

Unapproved (non tax-advantaged) options

An employer's guide



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As with any other discretionary option plan, an unapproved share option plan involves the granting of a specific number of options to an individual. These options will provide that the individual can, at an agreed date or point in time, acquire a given number of shares (the underlying shares) for a fixed price.

Given that there is both no upfront cost to acquiring the options and no requirement for the individual to pay over any money unless the underlying shares increase in sufficient value there is little risk attached to the receipt of options.

Key considerations

- o Under an unapproved plan, there is no limit as to how many options are granted.

Grant of options

- o The terms of the options will need to be set out in a suitable legal document (known as the Rules or option agreement). The Rules will govern all pertinent matters between the company and employee.
- o One of the key terms will be the price that the individual has to pay to acquire the share (the exercise price). No tax arises on the granting of share options. As a result, the exercise price can be set at any figure from a share's nominal value upwards.

Terms of the options

- o As the Rules of an unapproved plan do not have to be agreed with HMRC, they can be drafted wider than for approved plans and can often better reflect the commercial terms of the issuing company.
- o You can decide on matters such as length of the option period, vesting conditions and leaver provisions.
- o The option period will run from the date the options are granted until an agreed date in the future, or an

exit event. The period can run to any length of time.

- o You may include vesting conditions i.e. particular requirements that must be fulfilled before the employee can exercise the option and can be broken down into two broad areas: time requirements and performance conditions.

- o Time requirements will set out the period during which the option must be held before exercise can occur. This will be a commercial decision and will reflect the minimum length of time that the company would wish the employee to hold the option before acquiring the underlying share.
- o Options do not need to vest all at the same time and, often, there may be a

phased approach such that only a proportion of the options can be exercised at particular dates in the future.

- Even where the options are within the window in which they could be exercised based on the time requirements, some of the options may still not be considered to have vested if the additional performance conditions are not also met. Performance conditions can either be personal to the individual or be based on corporate performance. In order to avoid uncertainty, any performance condition should ideally be capable of objective measure.

- Leaver provisions will govern what rights an employee has in respect of keeping the options on leaving employment or other association with the company. As options will typically be offered as part of a retention package to employees, directors or consultants, the leaver provisions will often be drafted such that all the options lapse on employment ceasing.

Exercise of the options

- Broadly speaking, on exercise, there will be a tax charge for the employee or non-exec equal to the difference between the price paid

for the share and the market value of the underlying share acquired on the date of exercise.

- Unless the underlying share acquired is a readily convertible asset (RCA) there should be no NIC due on employee or employer. Shares would be RCAs where there is a ready market or buyer for the shares (usually only on an exit event).
- In addition to the exercise price, the employee will, at the relevant date, have to pay the tax/NIC liability on acquiring the shares. However, if, as terms of the share acquisition, some of the shares cannot be sold by the time that the tax is due, this will mean that the employee will have to find the necessary funds from other sources.

Tax treatment and reporting

Tax on company

- The granting of the option is not a taxable event for the Company other than Employers' NIC will be due from the company on the exercise of the option if the underlying share acquired is an RCA. Where this is the case, Employers' NIC will need to be paid over to HMRC in the PAYE payment that relates to the tax month in which the option is exercised. Very often the employee will indemnify the company for the Employers' NIC.

- A corporation tax deduction should be available for the company (as per CTA 2009, Pt 12) equal to (a) the amount assessed liable to income tax on the individual employee and (b) any Employers' NIC paid over.

Tax on individual

- The receipt of options, for a UK resident individual, is not a taxable event for the individual employee.
- Income tax will be due on the difference between the exercise price and the relevant market value of the underlying share acquired on the date of the exercise.
- Where the share acquired is a RCA, the income tax and Employee's NIC will initially be paid over to HMRC by the employing company, with the employee due to refund these monies within 90 days in order to avoid the additional charges due for late reimbursement.
- Where the underlying share is not an RCA, only income tax will be due. This will need to be paid via the employee's self-assessment tax return (SATR) in the normal manner.

How we can help

We can draft your unapproved option agreement. We are able to offer realistic fee rates that suit growing entrepreneurial companies. Typically, we can deal with the documentation by phone, post and email. We take care of all the scheme documents you need. Fees – a fixed fee of £895 + VAT.

'Jerry set up our EMI scheme and I can't recommend him highly enough, Jerry provided us with all the advice, documentation and dealt with HMRC to get us heavily discounted options.' – Paul Thomas, Cupris Software

'We chose the Mill Consultancy to create our share scheme based on the all-inclusive package (i.e. including the company valuation and having no hidden extras) and the price which was extremely competitive. We were very happy with our decision. Jerry at Mill Consultancy was fast and effective whilst always maintaining great communication and being happy to help with any questions we had. What to a small company had seemed a daunting task turned out to be a very smooth procedure indeed and all thanks to Jerry for that. It is very easy to recommend the Mill Consultancy to you for your EMI share scheme.' - Rodney Higgins - CEO - VSR2 Limited

Pricing matrix – fixed fees - All fees are plus VAT

Growth Share scheme - £3495

- Advice on design and structure
- Share Valuation
- New Articles of Association
- Board minutes
- Shareholder resolutions
- Employee share subscription agreement
- Scheme Rules
- Companies House filings
- A briefing document for employees

Full EMI option scheme service – £3495

- EMI Option Agreement providing for the grant of EMI options exercisable either based on time vesting, performance measures or on an exit/sale of the company and incorporating standard leaver provisions.
- Review of your Articles to assess conformance with the EMI scheme
- HMRC Share Valuation Application consisting of the letter to HMRC requesting agreement to the proposed share valuation, compiling supporting documentation and then any dialogue or negotiation with HMRC if required.
- Help sheets and discussions to guide you through every step of the process.
- A briefing document for employees showing the key terms of the EMI agreement including the tax implications.
- Board minutes approving the terms of the EMI Option Agreement and the grant of EMI options.
- Formal notice of the grant of the EMI options to HMRC.

Add-ons if required

- Advance assurance application, if necessary, to HMRC (for clearance that the company is eligible for EMI purposes) including preparing and sending the letter to HMRC requesting advance assurance, and the supporting documentation. £595
- Amendments to Articles – if you need to change your Articles of Association e.g. to create a separate class of shares, or provide for share buy back from leavers, you will need board minutes, shareholder resolutions and new Articles (or just an addendum) - £295 - £395
- Visit by us to your premises e.g. to explain scheme to your staff - £750

Separate services

- Unapproved option agreement (plus board minutes) - £895
- HMRC Share Valuation Application consisting of the letter to HMRC requesting agreement to the proposed share valuation, compiling supporting documentation and then any dialogue or negotiation with HMRC if required. £1695
- EMI Option Agreement providing for the grant of EMI options exercisable either based on time vesting, performance measures or on an exit/sale of the company and incorporating standard leaver provisions. Help sheets to guide you through every step of the process. A briefing document for employees showing the key terms of the EMI agreement including the tax implications. Board minutes approving the terms of the EMI Option Agreement and the grant of EMI options. Formal notice of the grant of the EMI options to HMRC. £1895

To discuss your requirements please call or email Jerry Davison: 01392-432654 or jerry@millconsultancy.co.uk