A quick guide to share options

Share options often become a key part of the strategy for start-ups and fast-growth businesses. We look at the different schemes available, the benefits and the tax implications.

With many sectors facing fierce competition for the best talent, share options can be a good way to remunerate, retain and motivate key employees.

A share option is the right to buy a certain number of shares in a company, at a fixed price, sometime in the future. The potential value of the shares encourages employees to take greater interest in the performance of the business and can help to keep offers from head-hunters at bay.

Options often come with conditions such as shares reaching a target price before they become available, or employees having to stay with the company for a specified time or achieving specific performance targets.

Options v shares

Options are a right to buy shares in the future, which is very different to letting someone buy shares immediately. The latter would mean they become a shareholder with voting rights and dividend payments.

No money changes hands when options are granted: an option-holder (usually an employee) only pays the pre-agreed fixed price (strike price) when they convert their option into shares. The strike price is usually a discount on the market value at the time the options were granted.

Share options and taxes

The main share option schemes for small and medium-sized businesses are the Enterprise Management Incentive (EMI), Save As You Earn (SAYE) and the Company Share Option Plan (CSOP).

Tax is only charged when options are exercised, ie, when the shares are bought. Outside EMI-related schemes, the employee will pay income tax and NICS on the difference between the strike price and actual market value of the shares when they exercise their option. If they sell their shares, they'll be liable to capital gains tax (CGT) on any profit. For employers, there should be no tax cost (subject to certain conditions).

EMI schemes are popular because they are backed by HMRC and come with tax benefits. If the market value of the shares has been agreed by HMRC when the options were granted, the option holder doesn't pay the income tax or NICS. This is as long as the shares are bought for at least the market value when the options were granted.

CGT on the sale of shares also reduces to 10% (based on business asset disposal relief being available) and the company pays no CGT on the options either. Another bonus is that corporation tax relief is available on EMI share schemes where the qualifying shares are acquired upon exercise of the option.

Don't fall foul of HMRC

Failure to agree a fair market value for shares with HMRC runs the risk of negative tax implications later. Here's an example: a funding round takes place at a business and the shares are sold at £5 per share. If at a later date it was decided to grant EMI options at £2 per share, HMRC would argue the market value at the time of granting the options was at a discount. It would then be difficult to prove the £2 valuation to HMRC.

Timing is everything

Timing is particularly important for fast growth start-ups facing imminent or multiple funding rounds. Ensure approval of share option valuations are obtained at the right time for your business.

If the company is not able to qualify for HMRC-approved option schemes like EMI, there are still ways to use shares to incentivise employees. To find out more, please get in touch with Hannah Van Ross or go to the Shipleys website at: *https://tinyurl.com/33txapck*