

CSOP options (Company Share Option Plan)

What is the CSOP?

The Company Share Option Plan (CSOP) allows UK employees to participate in share options without having to pay income tax or National Insurance (NI) on their option gains.

How does it work?

Imagine that:

- *in 2005 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 price (£3 per share).*
- *three years later (2008) the share price has increased to £5. Grace decides to exercise her option in full, paying £30,000 for shares which are now worth £50,000.*

Normally Grace would have to pay income tax and possibly NI on this £20,000 benefit (even though it may only be a paper gain if she hasn't yet sold the shares). However, if the option is a CSOP, 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) on any gain she has made up to the point of sale. But it will often be much better to pay CGT than income tax or NI:

- *there is an additional tax free slice - £8,500 for 2005-2006*
- *taper relief can significantly reduce the rate of CGT*
- *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.*

Can we choose which of our employees participate?

Yes, unlike SAYE options you can choose any employee of full time director to participate.

Is it the only way to have income tax and NI free options?

No, there are two other option plans providing similar benefits for UK employees, SAYE and EMI.

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.

However, to the extent she eventually exercises her options, more could then be granted:

- *in 2008 Grace exercises options over 5,000 shares, rather than 10,000. Remember these were worth £15,000 on grant*
- *your company can (if it wishes) grant her CSOP options over 3,000 more shares (£15,000/£5)*
- *she continues to hold unexercised options over the other 5,000 shares*

What happens to leavers?

When creating your CSOP you will want to think about how to treat leavers:

- *you could stipulate that unexercised options of employees who leave will lapse.*
- *or you could allow them to exercise if they were leaving for "good reasons".*

For employees leaving within three years of option grant, lapse will mean they 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.

What happens if our company is taken over?

You should plan ahead for this as well. Your CSOP could stipulate that:

- *all options become exercisable even though three years may not have passed; or*
- *a proportion of the options become exercisable, depending on how much time has passed between grant and takeover*

But if any are exercised within less than three years of grant, income tax and possibly NI will be due on option gains.

Can my company have a CSOP?

Most independent companies will be able to meet the requirements of the CSOP legislation, but you will need to look at them carefully – preferably with professional help. Granting CSOP options over shares in a company which is controlled by another is an immediate showstopper, unless either of the companies is listed.

Shares must be:

- in a company not controlled by another (unless listed)
- ordinary shares, fully paid, not redeemable
- not subject to any restriction unless it applies to all shares of the same class

And (if the company has more than one class of share) *either* a majority of the class of shares used must not be held by directors or employees *or* (very unusually) that class of shares must give employees control.

How many companies have a CSOP?

According to the Inland Revenue, by April 2003 about 9,800 companies had established a CSOP, of which 251 were AIM listed and 380 were smaller, fully listed companies.

What if we are a UK subsidiary of an overseas company?

It will often be possible to create a CSOP for your UK employees, under which options may be granted over shares in your holding company. Some 109 of companies with a CSOP are overseas controlled.

For example, a US-owned company might set up a CSOP to provide similar tax benefits for its UK employees to those enjoyed by its US employees holding Incentive Stock Options.

What is the accounting impact?

The Accounting Standards Board is to require a company providing share-based benefits for its employees to show that as a cost in its accounts. For listed companies, this will apply in respect of financial years beginning on 1 January 2005 onwards. For unlisted (including AIM) companies, the starting date is 1 January 2006.

However, this will accounting treatment will not apply to smaller companies whose accounts are prepared under FRSSE.

Many companies paying UK corporation tax may now claim as a statutory deduction against corporation tax the value of any benefit provided through options.

How do we find out more?

Please contact Robert Postlethwaite rmp@postlethwaiteco.com or Sarah Anderson sa@postlethwaiteco.com

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