

Company Share Option Plan (CSOP)

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What is a Company Share Option Plan (CSOP)?

Under a Company Share Option Plan the employer can grant tax-approved share options on a discretionary basis to employees up to a value of £30,000, which they may exercise between three and ten years following the date of grant. CSOPs can be used for all employees but are most often used for the benefit of managers and other senior employees on a discretionary basis.

Otherwise commonly known as executive share option plans (ESOP), they are HMRC approved and offer a tax-advantaged way of remunerating select employees.

The options are granted at an 'option price', which allows participants to exercise their right to acquire the shares in the future at this set price. The expectation is that the share price of the company will increase over time, allowing the employee to exercise and acquire the shares at the option price making a cash 'gain'.

The CSOP usually has one or more performance conditions attached, measured over the three-year period following the granting of options.

HM Revenue & Customs Approved Status

In order to receive and maintain HMRC approved status, the following must apply to the operation of the CSOP:

- Participation must be limited to employees, including full-time executive directors.
- Participation is not permitted to people who own more than 30% of the company.
- Options must be granted at no less than the fair market value of the underlying shares. For listed companies, this is usually the market value at the time of grant, but non-listed companies may need an accountant or auditor to determine a fair value.
- Options must not be transferable or pledged as a security.
- The shares must be fully paid (nominal or par value) non-redeemable ordinary shares with the same rights attaching to all shares of the same class.
- The options may be exercisable for a period of between three and ten years.
- If the rules permit, an exception for good leavers (injury, disability, redundancy or retirement) can be made whereby they exercise their option within 6 months of leaving.

- There is a limit of £30,000 (currently) on the aggregated market value of options granted per participant.
- Any options granted above the £30,000 limit will form part of an unapproved plan under which income tax is payable upon exercise of the option.

Tax implications

For Employees:

There is no income tax or NICs payable when the option is granted.

There is no income tax on the increase in value and the disposal of shares upon exercise, providing the options have been exercised in accordance with the provisions of the HMRC approved plan rules. However, Capital Gains Tax (CGT) may be payable if gains exceed the employee's annual tax-free allowance.

For unapproved CSOPs, an income tax and NICs liability will arise at the time of exercise.

For Employers:

If all statutory conditions are met then the company will qualify for corporation tax relief against the costs of establishing and maintaining a CSOP.

Exercise process

Usually at some stage when the market price is higher than the option price, the participant will choose to 'exercise' his/her share option, and will either buy the shares by providing funds to cover the option price and keep them, or can sell them immediately. The participant does have to pay for the shares at the set option price, but a short-term loan can be provided as part of the exercise process, whereby a certain number of shares are sold to cover the cost (known as a cashless exercise).

Example:

Employee A is granted 5,000 share options at a fair market value of £2.50 per share. Upon exercising this option, employee A will need to provide £12,500 to acquire the shares. If at this time the market value of shares is £3.00 per share, then the gain to the employee is £2,500. If employee A cannot raise £12,500 to exercise his/her share option, this is where a cashless exercise can be utilised. The broker will sell 4,167 shares ($4,167 \times £3.00 = £12,500$) to fund the purchase and the remaining shares can either be kept or sold by employee A.

Share Plan Partners can advise and help you with the setting up of a CSOP, which will require the establishment of plan rules, HMRC approval and choosing a savings provider. Please contact us for more information.

T: +44 (0)7838 491 550

E: ian.muphie@shareplanpartners.com

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Share Plan Partners Limited. Registered in England No. 08791239. VAT Reg No. 798 1639 61.
T: +44 (0)7838 491 550 | E: ian.muphie@shareplanpartners.com | www.shareplanpartners.com