

EMPLOYEE SHARE SCHEMES

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By **granting shares**, or **options** over shares, to valuable employees, an employer can generate **incentives** for those employees to help build a successful business.

Share Option Schemes have been **tax favoured** in the UK for many years, with successive governments seeing the advantages to future tax revenues of a motivated work force.

However, **not all share option schemes have tax advantages**. We outline here the framework of the main share schemes available.

UNAPPROVED SHARE OPTION SCHEMES

- In general, if an employer gives an employee **shares**, except under an approved scheme, the employee is usually **taxable** on the **value of the shares** at the time.
- If the employer enables the employee to acquire shares at **less** than their market value, then the **value discounted is taxable**.
- If a share **option** is awarded, except under an approved scheme, there is also a **possible income tax** charge. Generally, this occurs on grant if the option can last more than ten years, and the option is awarded at below current market value.
- In addition, an **income tax** charge can arise on **exercise of an option** if the market value at exercise exceeds the option price. Any tax paid on grant is offset against this charge.
- If the employee holds the **shares** after exercising the option, and sells them at a profit, this is subject to **CGT**. The acquisition cost is the total of the amount paid for the shares, the amount paid for the option, and any amount already taxed as income because the shares were bought for less than their market value.

COMPANY SHARE OPTION PLANS (CSOPs)

- CSOPs (formerly Executive Share Option Plans) are available for use by all companies regardless of size and type of trade.
- Selected employees are granted an option to purchase shares at a future date but with the price fixed at outset and usually being market price at date of grant.
- Any executive not owning more than 10% of company voting rights can be granted options.
- The value of shares (market value at date of grant) under option to each employee must not exceed £60,000 (£30,000 before April 2023).
- The option must be exercised between 3 and 10 years after grant.
- Provided the requirements are met, no income tax or NIC arises on the award of options.
- Shares acquired on the exercise of options are subject to the normal CGT regime. For CGT purposes the base cost is the amount the employee pays for the shares, not the market value.

SAVE AS YOU EARN (SAYE)

- The SAYE scheme must be open to all employees with at least 5 years service and uses a SAYE contract.
- Savings from £5 up to £500 per month are possible with a building society or bank under an SAYE contract with interest earned tax-free.
- The proceeds can be used to buy shares on the exercise of options after 3 or 5 years, when the SAYE contract ends. The exercise period can be up to 6 months.
- Shares can be purchased at a discount of up to 20% of the share price when the option was granted.
- Provided the requirements are met, no income tax or NIC arises on the award of options.
- Shares acquired on the exercise of options are subject to the normal CGT regime. For CGT purposes the base cost is the amount the employee pays for the shares, not the market value. However, shares transferred into an ISA (amount for ISA limits based on the market value at transfer) within 90 days of exercise will not be subject to CGT by concession.
- The employee will only begin to accrue business taper relief on the shares from the date the option is exercised.
- The scheme proceeds can be taken as cash, rather than used to buy shares; this may be desirable if the value of the shares falls during the term.



SHARE INCENTIVE PLANS (SIPs)

- A SIP must be open to all employees on the same basis, but the company can apply a qualifying service period of up to 18 months.
- The maximum value of shares that can be appropriated to one employee in tax year is divided as follows:
 - **Free shares** from the company - £3,600
 - **Partnership shares** purchased by the employee from pre-tax income - £1,800 (maximum 10% of salary)
 - **Matching shares** allocated in proportion to partnership shares, up to 2:1 - £3,600
 - **Reinvested dividends**, tax free
- Providing the shares are held in trust for 5 years after appropriation then there is no income tax charge on withdrawal.
- Provided the requirements are met, any gains arising whilst the shares are held in trust will be free from CGT, income tax and NIC.
- If shares are withdrawn within 3 years then there will be an income tax and NIC charge based on market value of the shares at that time.
- If the shares are withdrawn within 3-5 years then there will be an income tax and NIC charge on the lower of the share value at appropriation and the value at the date of withdrawal.
- Shares must be taken out of the plan when employees leave (unless due to redundancy, disability, retirement or death). If this is within three years of starting the plan, they may lose the free and matching shares.
- The advantage to employers is that shares can be allocated on the basis of performance, and there is also a tax and NIC saving on the salary effectively paid as free shares.
- However, SIPs can involve a considerable amount of administration for a fairly low level of benefit.



ENTERPRISE MANAGEMENT INCENTIVE (EMI) SCHEME

- The EMI scheme is specifically aimed at the smaller higher risk company and provides greater benefits and more flexibility than a CSOP. EMI schemes are available to qualifying trading companies with gross assets not exceeding £30million.
- The value of share options awarded to each individual must not exceed £250,000 at date of grant.
- The maximum total value of unexercised options over the company's shares must not exceed £3million.
- The employee must spend at least 25 hours a week working in the business, or, if less, at least 75% of their available working time.
- EMI options cannot be granted to an employee if he has, together with associates, at least a 30% equity interest in the company.
- The options can be granted conditionally subject to performance.
- There is no minimum holding period but the maximum is 10 years.
- The grant and exercise of options is free from income tax and NICs, where the options are granted at or above market value.
- Any profit on exercise is subject to CGT not income tax.
- The scheme does not need prior Inland Revenue approval but notice of each grant of options must be given to the Inland Revenue within 92 days.
- Gains made on shares acquired through exercising EMI options after 5 April 2013 are eligible for Business Asset Disposal Relief – effectively bringing the applicable CGT rate down to 14% (18% from 6 April 2026).



EMPLOYEE SHAREHOLDER STATUS

Since September 2013, employers have been able to offer '**employee shareholder**' employment status. Employees are not forced to take this up, but it may be that new jobs can be advertised only on this basis. Please note that this is **not a share option scheme**, and does not require prior approval from HMRC. However, **special tax considerations do apply**.

Employees can give up some of their statutory employment rights such as protection against unfair dismissal, redundancy pay, rights to request flexible working.

For this, employers grant a minimum of £2,000 of full shares in the company (income tax and NIC might be due on grants above £2k, or for grants after 1 December 2016). There is no maximum. For agreements made before 17 March 2016, gains on these shares are CGT free up to a share value granted of £50k. For agreements made from 17 March 2016, the employee is only liable to CGT on gains, on these shares, over £100,000 made in their lifetime.

Employers must fund independent legal advice for the employee before they make the decision whether to give up rights, which they pay for regardless of the decision the employee then makes.





Important Information: Our views are based upon our understanding of current legislation in England, unless stated otherwise. Levels and bases of, and reliefs from, taxation are subject to change and their value to you will depend upon your personal circumstances.

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