How do Employee Stock Option Plans (ESOPs) work in the UK?

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Overview

- Share issues to UK resident employees
- Option grants to UK resident employees
- Scheme design
- Tax treatment
  - Non tax-advantaged
  - Tax-advantaged
- EMI Options

Share issues

- Direct equity acquisition – become a shareholder immediately
- "Employees"
  - Includes executive and non-executive directors
  - Includes former, current and prospective employment
  - Includes associated persons
- Unrestricted market value acquisition
  - No tax implications on acquisition
  - s431 election
- Acquisition for less than market value
  - Tax on acquisition
  - s431 election
- PAYE/NICs (i.e. payroll withholding) vs Self Assessment

Option grants

- Right to acquire shares in the future at an exercise price
  - Exercise price: amount payable to exercise option
- Terms agreed on grant
- Non tax advantaged schemes / “Unapproved” schemes
  - Discretionary
  - Flexible terms
- Tax advantaged schemes / “Approved” schemes
  - Must meet statutory requirements
  - EMI and CSOP = discretionary
  - SIP and SAYE = must be offered to all qualifying employees
- Employer’s national insurance contributions can be passed on
- Corporation tax deductions
- Internationally mobile employees

Option grants

Scheme design

- Exercise conditions
  - Exit only (e.g. sale or listing)
  - Performance-based (e.g. company financial targets being hit)
  - Time-based (e.g. 25% annually)
- Vesting
  - Part of an option is ‘banked’ and can be exercised once exercise condition is met
    - Tranches
    - On exit
    - To extent a performance condition is met
  - Automatic acceleration on exit / Board discretion to accelerate / no acceleration
- Leaver provisions
  - Lapse
  - “Good leavers” e.g. death, illness or disability, retirement, redundancy or sale of business out of the group

Option grants

Tax treatment - non tax advantaged options / “Unapproved” options

- Option grant and vesting
  - Generally no tax liability

- Exercise of option
  - Tax liability = market value at exercise date less exercise price

Option grants

Tax treatment – EMI options (tax advantaged)

- Option grant and vesting
  - Generally no tax liability

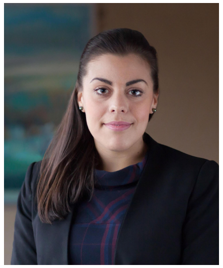
- Exercise of option if qualifying
  - Market value exercise price (at grant) = no tax/NICs on exercise
  - Discount to market value exercise price (at grant) = income tax and NICs limited to that discount
  - Growth capital gains tax
  - Business Asset Disposal Relief – 10% capital gains tax (vs potentially 20% capital gains tax)

EMI Options

Main conditions

- Smaller companies – 250 employees, gross assets <£30m
- Independence (i.e. not under control of another corporate)
- Option agreement
- Employees only – <u>not</u> NEDs
- Amendments to EMI options – avoid at all costs!

Contact Information



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