

Non Tax-Advantaged (Unapproved) Share Option Plans



OVERVIEW

Rewarding employees with shares is a motivating factor and, if 'approved' (by HM Revenue & Customs), can be a tax efficient form of remuneration.

An unapproved option is an option which does not have tax favoured status under an enterprise management incentive ('EMI') option plan, approved executive option plan or under an approved savings option plan. However, they are very flexible and simple to administer. Approved plans carry significant tax advantages for the employee and should therefore be considered in priority to issuing shares under an unapproved scheme, though approved plans tend to favour smaller businesses and do carry an administrative burden.

Grant of Unapproved Options

There is no income (or other) tax charge on grant of an unapproved option.

There is an obligation for the issuing company (and the subsidiary if applicable) to report the grant of the options to HM Revenue and Customs ('HMRC') by 6 July following the end of the relevant tax year. The transaction is recorded on a Form 42.

Exercise of Option - Income Tax

On exercise of the option, income tax will be chargeable on the difference between the market value of the shares at the date of exercise and the exercise price of the option.

Unless withholding obligations apply (please see below) the income tax will be payable by the employee through their self-assessment tax return for the relevant tax year.

Exercise of Option - National Insurance Contributions ('NICs')

If the shares under option are in, broadly, (i) a listed company (ii) a company which is controlled by a privately held company or (iii) a company with arrangements to be sold or to be listed, the shares are regarded as 'readily convertible assets' ('RCAs'). Employer and employee NIC will be payable in this circumstance on the difference between the market value of the shares at the date of exercise and the exercise price of the option.

Employees currently pay NIC at 12% / 2% and employers at 13.8% depending on earnings.

A higher rate taxpayer who under the option agreement also had to meet the employer's NIC liability, would suffer an effective rate of tax and NICs of >50%.

Withholding Obligations ('PAYE')

At exercise there are withholding obligations for the employing company if the shares are RCAs. It is common to provide a mechanism for withholding in the option documentation.

The exercise of options must be reported to HMRC by 6 July following the end of the relevant tax year. The transaction is recorded on a Form 42.

Sale of Shares

On the subsequent sale of shares there will be a charge to capital gains tax ('CGT') on the difference between the price received for the sale of the shares and the market value on the date of exercise of the option. If an unapproved option is exercised and the shares sold on the same day then there should be no CGT to pay.

The employee can use their annual allowance (£11,100 for 2015/16) such that only gains in excess of this amount will be subject to CGT. Gains are then taxed at 18%/28% depending on the individual's level of income.

The CGT rate applicable could be 10% providing the employee owns at least 5% of the shares for a period of 12 months before disposal.

Corporate Tax Deduction

The employing company will be able to claim a corporation tax deduction for the difference between the market value of the shares at the date of exercise and the exercise price of the option, subject to certain conditions.

How can Rawlinson & Hunter help?

There are many ways to give employees the opportunity to participate in the growth of the company which can have a positive impact on their motivation. Depending on the size and nature of the business, approved share options could be issued and will give rise to a lower tax charge on the individual. Unapproved option arrangements are however very straightforward to implement and this should never be overlooked. Whether approved or unapproved, with our extensive experience in this area, Rawlinson & Hunter are well placed to advise.

If you are interested in further information in this regard, please call the Rawlinson & Hunter partner who normally acts for you. Where you are not one of our regular clients, please contact Craig Davies or Andrew Shilling, who would be delighted to discuss this with you in more detail.

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