

CSOP Fact Sheet

Background

The Company Share Option Plan, or 'CSOP', was originally introduced under the 1984 Finance Act, and was known at that time as the Discretionary Share Option Scheme or Executive Share Option Scheme. It was designed to meet the needs of companies wishing to motivate and reward senior management within a company. In 1996 certain changes were made to the legislation and the plan was re-named The Company Share Option Plan.

There are over 2150 companies operating a CSOP (Source: HMRC June 2010).

It is worth noting that although there are far more CSOPs than SAYE or SIP schemes, there are far more employees participating in SAYE and SIP schemes. So although there are fewer SAYE & SIP schemes they are reaching far more people.

General Features

A Company Share Option Plan (CSOP) is a scheme under which an employee is granted a right (known as an 'option') to buy a fixed number of shares at a fixed price in a set period of time.

There would normally be an income tax liability upon the exercise of a share option. However, if the scheme is approved then there is income tax and NIC relief available for employees.

Eligibility

Discretion is given to the company as to which employees are eligible to participate and are granted options.

Limits

The total value of shares subject to an employee's options held under the CSOP or other approved discretionary scheme must not exceed £30,000 (at option price).

The price of the options is fixed at the time of grant. It must not be less than the market value of the shares and is valid for 10 years from the date of grant, but cannot be exercised in the first 3 years.

Options granted in excess of £30,000 can be held as unapproved options. Unapproved options are not subject to income tax or NIC relief.

Exercise of Option

Specific conditions can be set which must be met for an individual to be entitled to exercise his/her options. These are normally more relevant to listed, rather than private, companies. If conditions are included, they must be clearly stated at the time the option is granted. The most common conditions imposed include total shareholder return (TSR), adjusted earnings per share (EPS), pre-tax profits or turnover.

The company may sometimes arrange a loan and sale facility (known as a cash-less exercise) so that the participants can finance the exercise of options, perhaps subsequently selling sufficient shares to repay the loan.

Cessation of Employment

Since the intention of many CSOPs is to encourage an executive to stay with the company, it may often be provided in the rules of the scheme that the option would lapse if the employee left the company.

Special requirements may be included in the case of death so that the personal representative(s) can still exercise the option. They would normally have to do so within 12 months of death.

If any employee leaves through redundancy, ill health or retirement then the scheme may be set so that the employee can exercise the option within three years of grant without being liable for income tax or NIC. Employees leaving within three years as bad leavers - resignation or dismissal - may exercise if the option rules allow, but will pay income tax and NIC on their option gains.

Capital Gains Tax

After exercise there may be a liability to Capital Gains Tax (CGT) on the gain between the sale price and the exercise price. If the employee makes a profit on shares when he/she sells them, the employee may have to pay CGT on part of that profit. In general terms, the employee is liable to pay CGT on any Capital gains made in the course of a tax year.

From 22 June 2010 the flat rate of 18% only applies to basic rate tax payers. Higher rate tax payers will now have to pay a new rate of 28% CGT. Any gains less than the annual exempt amount (AEA) - £10,100 for the 2009/2010 tax year - are free from CGT.

From 6 April 2008 all shares of the same class in the same company will be treated as forming a single asset (a share pool), regardless of when they were originally acquired. However, different rules apply to assets acquired and sold on the same day and under "bed and breakfasting" arrangements.

Example:

John was awarded 10,000 options at £1; he exercises his shares when they are £3. The gain is calculated as follows:

Gain:	10,000 options exercised @ £3 =	£30,000
Less cost of option	Gain – (10,000 options x £1 (option price)) £10,000 =	£20,000
Gain		£20,000
Less Annual Exception:	£20,000 - £10,100 =	£ 9,900
Taxable gain:		£ 9,900
CGT payable Basic rate:	£9,900 x 18% =	£ 1,782
CGT payable Higher rate	£9,900x 28% =	£ 2,772

Dividends

As only options are held then there are no dividend payments until the shares are received on the exercise of the option.

Benefits Associated in Operating a CSOP

Employer:

The costs incurred in setting up an approved scheme are allowable as a deduction in computing the company's profits for corporation tax purposes.

The Finance Act 2003 made option gains of employees deductible against corporation tax.

Benefits to Employees:

Since the scheme has been approved there is no income tax liability on the granting of the option. If the option is exercised between years 3 and 10 then there is no income tax or NIC liability on the exercise of the option.