

## COMPANY SHARE OPTION PLAN (“CSOP”)

A CSOP is the traditional method of giving selected executives (and sometimes others) a personal interest in the future success of the company. Under a CSOP, participants are granted options to acquire shares in the company, normally between 3 and 10 years after grant, at an exercise price that is set at the time of grant. For a plan approved by HM Customs & Excise (“HMRC”) this must be at least market value at the date of grant.

Options under a CSOP approved by HMRC enjoy particular taxation advantages. Broadly, there is normally no charge to income tax and National Insurance either on the grant or exercise of an option although, subject to the annual exemption and any taper relief which may be available, there is a potential liability for Capital Gains Tax on a subsequent disposal of the shares. (For 2008/09 the first £9,600 of capital gains are tax free and gains above this are charged at 18%).

To qualify for HMRC approval, the rules of a CSOP must meet prescribed statutory requirements and there are limits both on the value of the options which may be granted and on participation. These include:

- i. the aggregate market value of shares which may be held under option at any one time by an employee under all discretionary HMRC approved plans is limited to a fixed amount which is currently £30,000 calculated at the respective dates of grant;
- ii. whilst it is possible for part-time employees to participate in a CSOP it is only open to “full time” directors, defined as those who devote at least 25 hours per week to the duties of the office; and
- iii. an employee may not participate if the company is a close company for tax purposes and if the employee, together with his associates, has an interest in more than 25% of the shares in the company.

Obtaining HMRC approval is a two stage process. The first involves the draft rules of the scheme and ancillary documentation being submitted to HMRC for confirmation that they are in a form which is capable of formal approval. Following the adoption of the scheme by the Company, the documentation can then be submitted to HMRC in final form for formal approval. Approved options cannot be granted until formal approval in writing is received from HMRC. This process normally takes 4 to 6 weeks from the date of the original submission of the draft rules.

Typically, options outside the £30,000 limit are granted under a separate section of the plan rules not approved by HMRC.

In the case of unapproved options, there is no charge to income tax and National Insurance on the grant of an option provided that the option is not capable of exercise more than ten years after the date of grant. A charge to income tax and National Insurance arises on exercise on the difference between the market value of the shares acquired and the aggregate exercise price paid for them. This will have to be accounted



for under the PAYE system, if , at the time of exercise the shares acquired are what are known as “readily convertible assets”. Broadly, this means that the shares are capable of being sold easily. It is possible to grant unapproved options on terms such that the employee bears all or part of the employer’s National Insurance contributions (currently 12.8%).

The exercise of options may be made conditional on the satisfaction of performance criteria. In private companies, exercise is often dependent upon achieving an objective such as a flotation or a trade sale. Listed companies will normally follow the challenging criteria suggested by the ABI and other similar bodies.

*This summary is intended to provide a broad overview only and readers should take specific advice before applying the information contained within it.*

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