Field Fisher Waterhouse

Unapproved share options

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What does unapproved mean?

There are various HM Revenue and Customs (HMRC) employee share and share option plans that are tax advantaged. Apart from enterprise management incentive (EMI) arrangements, these other tax advantaged plans have to be approved in advance by HMRC and so they are known as approved plans. Plans other than approved plans or EMI are known as unapproved plans.

An unapproved share option plan allows companies to grant share options to employees and others. In contrast to tax advantaged plans:

- unapproved plans can be more flexible, although there are some restrictions, but
- they do not benefit from tax advantages.

Flexibility

The flexibility of an unapproved share option can be seen by comparing it with an option under, for example, an HMRC approved company share option plan (CSOP). In contrast to an option under a CSOP:

- An unapproved option can be granted to a participant over shares with a value, at the date of grant, in excess of £30,000 (this is the limit under a CSOP).
- The exercise price can be set at below market value at the date of grant (although if the option is over new issue shares under UK company law it cannot be set at below par value).
- There is greater flexibility when setting exercise and lapse conditions.
- Unapproved options can be granted over shares in any subsidiary company.
- A wider category of participants can receive unapproved options.

Similarly, if an EMI arrangement cannot be used because the corporate or individual qualifying conditions cannot be met, an unapproved share option plan can be used as an alternative.

Taxation

No income tax is payable on the grant of any type of employee share option to UK employees.

However:

- Income tax is payable on the exercise of an unapproved option on the difference between the exercise price and the market value of shares at the date of exercise.
- National insurance contributions (NICs) are also payable on exercise when the option shares are regarded as being convertible into cash (a wide range of factors is taken into account by HMRC including whether or not there is an internal or external market in the shares.
- When the shares acquired on the option exercise are sold it is only the increase in value from the date of exercise that may be subject to the more favourable capital gains tax (CGT) regime.

Under tax advantaged plans, there is usually no income tax or NICs charge when an option is exercised, and the whole increase in value above the exercise price is taxed under the CGT regime when the shares are sold.

Why unapproved options?

In summary, typical reasons are:

- To benefit participants who are ineligible under tax advantaged plans.
- To provide "top-up" options over shares in excess of the individual participation limits in tax advantaged plans.
- To provide options over shares in a subsidiary company in cases that are not permitted under tax advantaged plans.
- To provide options over types of shares that do not qualify for use under tax advantaged plans.
- As a simpler alternative to other plans.

How we can help?

The Equity Incentives team at Field Fisher Waterhouse can advise on whether or not a tax advantaged share or share option plan is possible for your company and, if not, on alternatives. We can prepare documentation and deal with HRMC notifications. We can assist with other aspects of introducing equity incentive arrangements.

Contacts

For further information, please call the Equity Incentives team on +44 (0)20 7861 4717 or contact:

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As a member of the HM Treasury employee ownership advisory group, the head of our team, Graeme Nuttall, helped HM Revenue and Customs develop and introduce the share incentive plan (SIP) and the enterprise management incentives arrangement. He also drafted the Employees' Share Schemes Bill, a successful private member's bill enacted as the Employees Share Schemes Act 2002 that increased the tax effectiveness and democracy of SIPs.

The Field Fisher Waterhouse Equity Incentives team has substantial experience in all aspects of employee benefits, including equity incentives. We have particular expertise in advising on creating and sustaining employee ownership solutions for a variety of businesses.

Through our German and Belgium offices and our other overseas affiliated and associated offices we advise on international share plans.

EQUITY INCENTIVES

www.equityincentives.co.uk

Our Equity Incentives website is a valuable information source on different types of employee share and share option plans and includes a number of briefing papers, case studies and other helpful information.

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