefits	• Traditional approach. • Simple. • No compliance/ legal costs. • No FMCA (Financial Markets Conduct Act) requirements.	• Competitor can always offer more. • Impact on working capital. • No "buy in" by the employee. • No incentive to meet targets. • Typically, a re-negotiation each year. • Often ad-hoc (and favours the squeaky wheel).	Low	All businesses	• Nil tax for the company, but PAYE deductions required. • Salaries are a deductible expense. • FBT may apply to certain benefits (e.g. motor vehicles). • PAYE for the employee	None.
2.	Formal, documented employee bonus or commission scheme	• As above. • Minor legal costs. • Bonus scheme can be discretionary or based on performance targets. • May be varied each year if properly documented. • No FMCA requirements.	• As above. • Requires administration, tracking and calculation of target metrics. • Focus on short term objectives (making the sale). • May create the wrong behaviours. • May not always be appropriate for "relationship" businesses (on-going, support and service).	Low/Medium	Most businesses, but particularly businesses driven by new sales.	• Nil tax for the company, but PAYE deductions required. • Bonuses are taxed depending on their type and frequency. • Frequent and regular bonuses treated as part of earnings and have PAYE deducted. • Annual bonus treated as a lump sum payment with specific PAYE calculation.	$ Small cost may be involved in drafting bonus scheme and variations to employment agreement and policies.
3.	Direct shareholding	• Sale price may provide cash to shareholders or company (depending on structure). • Provides "buy in" by the employee/ focus on longer term objectives. • No negative impact on working capital (and may improve if share price paid to the company). • Provides options for exit, succession and transition to increased ownership. • Control issues may be mitigated by structure – e.g. shares may be issued as "B" shares or limited veto rights.	• Increased cost and complexity. • Reduces founder's control and equity. • Gives minorities influence. • Price often loan funded (with security risk) or paid off by dividends. • May require a valuation of the company to establish entry price. • Requires more complex legal documentation (sale or subscription agreement and shareholders agreement). • Need to consider:	High	Businesses with key management team, who want direct ownership (and some control), rather than passive investment. Typically, participants part of the succession plan.	• Low tax impact for the company if properly structured. • No capital gains tax for the employee.	$$$ Needs share sale or subscription agreement and well thought out shareholders agreement. May require entry valuation.

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			○ tags and drags. ○ good leaver/ bad leaver events. ○ negative control. ○ Minority buy-out rights. • Permanent. Not easy to remove employee shareholder unless good leaver/ bad leaver provisions included. • FMCA requirements must be considered.				
4.	Employee share scheme – loan scheme	• Employee funded into equity ownership with loan. • Provides "buy in" by the employee/ focus on longer term objectives. • Loan often low/no interest. • Repayment normally funded by: ○ cash contributions. ○ dividends and bonuses ○ exit or liquidity event • No negative impact on working capital. • Payments may provide working capital to company. • Control issues may be managed by use of custodian structure. • "Overstayer" issues may be managed by good leaver/ bad leaver provisions. • Can use trust structures to mitigate the control and exit issues.	• As above. • Requires a valuation of the company to establish entry price. • Loan must be full recourse in order for it to not be taxable. • Employee bears risk that share value less on exit than entry (with outstanding loan liability). • Shares often vest day 1 (before loan repaid). May be managed by good leaver/ bad leaver provisions (failure to stay [x] years deems the employee a bad leaver). • Need to consider: ○ tags and drags. ○ good leaver/ bad leaver events. ○ negative control. • Minority buy-out rights • Permanent, and not easy to remove employee shareholder unless good leaver/ bad leaver provisions included. • FMCA requirements must be considered. • If trusts are used, this adds to complexity.	High, especially if good leaver bad/ leaver provisions included and trusts are used	Often more of a passive investment. Suit businesses with multiple key employees who: • the business wishes to retain; • do not want "control"; but • are not seen as "successors".	• Low tax impact for the company if properly structured (but need to be mindful of FBT on the loan). • Employees may pay tax on value uplift on exit depending on how structured.	$$$ Needs subscription and loan agreement, custodian deed, shareholders agreement. Entry valuation required.

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5.	Employee share scheme – option scheme	• Provides option for employees to buy shares at a specified strike price. • Provides "buy in" by the employee/ focus on longer term objectives. • Strike price should be the market price at the date of grant of the option. • Entry valuation often needed, but no exit valuation needed. • No negative impact on working capital. • Options usually vest: ○ Annually (incentivising employees to stay); and/or ○ on KPIs achievement. • Options lapse if not achieved or exercised. • Options often automatically vest on liquidity event (and often can be cash settled on liquidity event). • Typically, options not transferrable with no right to dividends and no pre-emptive rights. • Fewer control issues, as most options remain outstanding until liquidity event. • No tax unless exercised. • Options can lapse in bad leaver situations • Employee can never lose money if the options remain unexercised.	• Often requires valuation to establish strike price. • Requires more complex legal documentation (option deed and shareholders agreement). • FMCA requirements must be considered. • Full marginal tax applies for the employee on gain.	Medium	Often used in start-ups/ high growth businesses focussed on reducing working capital and on ultimate exit event.	• Low tax impact for the company if properly structured. • The employee will be taxed on the difference between the strike price and the market value of the share on the date the option is exercised.	$$ Needs option deed and shareholders agreement. Requires entry valuation.

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