



Company Share Option Plans

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Background and structure

The Company Share Option Plan (CSOP) is a tax efficient form of share option plan, providing for the grant of options over shares with a value, at grant, of up to £60,000.

Historically, CSOPs have been favoured by listed companies, but due to a relaxation, from April 2023, of the statutory requirements that must be satisfied in order to establish a CSOP, the grant of CSOP options is now a viable alternative for unlisted companies which are unable to grant tax-advantaged EMI options.

CSOP options are a risk-free form of incentive for employees since there is no requirement for employees to pay for the grant of a CSOP option and there is no obligation for an employee to exercise a CSOP option in the future.

Companies can only grant CSOP options if certain qualifying conditions are satisfied, however, those conditions are less strict than those applying to EMI options.

Eligibility

The key statutory requirements applying to a CSOP are as follows:

Shares

The shares over which the CSOP options are to be granted must, broadly:

- form part of the ordinary share capital of the company establishing the scheme (referred to as the "scheme organiser") or a company which controls the scheme organiser;
- be of a class listed a recognised stock exchange or be in an independent company (ie a company not under the control of another company) or be in a company which is subject to an employee ownership trust; and
- be fully paid and not redeemable.

Participants

As the CSOP is not an all-employee form of incentive, a company is free to choose which employees it wishes to grant options to – some companies choose to operate a CSOP on an all-employee basis.

An individual will qualify to receive the grant of a CSOP option if they are an employee or full-time director of the company (HMRC interpret this requirement as meaning that the director must work for at least 25 hours per week (excluding meal breaks)). An employee (or full-time director) who holds a "material interest" in the company will not be permitted to receive the grant of a CSOP option – a material interest is broadly an interest in more than 30% of the company's share capital or the company's assets on a winding up.

Purpose

The purpose of the CSOP must be to provide benefits for employees and directors – this means that the CSOP may not provide for cash payments to participants as an alternative to share options.

Limits

As referred to above, there is a limit of £60,000 on the market value of the shares (ignoring any restrictions applying to the shares) over which CSOP options can be granted to any individual.

How do CSOPs work?

A company must adopt a set of CSOP plan rules so that it can grant CSOP options to employees (including executive directors). Once a plan has been adopted, the company grants the employee a share option (being a right to buy shares in the company in the future at a specified exercise price). The exercise price must be not manifestly less than the market value of the shares (as agreed with HMRC) at the date of grant of the CSOP option.

If a company establishing the CSOP is the parent company of a group, all group companies which are controlled by the parent company may (if the parent company so wishes) be included within the CSOP.

In order to secure the tax-advantaged treatment that applies to CSOP options, a participant is not normally permitted to exercise a CSOP option (and acquire the underlying shares) until the third anniversary of the date of grant. However, after that anniversary, and subject to the rules of the CSOP, the participant can exercise the option if and when they choose.

Typically, leaver provisions will apply to options granted under a CSOP with the result that a participant's CSOP option will lapse if they leave employment. The rules of the CSOP may, however, provide for good leavers (for example, retirees or participants who leave employment due to injury or disability) to allow them to exercise their option early (in whole or in part).

In order to secure the tax-advantaged treatment that applies to CSOP options, a company must notify HMRC of the adoption of a CSOP and make a declaration to HMRC that the CSOP complies with the relevant statutory requirements. Both the notice and declaration must be given online using HMRC's ERS portal.

Tax treatment of CSOP options

No income tax or NICs liabilities should arise on the grant of a CSOP option nor on the exercise of a CSOP option provided that it is exercised:

- on or after the third anniversary of the date of grant of the CSOP option (but no later than the 10th anniversary of the date of grant);
- before the third anniversary of the date of grant of the CSOP option if the option holder ceases to be employed in certain specified circumstances including injury, disability, redundancy or retirement and provided that the option is exercised within six months of cessation; or
- before the third anniversary of the date of grant of the CSOP option if there is a takeover or change of control of the company and the option holder receives cash only as consideration for the sale of the shares acquired on exercise.

The option holder may be liable to pay capital gains tax on the sale of the shares acquired on the exercise of a CSOP option although business assets disposal relief may be available to the option holder to reduce any capital gain, if the option holder holds the shares for at least two years following exercise and certain statutory conditions are satisfied during that period.

The company may be entitled to corporation tax relief in relation to the costs of setting up the CSOP and on the exercise of the CSOP options.

Example

The example below shows how a CSOP option can work:

- Company A grants a CSOP option to Employee Z over 500 shares.
- It is agreed with HMRC that the market value of the shares at grant is £2 per share and that amount is used as the option exercise price.

- The CSOP option can be exercised at any time on, or after, the third anniversary of the date of grant.
- Three years later, Employee Z exercises the CSOP option and acquires the underlying shares. The shares are immediately sold for £100 each.
- Overall, Employee Z's return is £49,000.

Since the CSOP option is exercised on the third anniversary of grant, no income tax or NICs are payable on the exercise of the option. Instead, Employee Z's return is taxable to capital gains tax so Employee Z is liable to pay capital gains tax at only 24%.

Company A has no tax to pay. In fact, Company A is legally entitled to deduct the option gain of £49,000 from its profit to materially reduce its corporation tax bill.

As a result, the employee receives £49,000 in cash and pays tax to HMRC of £11,760 (ignoring the CGT annual allowance). The Company can claim (as of right) a corporation tax saving of around £12,250 (on the basis that the 25% corporation tax rate applies).

This guide is a high-level summary only of the CSOP in the UK and is not intended to provide specific advice.

About the team

TLT's Employee Incentives team is headed up by partner Ben Watson, who is actively interested in furthering awareness of the benefits of employee ownership and speaks nationally on the subject. The team works from our Bristol, London and Manchester offices and acts for all types of company, from start-ups to FTSE 100 plcs.

We are experienced in establishing, and advising on the day-to-day operation of, all types of employee share plan and bonus schemes and have an awareness of current market trends. The team also has a wealth of experience advising on the employee share plans aspects of flotations, mergers and acquisitions.

We believe strongly in a total reward strategy which means working with clients to ensure that incentive schemes fit sensibly within the whole benefit package. We help clients by being approachable and efficient and our team is enhanced by additional skills and experience from our Employment, Pensions and Corporate Finance teams.

Key contacts

If you would like more information on CSOPs or any other type of incentive arrangement, please contact a member of the team:



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