

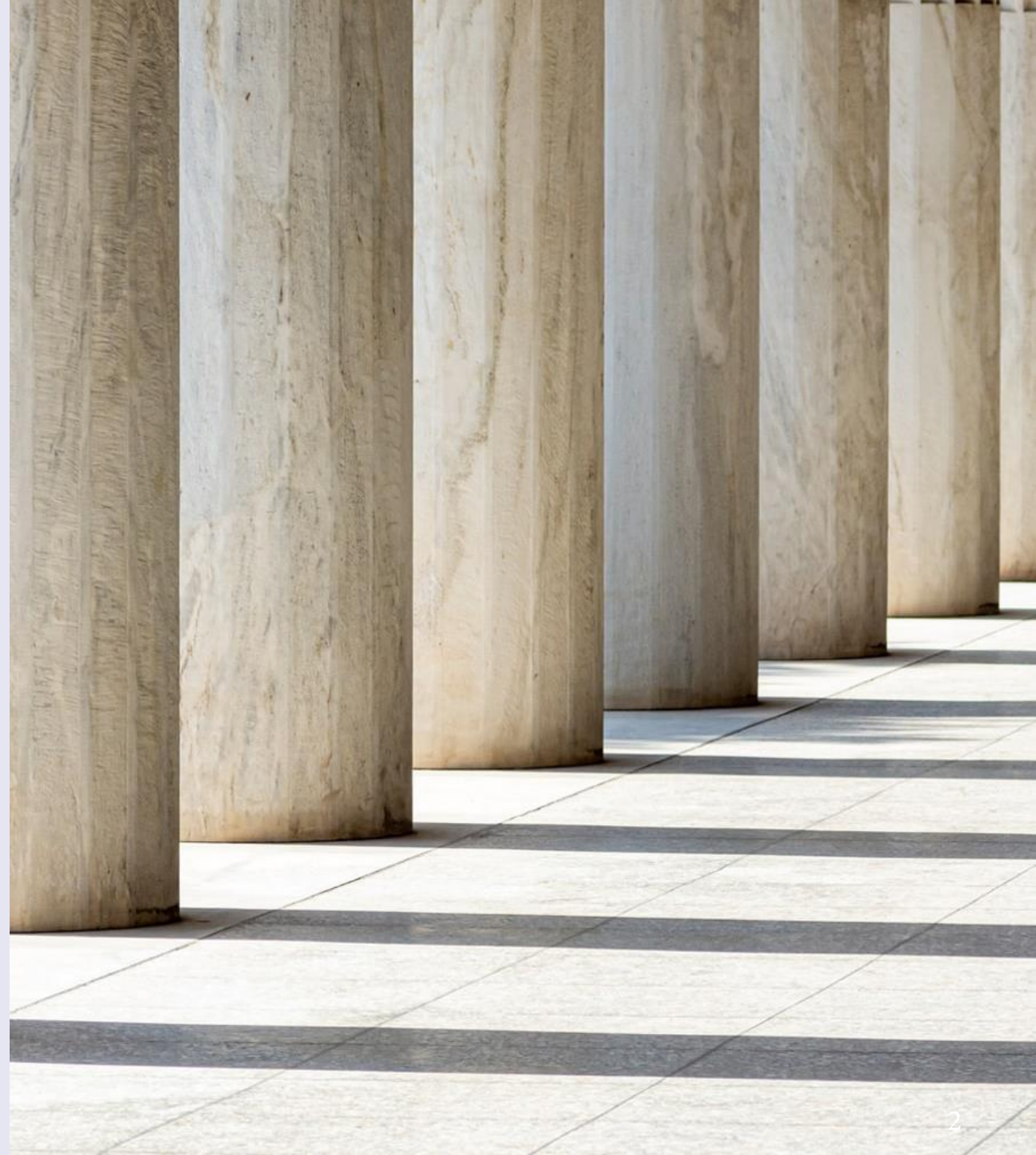
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A guide to *Company Share Option Plans*

2024

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What is a Company Share Option Plan (“CSOP”)?

A CSOP is a form of discretionary share option scheme which can have favourable tax treatment.

The eligibility rules for CSOP schemes recently changed with effect from 6 April 2023, meaning CSOP is now an alternative open to some companies who previously did not qualify. The individual financial limit has also been doubled from £30,000 to £60,000. This limit is significantly less than for EMI options (£250,000); however, unlike for EMI options there is no overall company limit or three-year limit.

The eligibility requirements are less strict for CSOPs than for EMI. However, the tax treatment is often less beneficial such that most companies who qualify for EMI would choose to opt for an EMI scheme over a CSOP scheme. However, for companies that no longer qualify for EMI, e.g. because they are too large, CSOP can be an attractive second choice.

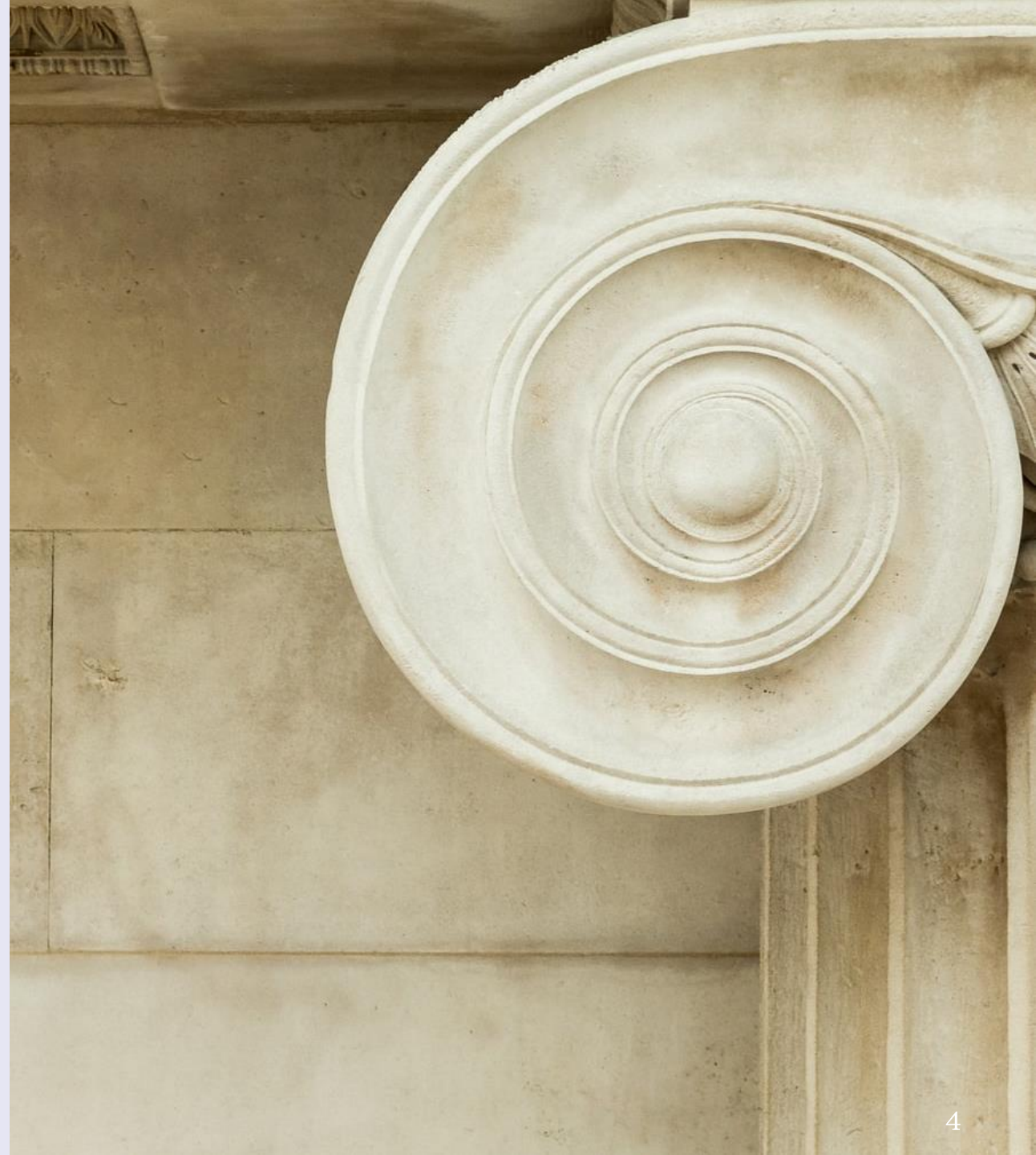
What kind of shares can CSOP options be granted over?

CSOP options can be awarded over the shares of UK private, public or listed companies, and also over the shares of foreign parent companies, provided that the relevant statutory requirements are met.

The shares must be:

- ordinary share capital;
- fully paid up and non-redeemable; and
- one of the following: (a) of a class listed on a recognised stock exchange, (b) in a company which is not under the control of another company, or (c) in a company which is subject to an employee-ownership trust.

Previously, an additional requirement applied in respect of CSOP companies with more than one class of ordinary shares which limited their ability to utilise CSOP options. However, this “worth having requirement” was removed for share options granted under a CSOP from 6 April 2023.



Who can be granted CSOP options?

An individual can be granted CSOP options if:

1. they are a *full-time director or an employee* of the company or in the case of a group scheme, a constituent company (i.e. a company which the parent controls and which the scheme is expressed to extend to); and
2. the individual (and/or their associates) *does not have a “material interest”* in a close company which is either the CSOP company, its parent or in any member of a consortium which owns such a parent company.

Unlike EMI, the meaning of “full-time director” is not defined in the legislation. HMRC considers a full-time director to be a director who works at least 25 hours p/w which may be aggregated across several participating companies.

A “material interest” is broadly an interest in more than 30% of the share capital of the company or assets of the company on a winding up.



What are the limits?

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- The exercise price of the options must be stated at the time of grant and cannot be manifestly less than the unrestricted market value (**UMV**) of the shares of the same class at the time when the option is granted. As a tax-advantaged scheme, the UMV can be agreed upfront with HMRC.
 - With effect from 6 April 2023, each individual can only hold unexercised qualifying CSOP options over shares worth £60,000. This limit is significantly less than for EMI options (£250,000); however, unlike for EMI options there is no overall company limit or three-year limit.

Tax treatment on exercise

The income tax treatment on the exercise of CSOP options depends on when the CSOP options are exercised, and the circumstances in which they are exercised.

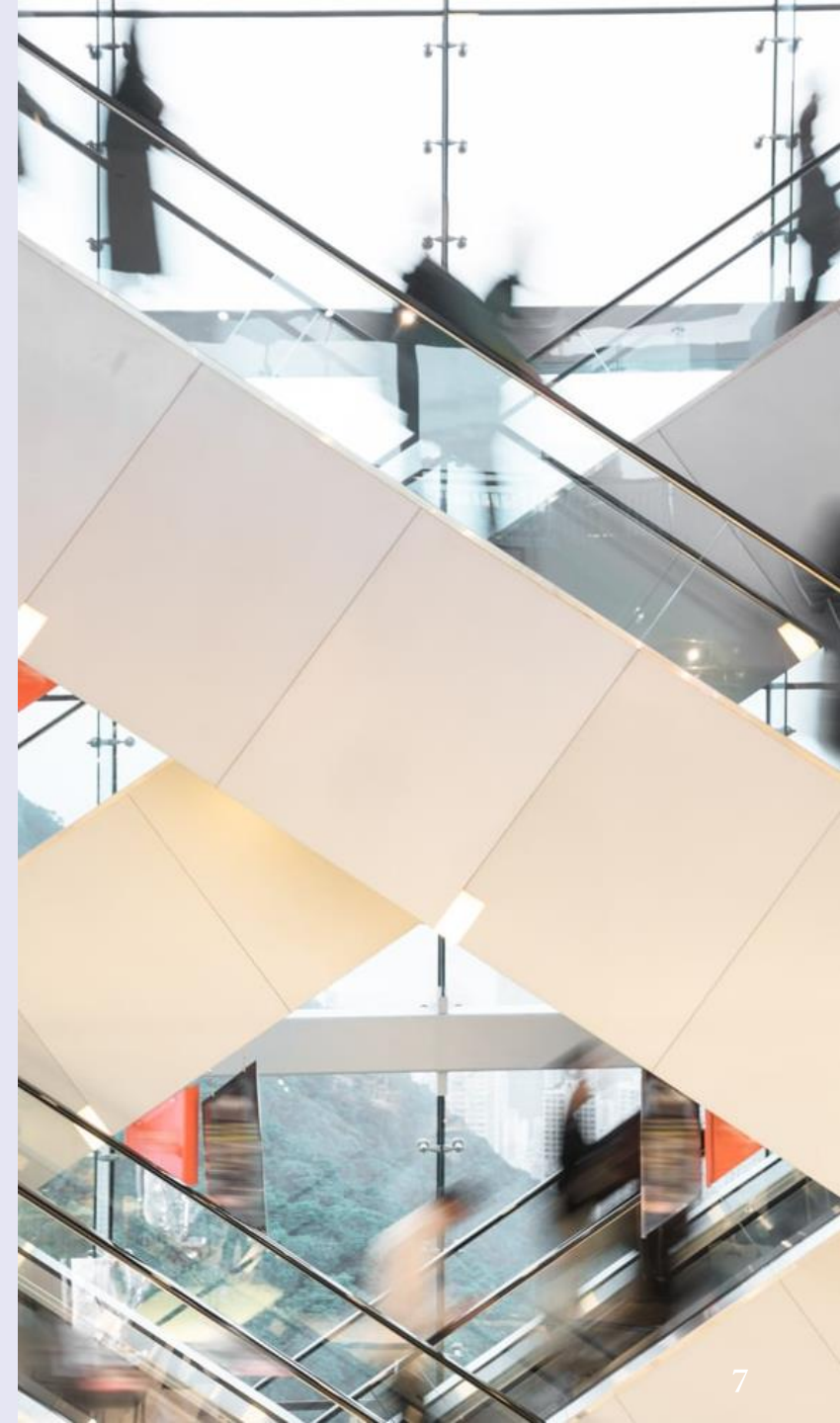
There is no income tax or National Insurance contributions (**NICs**) on exercise of CSOP options:

1. on or before the tenth anniversary of the date of grant of the option; and
2. on or after the third anniversary of the date of grant.

Beneficial tax treatment is also available in limited situations where CSOP options are exercised within three years, including:

- a) When someone has left work for reasons associated with injury, disability, redundancy or retirement (provided the CSOP options are exercised within 6 months); and
- b) Certain types of takeover, noting that this generally does not include most takeovers of private companies because of the typical way in which such takeovers are structured.

For any CSOP options exercised *outside* of the statutory “safe harbours”, income tax (and National Insurance contributions and potentially the Apprenticeship Levy), will be payable on the amount, if any, by which the actual market value of a share at the date of exercise exceeds the exercise price paid.



Advantages / disadvantages of establishing a CSOP

The main advantages of CSOPs are as follows:

- There is no income tax or NICs payable on the exercise of CSOP options if the CSOP options are exercised within the statutory limits.
- As a CSOP is an HMRC tax advantaged scheme, HMRC will agree the market value of shares subject to proposed CSOP options before the options are granted, therefore giving more certainty in relation to the future tax treatment of the options.
- Assuming the relevant criteria are met, the company will receive corporation tax relief on the acquisition of shares following the exercise of CSOP options, even where the employee is not subject to income tax on the option gain because of the tax relief available.
- The employer can choose to pass on employer's NICs to the option holder by an agreement or election (as is the case under EMI).
- CSOPs are discretionary schemes and therefore do not have to be offered to all employees.

Some potential disadvantages of CSOPs are:

- For CSOP options to benefit from tax advantages in most circumstances there are minimum holding periods. The exercise of CSOP options outside of the statutory provisions or time limits gives rise to income tax (and potentially NICs) liabilities.
- The effect of the conditions means that CSOP options are unlikely to be effective when a private company anticipates an exit within three years.
- An individual can only hold CSOP options over shares (valued at the date of grant) worth a total of £60,000 which is much lower than the financial limit under EMI.
- Employees with a "material interest" in the company do not qualify to be granted CSOP options.
- A CSOP is subject to self-certification, registration and filing requirements in order to benefit from tax favoured treatment. This can sometime be time-consuming and requires ongoing compliance.

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