STEPHENSON HARWOOD

September 2022

Company Share Option Plans: mini-Budget announcements

Summary

In a surprise move, the Government has announced that the maximum award under the Company Share Option Plan ("**CSOP**") is being increased. With effect from 6 April 2023, employees will be allowed to hold options over up to £60,000 of shares, a doubling of the current £30,000 limit which has been in place for almost thirty years.

CSOP options can also be granted over special employee-only classes of shares from that date.

Background: What is a CSOP?

Tax legislation sets out four plans which give employees favourable tax treatment, as opposed to the normal income tax and National Insurance ("**NIC**") treatment, of gains they make through receiving shares in employing companies or their parent company. Other arrangements may also achieve this, but they normally involve employees paying money to acquire actual shares up-front, more structuring and/or have less certain tax treatment.

Two of those tax-favoured plans set out in legislation (the Save as You Earn Plan and the Share Incentive Plan) are all-employee plans.

The other two (Enterprise Management Incentive ("**EMI**") and CSOP) are discretionary plans where a company which is "independent" (not controlled by another company) can award share options to selected employees. The most popular is the EMI plan, but this is only available to smaller companies and not available to those in certain business sectors, e.g. finance and property development.

It is in those cases where an independent company cannot operate an EMI plan that the final scheme, the CSOP, may be worthwhile, although an EMI plan offers significantly better benefits and should be used in priority. Under a CSOP employees can hold options over up to £30,000 of shares (to rise to £60,000 on 6 April 2023). The exercise price (i.e. the price that employees must pay to exercise or buy their shares in due course) must not be less than the share price when the option is granted. Companies also commonly set employment and other conditions that must be met before employees can receive shares.

What is the favourable tax treatment a CSOP offers?

When an employee exercises a CSOP option in qualifying circumstances (normally after having held the option for at least three years but also on a cash sale of a company), any gains are free from income tax and NICs.

Instead, normal capital gains tax rules apply when the shares are sold. The first £12,300 will be tax-free due to the capital gains annual allowance (if not already used) and then any balance will be taxed at 10% or 20% depending on the taxpayer's other income and gains.

Accordingly, a CSOP can provide a considerable tax and NIC saving for both employer and employee, particularly if a large number of employees is involved, although not as much as an EMI plan is able to deliver. A corporation tax deduction for the gain an employee makes is also available.

Will much change because of the increase to £60,000?

While welcome to those that are already using the schemes, an increase in the limit is probably not going to persuade many companies without a CSOP to adopt one.

- First, subject to a small change being proposed below, no structural change is being made to the CSOP scheme. Companies still have to be independent to use the scheme and that excludes a large number of companies from using it, particularly private equity owned companies. There is no change proposed to this core requirement.
- Secondly, for many companies, options with market value exercise prices have fallen out of fashion as a remuneration tool. This is particularly for quoted companies over recent years. It is not clear that the tax benefits of a CSOP option would outweigh the perceived remuneration shortcomings.
- Finally, with salary and bonus inflation over the last few years, for some companies the maximum CSOP option over £60,000 of shares (where the share price needs to double to provide a gain of £60,000) will still not incentivise participants sufficiently. While clearly a £60,000 award is better than the current £30,000 maximum, and for many employees in the current environment any increase in remuneration or award at that level would be welcome, the limit increase may not be enough to shift the balance in favour of a company using a CSOP scheme as part of its remuneration needs.

What is the other change being made?

Currently, CSOPs cannot be operated using an employee-only class of share.

This was designed to prevent employees receiving inferior shares – if they receive shares, they have had to receive the same shares as investors.

However, this blanket ban has not prevented determined companies from operating CSOPs. Share classes designed for employees can already be created in ways which do not infringe legislation. Nonetheless, ideas are already circulating about how to take advantage of the increased £60,000 award limit and this change on employee-only classes of shares in tandem, and thereby provide some structured solutions in both private and listed companies.

Comment

Companies which already operate CSOPs should consider increasing their award limits and, if desirable, top up existing awards made to employees. Scheme rules will often cap maximum awards by reference to the limit set under tax legislation from time to time, and so will automatically be amended on 6 April 2023, but some schemes may require active Board and/or shareholder approval to make these changes.

For other companies, these two changes to CSOPs are welcome but do not go to the core issue for both CSOPs and EMIs (or indeed any tax-favoured share plan) which is that only "independent" companies can operate them. A large number of companies have controlling corporate shareholders and so are excluded from these schemes. Regardless of company size or other factors, the need for company independence seems an outdated restriction on operating share plans. It is hoped that the Government, having now proved willing to amend tax legislation, will in due course focus on how other underlying policy issues can be targeted more effectively.

Please see our recent articles The not so "mini" budget: what does it mean for employers? and Nothing 'mini' about it for more details on the mini-budget.

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