

### Introduction

The Company Share Option Plan ("CSOP") is a tax-advantaged discretionary share option plan which can provide tax benefits for UK tax-paying employees and full-time executive directors.

Under a CSOP, a company may grant options to any employee or full-time director to acquire shares at an exercise price which must be not less than the unrestricted market value ("UMV") of the shares on the date of grant. The exercise is generally tax relieved allowing gains to be taxed as capital on the sale of the shares.

### Main features

- The CSOP tax reliefs are very generous, so that:
  - there is no income tax or national insurance contributions ("NICs") on grant;
  - there is no income tax or social security on exercise providing certain conditions are met (see below); and
  - capital gains tax will arise on the sale of the option shares with no minimum holding period.
- The terms relating to CSOP options can be very flexible and allow companies to align such terms with other arrangements which they may offer, such as to overseas participants.
- CSOP options must be granted at an exercise price which is not less than the UMV of the shares on the grant date.
- Up to £60,000 worth of shares can be granted to each eligible employee.
- It is possible to grant options over a specially created class of "growth shares" which are highly geared and have a low value thereby allowing the increased individual limit of £60,000 to "go" much further.

- The UK employing company will generally qualify for a corporation tax deduction equal to the spread for the accounting period in which the option is exercised (even where participants are relieved from income tax).

### Flexibility

There are very few requirements of the CSOP legislation relating to the option terms. The main ones are that:

- the options cannot be transferred (other than to personal representatives);
- they cannot be exercised after the tenth anniversary of grant;
- they must lapse within 12 months of death; and
- it must be clear the option is a right to acquire shares (so cannot contain excessive discretion).

### Operation

The options are typically granted using a set of plan rules and an option certificate which comply with the CSOP legislation. The purpose of the CSOP must be to provide benefits in the form of shares and it must not provide benefits otherwise than in accordance with the legislation.

Companies often structure the exercise provisions so as to minimize the chances of the options being exercised in circumstances which give rise to an income tax and NIC liability. So, for example, it is common practice to permit options to be exercised only after three years (or within 6 months of cessation in good leaver situations).

CSOP options can be subject to any performance conditions providing these are objective and stated in the option agreement. If CSOP options are being granted in conjunction with non-tax advantaged options, it makes sense to ensure the targets are looked at as a whole and treated as met first in so far as they apply to CSOP options to maximize the benefit of the tax relief.

## Qualifying companies

CSOP is available to private and public companies – unlike enterprise management incentives ("EMI") plans, there are no restrictions on the size of the company or number of employees.

A company granting CSOP options must not be under the control of another company. However, the parent company of a qualifying group can grant EMI options to group employees.

## Employee taxation

There will be no income tax or NICs at the date of grant or when the CSOP options are exercised.

On a disposal of the shares the increase in value from the UMV at grant will usually be liable to capital gains tax and the standard rate of 10% and/or 20% will apply depending on whether the individual is a standard or higher rate taxpayer.

## Qualifying options

The tax-advantaged treatment will be available if the CSOP option is:

- as stated above, granted at an exercise price which is not less than the UMV of the shares on the grant date; and
- exercised at least three years after the date of grant or, if earlier:
  - within six months of cessation of employment for certain "good leaver" reasons (injury, disability, redundancy, retirement or the transfer of the company that employs the participant out of the group or a transfer of employment on the sale of a business out of the group); and
  - within six months of certain corporate takeovers.

Income tax relief on the exercise of CSOP options is also available in the case of an exercise by the participant's personal representatives within 12 months of the participant's death.

In order to qualify for beneficial tax treatment, a CSOP must also meet requirements in respect of:

- eligibility of individuals to participate;
- limits;
- shares which may be subject to option; and
- self-certification.

## Eligible employees

Options may be granted on a discretionary basis to any employee or any full-time executive director of the establishing company (or any constituent company in the case of a group plan).

If the establishing company is a close company, participants are ineligible if they (or their associates) have (or have had within the previous 12 months) a "material interest" (broadly 30% of the ordinary share capital or assets) in the company.

## Individual limit and exercise plans

The maximum value of shares over which a participant may hold subsisting CSOP options was increased from £30,000 to £60,000 on 5 April 2023. The limit is calculated using the unrestricted market value of the shares on the grant date. The restrictions on the type of shares which can be used were also removed on the same date making it possible for the limit "go further" by granting CSOP options over separate classes of ordinary shares (such as so-called "growth shares"). A separate fact sheet growth shares is available.

## Plan Shares

Plan shares must be fully paid up, non-redeemable, ordinary shares which are:

- in an independent company; or
- listed on a recognised stock exchange (which includes for these purposes the London Stock Exchange, New York Stock Exchange, NASDAQ, the Australian Stock Exchange and Euronext Paris etc., but not AIM).

## Administration and valuation

On 5 April 2014 the previous system of applying to HMRC for formal approval of the plan was removed and replaced with a self-certification procedure. This has made CSOPs much easier and quicker to establish.

CSOPs now only need to be registered with HMRC on or before 6 July following the tax year in which options are first granted (i.e. on or before 6 July 2025 for options granted in 2024/25). When the plan is first registered the company must declare the CSOP meets the conditions of Schedule 4 ITEPA 2003. If the declaration is made after the options have been granted, the declaration must confirm the conditions were met at the time of grant.

For grant purposes, if the shares are listed on the London or New York Stock Exchanges, HMRC accept that the market value will be the mid-market closing price on the grant date. If the shares are not listed on either of these exchanges the market value must be agreed with HMRC before options are granted.

UK companies that satisfy the conditions for enterprise management incentives should first consider the grant of options as EMI options rather than CSOPs as the tax reliefs are more generous. A separate fact sheet on EMI is available.

## Next steps

Many CSOPs are bespoke to the company with individual rules and performance targets. Wedlake Bell can help with all aspects of the design, drafting and implementation of your CSOP, including communication, valuation and ongoing compliance requirements.

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