

Factsheet

Factsheet

A guide to Unapproved Share Plans

General Features

The broad structure of an unapproved share option scheme is very similar to the approved Company Share Option Plan or CSOP (see fact sheet on CSOPs). Accordingly, options are granted to individuals who are selected to participate, the option price is usually the market value of the shares under option.

The scheme will also contain provisions regarding exercise of options following the third anniversary of grant, early exercise in certain circumstances (redundancy, injury etc), the adjustment of options in the context of variations of share capital and amendments to the scheme.

Unapproved share options are normally granted where the employee has already received his full allowance of approved options (i.e. the scheme is used to 'top-up' the CSOP) or where a company cannot meet the requirements of the CSOP legislation.

Eligibility

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

Advantages of an Unapproved Scheme

There are two main advantages of an unapproved scheme:

- Flexibility
- Number of shares which can be placed under option in respect of any one participant

Flexibility

An approved (CSOP) scheme must, of course, comply with the legislation in order to obtain Inland Revenue approval. The legislation restricts the types of shares that can be placed under option (broadly the legislation requires shares to be part of the ordinary share capital of a company that is either listed or not controlled by any other company. Shares must also be fully paid up, not redeemable and not subject to any restrictions other than restrictions which apply to all shares of the same class).

These restrictions may make it very difficult for private companies to establish approved option schemes, because, for example, the company may ultimately be controlled by another company or the articles of association contain restrictions which do not fall within the exemptions in the legislation. Unapproved options are not subject to these requirements.

Extent of Participation

Under an approved scheme options with a value (currently) of up to £30,000 may be granted. Given that such option schemes are primarily designed to provide benefits to directors and senior employees this limit may mean that an appropriate level of incentive cannot be provided.

Accordingly, companies will often establish an unapproved scheme, in addition to the approved scheme to provide benefits in excess of the £30,000 limit. Benefits will not be unlimited. The Association of British Insurers' guidelines provide that the value of shares under an annual option grant (including approved CSOP options) should not exceed one times the earnings (usually basic earnings) of a participant.

Taxation - Disadvantages of an Unapproved Scheme

Unapproved schemes, since they are not approved by the Inland Revenue, will not attract the tax advantages of an approved scheme. Accordingly, an unapproved scheme will be taxed as follows:

On grant

No income tax or National Insurance charged.

On exercise

Income tax will be payable on the difference between the option price and the market value of shares at the date of exercise. In respect of options granted after 5 April 1999 over shares regarded as convertible into cash (e.g. shares in a listed company) national insurance contributions, both employer and employee, will also be payable in the same way as income tax. In relation to employer National Insurance on options, it is possible to transfer liability for this to the employee - with their consent.

On sale of sales

Capital Gains Tax (CGT) will be payable on the difference between the market value of the shares at the date of exercise and the sale proceeds.

It should also be noted that the income tax charge (and National Insurance where applicable) will be collected under the pay-as-you-earn ("PAYE") system. This means that the employer will need to account to the Inland Revenue shortly after exercise.

To ensure that the employer reimburses the PAYE due, schemes will normally provide for the automatic sale of an appropriate number of shares immediately following exercise to raise sufficient funds to meet the PAYE.

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 an Unapproved Share Scheme**Employer**

An Unapproved Share Option is flexible and offers the company the opportunity to benefit directors and senior employees more extensively than an approved CSOP.

Under the Finance Act 2003 any financial benefit ultimately enjoyed by an employee will be deductible by the company against corporation tax.

Employees:

Employees can be provided with benefits in excess of the £30,000 limit under the approved CSOP.