

Company Share Option Plan

The Company Share Option Plan (CSOP) is a share option plan with formal approval from HM Revenue & Customs (HMRC). Under a CSOP, a company may grant options to some or all of its employees and/or those of its subsidiaries. CSOP options potentially attract income tax and national insurance contributions (NICs) relief.

Main features

- Most companies can operate CSOPs, regardless of their size or business.
- A CSOP is a discretionary share option plan that is approved in advance by HMRC.
- Companies are able to choose which employees will be granted CSOP options.
- There is no limit on the number of employees who may be granted CSOP options.
- An individual employee may be granted options over shares with a market value at the date of grant of up to £30,000.
- CSOP options must be granted with an exercise price at least equal to market value (measured at grant).
- Normally, no income tax or NICs will be charged on grant or exercise of the CSOP options.
- In order to obtain this relief, CSOP options must normally only be exercised between the third and tenth anniversaries of grant.
- CSOP options can be subject to performance and/or time conditions.

Limitations

CSOP options can only be granted over ordinary shares that are fully paid up and not redeemable. The shares can only be subject to restrictions if these restrictions apply to all shares of the same class.

It does not generally matter whether the company is listed or private but CSOP options cannot be granted in a company which is under the control of another company unless the latter company is itself listed.

Eligible employees

If the company is a close company, employees who have, or have held within the last 12 months, a 'material interest' of more than 25 per cent of the share capital cannot participate.

Directors are also eligible but must be full-time (25 hours or more per week) in order to participate. Non-executive directors cannot participate.

Employee taxation

There is no liability to income tax or NICs payable on the grant of a CSOP option.

Provided that the CSOP remains approved by HMRC, there is no liability to income tax or NICs on the exercise of a CSOP option:

- in the normal course, when the CSOP option is exercised at least three years from the date of grant; or
- if the optionholder exercised the CSOP option within three years from the date of grant as a result of the termination of his employment due to injury, disability, redundancy or retirement ('good leaver'), provided it is exercised within six months of leaving.

If the CSOP option is exercised within three years from the date of grant and the optionholder is not a good leaver (or the optionholder is a good leaver but does not exercise the CSOP option within six months of leaving), then the tax relief will be lost. The option will be treated as unapproved and there will be a

liability to income tax and potentially NICs on any increase in value of the shares.

If the underlying shares are readily convertible assets (i.e. in general terms, there is a market for the shares), the liability to income tax and NICs will be collected by the optionholder's employee under PAYE. If not, there may be no NICs and the income tax may only need to be paid by the employee by way of self-assessment.

When the shares are sold, there will be a potential liability to capital gains tax (CGT) on the difference between the sale proceeds and the exercise price paid for the shares.

Example

A CSOP option is granted in 2008 over 10,000 shares at an exercise price of £2 per share. The CSOP option is exercised in 2011 when the market value of a share is £5. After a further two years the shares are sold in 2013 for £7 per share. Assuming that the shares are readily convertible, the full CGT annual exemption of £9,600 is available to set against any gain on the disposal of the shares and entrepreneurs' relief is not available, the employee's tax position is as follows.

On grant: No tax is payable.

<i>On exercise:</i>	£
Market value on exercise	50,000
Exercise price	<u>20,000</u>
Gain	<u>30,000</u>

No income tax or NIC is payable on exercise.

<i>On disposal:</i>	
Sale proceeds	70,000
Less: Exercise price	<u>20,000</u>
	50,000
Less: Annual exemption	<u>(9,600)</u>
Chargeable gain	<u>40,400</u>
CGT @ 18%	<u>7,272</u>

<i>Net benefit for participant:</i>	
Sales proceeds	70,000
Less: Exercise price	(20,000)
CGT	<u>(7,272)</u>
Net benefit after tax	<u>42,728</u>

Employer issues

- The CSOP must be formally established by a company under a set of rules. Formal approval must be obtained from HMRC before CSOP options can be granted. Unlisted companies (including AIM companies) must agree a share valuation with HMRC Shares and Assets Valuation in advance.
- Statutory corporation tax relief may be available for the employing company on the amount of the gain but only on exercise and subject to a number of conditions.
- Any employers' NICs arising on exercise (e.g. a bad leaver exercising within 3 years) may be transferred to the employees.
- For accounting purposes, CSOP options must be measured at grant at 'fair value' and recorded as an expense in the accounts of the company. 'Fair value' will generally be determined according to an option pricing model, such as Black-Scholes or a binomial model.
- There are annual reporting requirements, as with all types of share incentive arrangements.

How can we help?

We can help with the design of your CSOP and think about the financial limits and timeframe to suit your business needs. We can advise on all aspects of design and implementation including participation policy, performance measures, communication and ongoing compliance requirements.

If you would like more information about CSOPs or if you have any other issues in relation to employee incentive arrangements please contact Bryan Rickman on 07939 583386 or br@dermotscully.com.

Information in the publication is intended to provide only a general outline of the subjects covered. It should neither be regarded as comprehensive nor sufficient for making decisions, nor should it be used in place of professional advice. Dermot Scully Solicitors and its solicitors accept no responsibility for any loss arising from any action taken or not taken by anyone using this material.

Whilst every care and attention has been taken to ensure the accuracy of this information, it is intended for general guidance only. It is assumed for all purposes in this flyer that optionholders are UK tax resident and ordinarily tax resident at all relevant times. NICs will apply where the shares are deemed to be "readily convertible assets". Please call us if you would like specific advice on any matter.