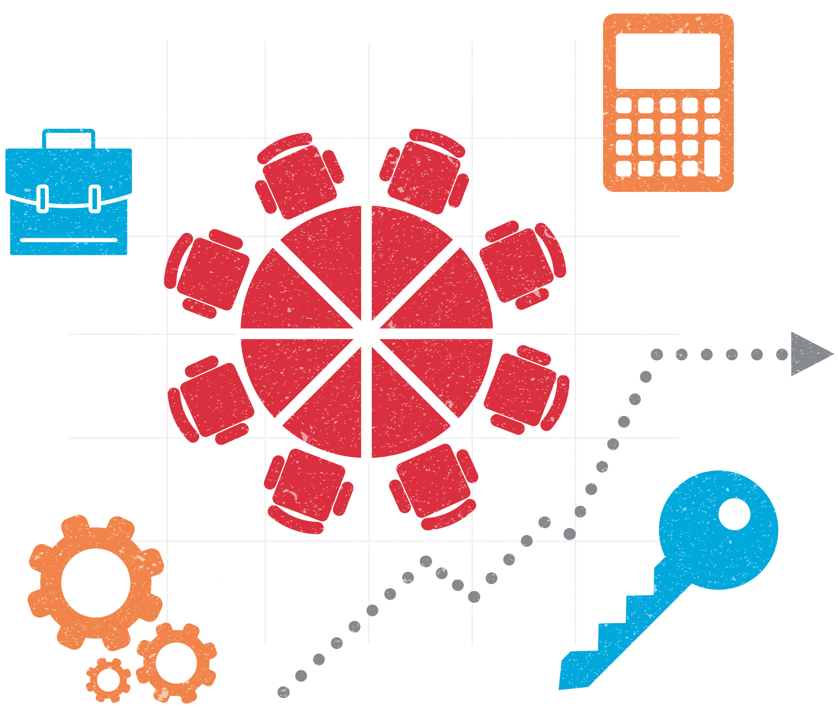
PKF FRANCIS CLARK
Shared Ambition

Company Share Option Plan (CSOP)

Share ownership for Employees



Share ownership for employees

Share options for incentive and reward

Share options are commonly used to incentivise and reward key staff. A share option is the right to buy shares in the future at a price set today.

The reasons for using share options include:

- *The employee benefits from growing the share price*
- *It costs the employee nothing up-front*
- *Using shares can strongly align to shareholder goals*
- *The employee does not become a shareholder until exercise (often an 'exit event' like company sale), so they have no votes etc.*
- *It is administratively simple to set performance targets and recover awards if someone leaves*

What is a company share option plan (CSOP)?

A CSOP is a particular type of tax-advantaged share option plan. Introduced all the way back in 1984, it remains relevant today.

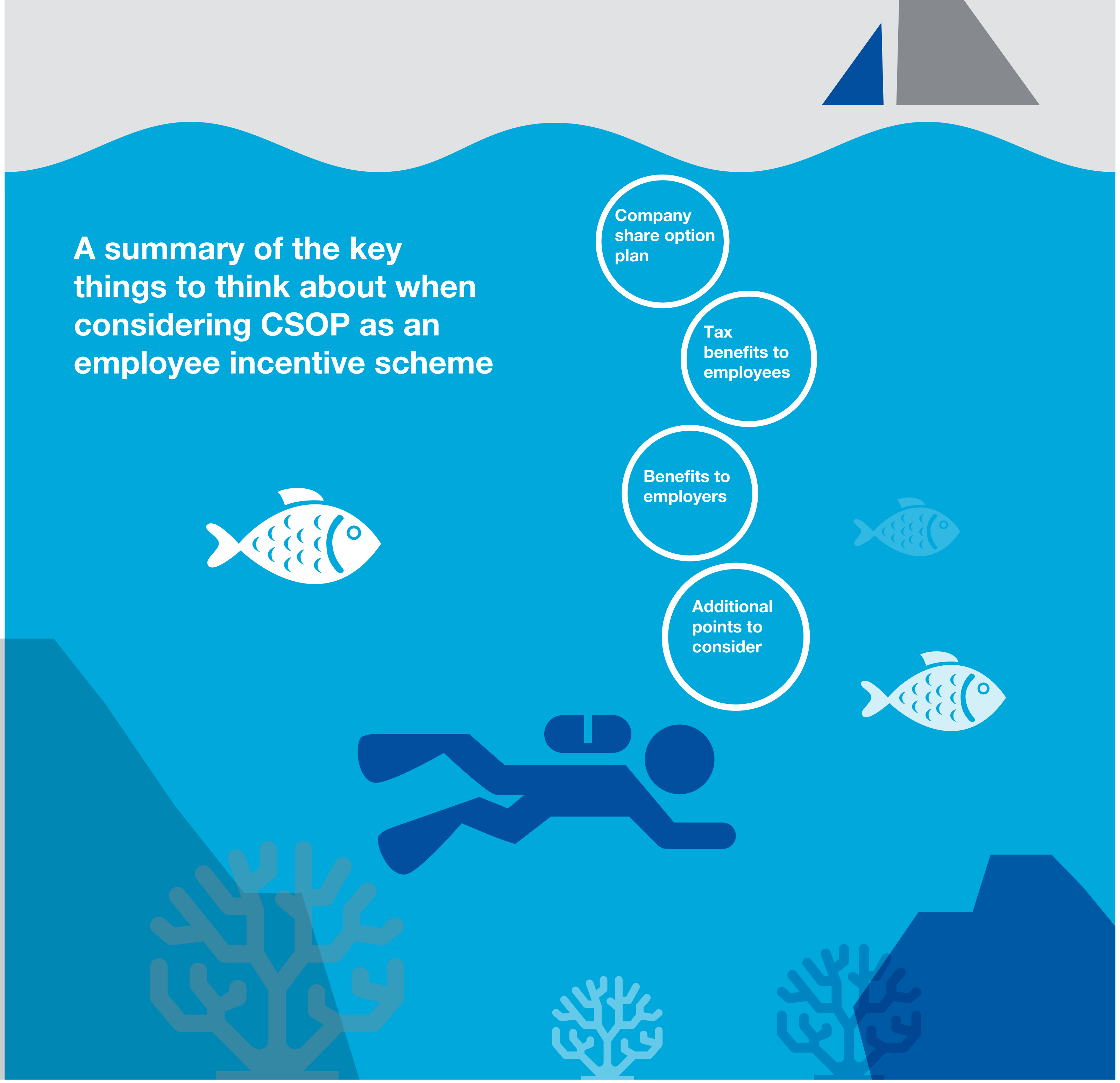
Subject to meeting some qualifying conditions, it provides some very useful tax breaks for participants, in overview:

- *Employee gains will generally be subject to tax as a capital gain (10% or 20% tax rate currently) not employment income*
- *There will normally be no national insurance charge for the employer when the options are granted, exercised, or when the employee sells the shares*
- *A corporation tax deduction for the employer company broadly equal to employees' gains*
- *A corporation tax deduction on the costs of setting up and running the scheme*
- *Lower risk – it is a well-trodden path, a statutory share plan with good support from the Government and HMRC for nearly 40 years*

CSOP
1984 Today

Dive into CSOP

A summary of the key things to think about when considering CSOP as an employee incentive scheme



An overview

Company share option plan

CSOP allows selected employees (often key to the employer) to be given the opportunity to acquire a significant number of shares in their employer through the issue of options. Whilst CSOP can offer significant tax advantages, the key driver for any incentive arrangement should be the commercial objective of the business. Unlike the enterprise management incentive scheme (EMI) which is another type of generous tax advantaged scheme aimed at small-medium sized businesses, CSOP does not have onerous conditions for the issuing company to meet. Notably, CSOP does not have any requirements on the size of the company or the nature of a company’s trade.

Why use a CSOP option?

CSOP allows for options to be granted to employees which may allow the shares to be received without any tax bill arising until the shares are sold.

An option gives the employee the right to obtain shares at a later date and, save for a few exceptional circumstances, any tax liabilities on the award of options to employees will be deferred until the time the options are exercised. This may still be expensive for the employee if they are not then in a position to sell some of the shares in order to pay the tax arising.

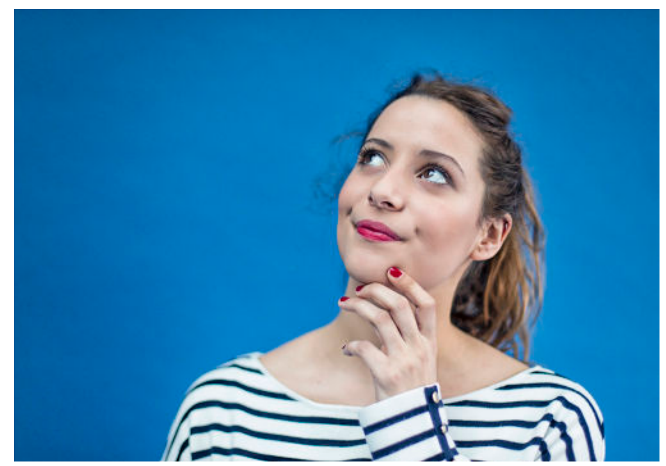
In contrast, if shares are simply given to an employee, the market value of the shares will be taxed as earnings from the employment. This can be expensive for the employee as they may not have any cash to pay the tax arising.

How does CSOP work?

Selected employees are granted options over shares of the company. To receive the tax benefits, the options should generally not be capable of being exercised within three years of grant (save in exceptional circumstances) and must be capable of being exercised within ten years of the date of grant.

In order to qualify for the income tax and national insurance contribution (NIC) reliefs, the option awarded needs to be exercised within ten years of the date of grant. There is also a statutory limit of £60,000 in respect of the options granted on or after 6 April 2023 (prior to this date the CSOP limit was £30,000) per employee. Following 6 April 2023, no employee may hold unexercised qualifying CSOP options with a market value of more than £60,000. This market value is taken at the date of the grant.

The employee is under no obligation to exercise the option. They may choose not to exercise if the value of the shares has not increased following the grant of the option (as there would be no financial benefit).



The advantages

Tax benefits to employees

The ‘exercise price’ of an option is the price per share the participant must pay to buy the shares under the option.

Provided the CSOP option is granted with an exercise price equal to the market value of the shares at the date of grant, the grant of the option will be tax free. The CSOP rules do not allow for nil cost and discounted options.

There will be no tax or NICs for the employee to pay when the option is exercised so long as the requirements of the CSOP scheme are met.

Following exercise of the option, the shares will be allotted to the employee. When they sell the shares (which may be immediately after acquisition for an ‘exit only’ plan), the employee will make a capital gain calculated by deducting the exercise price from the sale proceeds. Capital gains are subject to capital gains tax (CGT) on the individual. After setting any capital losses and the annual exemption (£6,000 for 2023/24) against the gain, the balance is taxable as follows:

- *CGT on taxable gains (or part of the gains) within a tax-payer’s unused income tax basic rate band will be charged at 10%*
- *CGT on taxable gains above this limit will be charged at 20%*

Business asset disposal relief (BADR) may be available, provided that the requirements of this relief are met. The conditions for this relief are complex and specialist advice may be required. Where BADR applies to a qualifying disposal, the CGT rate is 10% on the first £1m of taxable gains. This £1m is a lifetime limit.

When compared to a ‘non-tax advantaged’ option or a bonus, both of which are subject to income tax (rates currently at 20% for basic rate, 40% for higher and 45% for additional rate taxpayers), CSOP can be very attractive from a tax perspective.

Benefits to employers

- *Employees have a potential stake in their company and therefore retention and motivation of these employees will be enhanced*
- *Other than the costs of implementing the scheme, options will not directly cost the employer any money in comparison to paying bonuses or extra salary*
- *There will normally be no NICs charge for the employer when the options are granted, exercised, or when the employee sells the shares*
- *A corporation tax deduction for the employer company broadly equal to employees’ gains*
- *A corporation tax deduction on the costs of setting up and running the scheme*

Additional considerations

Additional points to consider

There are several issues to consider in deciding whether CSOP is suitable for your company. We can help navigate the many questions you will have, for example:

- *Which employees are eligible and who should be granted options?*
- *What type of shares will be issued?*
- *When will the rights to exercise options arise?*

Who is eligible to be granted CSOP options?

CSOP options can be granted to both employees and directors of the company, or employees and directors of a company within the issuing company’s group. Non-executive directors cannot participate.

An employee can be granted options provided they (alone or together with their associates) do not have a ‘material interest’ in the company. Broadly this requirement means that the employee does not hold more than 30% of the ordinary share capital of the company within the 12 months prior to the grant of the option. This requirement can be complex and specialist advice may be required.

In the case of directors, in addition to not having a material interest, they must also work at least 25 hours a week for the company or the group.

Subject to the above restrictions, an employer is free to decide which employees should be offered options. The sole test is that options are offered for commercial reasons in order to recruit or retain an employee.

What type of shares will be issued?

CSOP provides some flexibility for employers. For example, it is possible to limit voting rights or set other conditions in respect of shares which will be acquired on exercise of an option.

The shares must, however, be fully paid up ordinary shares.

As a general rule, a CSOP option cannot be granted in a subsidiary company and must be granted in a company which is not under the control of another company.

However, CSOP options can be granted over shares in a company under the control of another company where the shares are:

- *Listed on a recognised stock exchange*
- *In a company which is subject to an employee-ownership trust*

When will the rights to exercise options arise?

The options must be capable of being exercised within ten years of the date of grant, but there does not have to be a fixed date. Examples of circumstances in which the options could be exercised include:

- *Fixed period*
- *Sale of the company*
- *Profitability target or performance conditions being met*
- *Flotation of the company on a stock market*

Options can also be designed to lapse if certain events arise, for example the employee leaves the employment.

How we can help

The driver for any incentive arrangement should be the commercial objectives of the business. There are a variety of alternative arrangements which can be used, each with their own conditions and advantages.We can help you decide whether CSOP is appropriate for your business. Please contact us for advice on the most suitable options available to your business.

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