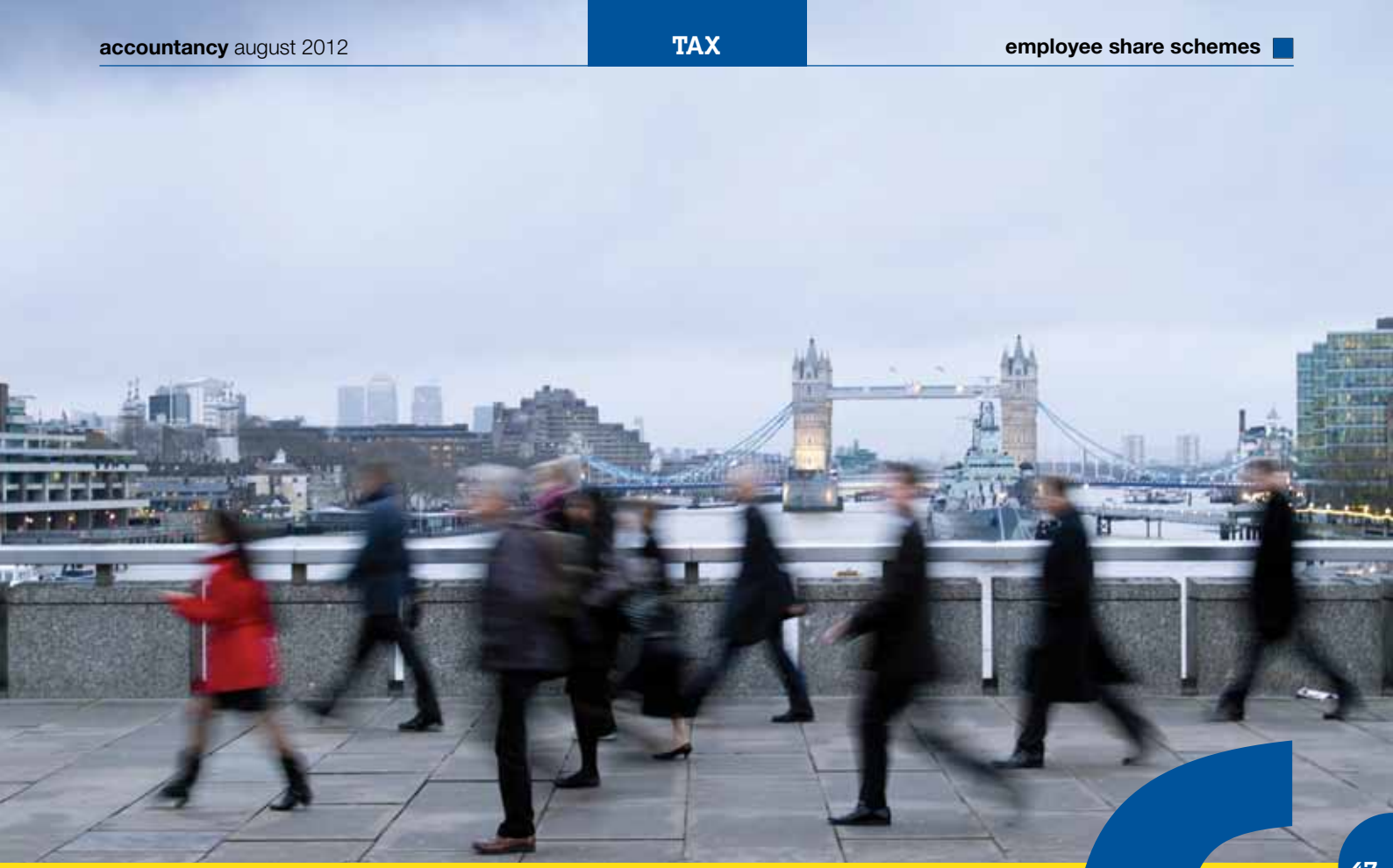

CALLING TIME ON THE CSOP?

Employee share schemes have been fraught with complexity so a new consultation should clear the ground for a fresh approach, says Lawrence Green

HMRC has at last published its response to the recommendations made by the Office of Tax Simplification (OTS) for reducing the complexity of tax-advantaged share plans. The proposed changes are a very welcome move towards simplification and harmonisation, and for the most part do not involve radical change. The one exception to this is the possibility that Company Share Option Plans (CSOP) will be abolished.

To set the scene, the four plans affected by the proposals are all designed to facilitate the acquisition of shares by employees in their employing company:

- **Share incentive plans (SIPs)** – these can be used to give tax-free shares to employees and to allow employees to purchase shares out of pre-tax income. The values involved are relatively small and the plan has to be available to all eligible employees;
- **Savings-related share option schemes (often referred to as SAYE or Sharesave)** – like SIPs, these have to be offered to all eligible employees and allow employees to save a limited amount out of post-tax income to fund the exercise of share options (which can be granted with an option price at a 20% discount to market value);
- **Company share option plans (CSOPs)** – originally designed for executive share options but the £30,000 value limit has reduced its relevance; and
- **Enterprise management incentive (EMI) schemes** – very flexible with more generous tax advantages than CSOPs, but limited to smaller companies.

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Company share option plans were originally designed for executive share options but the £30,000 value limit has reduced its relevance

The four plans affected by the proposals are Share Incentive Plans (SIPs), Savings-Related Share Option Schemes (SAYE or Sharesave), Company Share Option Plans (CSOPs) and Enterprise Management Incentive (EMI) schemes.

COMPANY A

SIPs
Company A wants to give away some of its shares to its employees provided that they remain employed for a set period. It decides to use a SIP to deliver a fixed number of shares to every employee worth up to £3,000. The shares must be retained in the SIP trust for five years to gain full tax-free status for the shares and the company specifies that the shares will be forfeited if the employee leaves in the first three years.

COMPANY B

SAYE/Sharesave
Company B wants to give all its employees an opportunity to buy its shares on favourable terms. It might offer employees the opportunity to either:

- save up to £250 a month out of post-tax earnings for three or five years and at the end of that period use the money saved to exercise an income tax-exempt SAYE option granted at the outset at a discount of up to 20% of the market value of the shares at that time; or
- buy shares out of pre-tax income worth up to £1,500 a year under a SIP and give up to two matching free shares for every one purchased. The shares must be retained in the SIP trust for five years to gain full tax-free status for the shares and the company specifies that the matching free shares will be forfeited if the employee leaves in the first three years.

HOW THE PROPOSALS WILL WORK IN PRACTICE

The OTS was asked to address the problem with the detailed rules governing these plans which have built up in an uncoordinated fashion. As a result, the plans are unnecessarily complex and can be expensive to implement. The OTS published its recommendations in March and HMRC has now revealed its response in a further consultation document.

CSOPs

The OTS questioned the continued relevance of CSOPs. The original purpose was to encourage companies to offer equity incentives to selected executives in order to promote the success of those companies. It is questionable whether the tax advantages granted to this plan are necessary to achieve the original objective and, in practice, the £30,000 individual limit and the inflexibility of the CSOP has reduced this plan's relevance and use.

However, some companies have used CSOPs to grant market value share options to a wide cross-section of less senior executives and/or the wider workforce to give them a modest equity stake in their employer that is conditional on continuing employment with the company. This avoids the problem of low take-up that can be an issue for companies offering SIPs and SAYE.

The government has taken the OTS comments on board and it is now up to companies that wish to continue to use the CSOP to make the case for its retention through the consultation process. The OTS also recommended merging the CSOP and EMI schemes. This would make some sense as these are the two plans that can be targeted at key employees. However, even on the basis of the OTS recommendations, there would be two strands within the merged plan, which could cause some confusion:

- One strand for all companies based on the CSOP and with the same individual £30,000 value limit; and
- Another strand based on the EMI options available to smaller companies with the current higher EMI individual limit of £250,000.

This suggestion will not now be addressed until the fate of the CSOP is announced in autumn 2012.

Merging the CSOP and EMI schemes would make some sense as these are two plans that can be targeted at key employees

ACCEPTED IN PRINCIPLE

A number of OTS recommendations for simplification have been accepted and are in the HMRC consultation. These include:

- Elimination of the cumbersome HMRC approval process for SIPs, SAYE and CSOPs. This will be replaced by a streamlined self-certification process (already used for EMI options). This exercise will be combined with examining the OTS recommendation for creating a single annual return for all tax-advantaged schemes operated by a company, including on-line filing and in time moving to real-time recording instead of an annual return; and
- Harmonising the approach to retirement across SIP, SAYE and CSOP (the EMI rules are so flexible that they aren't affected).

OPEN FOR REVIEW

There are a large number of other OTS recommendations on which the government has yet to make up its mind, pending the outcome of this consultation. These include:

- Extending the tax advantages of CSOPs, SAYE options and SIPs to apply when a takeover

COMPANY C

CSOP
Company C wants to give all its employees an equity interest in the Company's shares but doesn't want to give the shares away. It decides to grant all employees an income tax-exempt CSOP option with an option price set at the market value of its shares, exercisable three years after the grant of the option. Company C can choose to give greater allocations of options to senior management (up to a maximum of £30,000 worth of shares each) and may impose performance conditions that have to be satisfied before the options are exercised.

COMPANY D

EMI
Company D wants to give all its employees an equity interest in the company's shares but the company is smaller than Company C, with fewer than 250 employees and gross assets of less than £30m. It decides to grant all employees an income tax-advantaged EMI option with an option price set at a discount to the market value of its shares, exercisable in stages over the three years from the grant of the option. The growth in the value of the shares is income tax-exempt when the options are exercised. Company C can choose to give much greater allocations of options to senior management (up to a maximum of £250,000 worth of shares each) and may impose performance conditions that have to be satisfied before the options are exercised.

occurs before the end of the usual restricted period, which varies from three to five years (EMI options don't have a restricted period and so are unaffected);
- Giving more flexibility on the types of share that can be used for SIPs, SAYE and CSOPs (replicating some of the flexibility that already exists for EMI options);
- Increasing the flexibility in the operation of SIPs – in particular allowing more choices when calculating the price at which participants can purchase shares and removing the cap on reinvesting dividends on SIP shares back into the plan; and
- Extending the period during which EMI options can be exercised on an income tax-free basis after a 'disqualifying event' (such as the participant leaving employment) from 40 days to six months.

The OTS also recommended that the requirement for a company to appoint a carrier for SAYE savings contracts (which can be prohibitively expensive for smaller companies) be included in the review on the wider application of employee share ownership among smaller private companies by the Department of Business, Innovation and Skills (BIS). This is not included in the consultation process but has been referred to BIS and hopefully there will be more progress on this. Given that the current rate of interest on these accounts is 0%, this requirement has limited relevance in today's market.

REJECTED MEASURES

The OTS made a number of recommendations that would have had a significant cost to the Treasury and most of these have been rejected due to the cost or the danger of abuse. These include:
- Reducing the holding period for SIP shares from five to three years;
- Removing the 25 hour per week working time eligibility requirement for EMI for non-director employees;
- Relaxation of the 'excluded activities' that prevent certain types of company from granting EMI options; and
- Allowing participants under SIP, SAYE or CSOP, other than those who leave because of voluntary resignation or dismissal with cause, to be considered 'good leavers' and, therefore, benefit from the tax-advantages of the relevant plan. However, the government does propose that the 'good leaver' circumstances for SIP, SAYE and CSOP are harmonised to the position that currently applies for SIP, as this covers the widest range of circumstances of leaving.

The Seed Enterprise Investment Scheme gives valuable tax breaks but is not the easiest system to navigate. See p52

It started with a SEIS

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CONSULTATION

The consultation period ends on 18 September. The government will publish the outcome in autumn 2012, with draft legislation being published for further consultation (with a view to it being included in the 2013 Finance Bill). Although it is anticipated that most changes will take effect in 2013, some aspects (such as changes to the approval process) may take a longer, with implementation continuing into 2014 if necessary.

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