Share options: making the right choice

Share options are a popular way to incentivise staff and drive business growth. Here we highlight the respective merits of four different types of option.

Share options – a right to buy shares at some point in the future – can be effective in retaining and motivating key employees. However, there are different types to consider before choosing a share options scheme (or plan) to offer.

Unapproved share options
These commonly used schemes are offered at a fixed price (or strike price) – usually the market value of the shares on the date the option is granted.

For most schemes, the option holder will pay income tax on the difference in price between the strike price and actual market value of the shares when they exercise their option.

National insurance contributions (NICs) will only be due if shares are deemed readily convertible assets, which means that they can easily be sold quickly to generate cash – for example, if the shares are traded on a stock exchange. If shares are sold, there will be liability for capital gains tax (CGT) on any profits arising since the time the option was exercised.

These schemes are attractive to employers because they offer the discretion to tailor qualifying conditions for share recipients, such as meeting various performance targets.

Growth shares
While technically not options, growth shares are generally used in the same way as options, so we have included them here. Favoured by start-ups and for employees who do not qualify for enterprise management incentive (EMI) schemes (see below), growth shares allow recipients to benefit only from the growth in value of their company's shares, rather than the value at the time the shares were granted.

The employee pays CGT on the increase in value between when the shares were issued and when they eventually sell them. To ensure employees aren't also charged income tax, companies must change their articles of association to record the growth shares as a new class of B or C shares.

That record must make it clear that the growth shares only participate if the value of the company shares rises above a specific value threshold, known as the growth hurdle. This ensures the shares have a low value at the time of issue, which is important as employees are taxable on the value of the shares when issued to them (unless they pay an amount equal to the value of the shares when subscribing for them).

Enterprise management incentive (EMI) schemes
These schemes are popular because they come with tax savings. So long as the market value of the shares is agreed by HMRC when the options are granted, the option holder doesn't pay income tax or NICs on exercise, providing the shares are bought for at least the market value when the options are granted.

CGT on the sale of the share also reduces to 10% (based on Business Asset Disposal Relief being available). The capital gain is the difference between the sale price for the shares and the strike price of the options, meaning that the exercise gain – which is subject to income tax and potentially NICs in an unapproved option scenario – is also only subject to CGT for EMI options.

Company share option plans (CSOPs)
With no limits on company size or number of employees (unlike EMIs), these plans can be used by larger companies, listed organisations and those whose trade excludes them from EMIs (such as accountancy or banking businesses).

Options can be exercised without any income tax or NICs liability arising provided certain conditions are met. The conditions are met if the option is exercised within 10 years of grant and:

- the exercise is at least three years after the grant date, or
- it is within six months of cessation of employment for certain "good leaver" reasons
- it is done by the participant's personal representatives within 12 months of death, or
- it is within six months of certain cash takeovers.

Please do get in touch with one of Shipleys' share option schemes specialists to find out more.