Postlethwaite
EMPLOYEE OWNERSHIP LAWYERS

Company Share Option Plan – CSOP

A Company Share Option Plan (CSOP) provides statutory tax relief for employees on their financial gains.

The Company Share Option Plan (CSOP) allows a company's UK employees to acquire shares by first granting them options to acquire shares. A statutory tax relief means that they do not pay income tax or National Insurance (NI) on their gains.

An illustration

- *This year, your company grants an employee, Grace, an option, under which – after three years have passed – she can buy 10,000 shares at today's share value (£3 per share).*

- *Three years later the share price has increased to £10. Grace decides to exercise her option in full, paying £30,000 for shares which are now worth £100,000.*

Normally Grace would have to pay income tax and possibly NI on this £70,000 benefit (even though it may only be a paper gain if she hasn't yet sold the shares), and the Company may have to account for employers NI. However, if the option is a CSOP option, she doesn't have to do so, so long as (normally) at least three years and no more than ten years pass before she exercises her option.

So is it completely tax free?

No, if Grace sells the shares – which she might do either immediately or after some time – she will then have to pay capital gains tax (CGT) at 28% on any gain she has made up to the point of sale. But apart from the lower rate, it will often be much better to pay CGT than income tax or NI because:

- *there is an additional tax free slice under the CGT annual exemption (£11,100 in 2015-16)*

- *spouse/civil partner transfers may also be used to reduce the liability further*

- *unlike income tax or NI, CGT is due only when she sells the shares, and so when she has some cash to pay her tax bill.*

Your company will often be able to claim a deduction against corporation tax for the full amount of an employee's option gains.

Can we choose which of our employees participate?

Yes, you can choose any employee or full time director to participate.

Are there any limits?

No employee may be granted CSOP options over shares worth more than £30,000. So in our example Grace could not immediately be granted any more options, although additional options which are not tax-advantaged could be granted.

What happens if a participant leaves?

If you want to use your CSOP to encourage participants to stay with the company, you could:

- *stipulate that unexercised options will lapse if an employee leaves, or*
- *allow them to exercise if they were leaving only for "good reasons"; or*
- *allow options to be exercised in part depending on, for example, length of service*

Employees whose options lapse will never enjoy any benefit from holding their option.

Normally if CSOP options are exercised within three years of grant, the employee will pay income tax and possibly NI on their option gains. However, this does not apply to employees leaving for redundancy, injury, disability or retirement, where there is a cash takeover or where the employing company is sold out of the group within 3 years following grant.

Once an option has been exercised, the holder becomes a shareholder, and the rights attaching to the shares are governed by the articles. These may include leaver provisions in respect of shares.

Can my company have a CSOP?

Most independent companies will be able to meet the requirements of the CSOP legislation.

Shares must be:

- in a company not controlled by another company
- ordinary shares, fully paid, not redeemable

Can we set the exercise price ourselves?

The exercise price may not be lower (but can be higher) than the market value of a share, which must be agreed with the UK Revenue in advance. For small holdings, it is often possible to apply a substantial minority discount, so that, for example, a 1 % holding in a £10m company is worth a lot less than £100,000.

In this table we attach our own ratings for CSOP options for tax efficiency, ease of setting up and overall incentive and reward value.

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How it works

An option – the right to buy shares in the future at a fixed price.

TAX EFFICIENCY (INDIVIDUAL)	TAX EFFICIENCY (COMPANY)	EASE OF SETTING UP	OVERALL INCENTIVE AND REWARD VALUE
★★★★☆	★★★☆☆	★★★☆☆	★★★★☆
No IT or NICs for certain “good leavers” or if options held for at least three years. CGT on sale of shares.	CT deduction on option gains. No NICs if options held for at least three years.	Must be registered with HMRC and self-certified.	Simple to explain, no risk, tax efficient. Limited to £30,000 of shares per person.

Other issues

Some companies excluded. Options may not be granted at a discount.

If you would like to explore how an employee share scheme might be introduced in your company, please contact us for an initial discussion.

We are happy to meet at our offices without charge or commitment and will be very pleased to hear from you.

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