

Overview of taxation on UK non tax-favoured share options

November 2024

A non tax-favoured option is an option which does not have tax-favoured status under a company share option plan ('CSOP'), a save as you earn ('SAYE') option plan or an enterprise management incentive ('EMI') option plan¹.

The tax treatment of non tax-favoured options for a UK employee or director is the same whether the options are granted over shares in a non-UK parent or over shares in a UK parent or subsidiary.

This note summarises the UK taxation consequences of granting, exercising and selling UK non tax-favoured share options.

It is not a full description of all the circumstances in which a tax charge might arise. It is assumed that employees are resident and domiciled for tax purposes only in the UK from grant of the option to sale of the shares. There are complex rules applying to internationally mobile employees.

Grant of option

There is no income (or other) tax charge on grant of a non tax-favoured option.

There is an obligation for the issuing company and the UK employer (if different) to report the grant of options to HM Revenue and Customs

('HMRC') by 6 July following the end of the relevant tax year using an online form.

Exercise of option

On exercise of the option, income tax will be charged on the difference between the market value of the shares at the date of exercise of the option and the option exercise price.

For example, if an employee is granted an option over 5,000 shares and the option exercise price is £2 and the option is exercised when the shares have a market value of £5, the taxable option gain will be $(£5 \times 5,000) - (£2 \times 5,000) = £15,000$.

Graduated rates of income tax apply in the UK. In England, Wales and Northern Ireland, the first £12,570 of income is exempt under the personal allowance. Income tax is charged at 20% on the next £37,700 of income, at

40% on income over £50,270 and at 45%

on income over £125,140. The personal allowance is reduced by £1 for every £2 of income over £100,000².

Unless withholding obligations apply (see below), the income tax is payable by the employee through their self-assessment tax return for the relevant tax year. For the current tax year (6 April 2024 – 5 April 2025) this will be due by 31 January 2026.

1. Details of such plans can be provided, if required.
2. The income tax bands and rates in Scotland are as follows:

| | |
|-------------------------|-----|
| Over £12,570 – £14,876 | 19% |
| Over £14,876 – £26,561 | 20% |
| Over £26,561 – £43,662 | 21% |
| Over £43,662 – £75,000 | 42% |
| Over £75,000 – £125,140 | 45% |
| Over £125,140 | 48% |

Withholding obligations (PAYE)

Broadly, there are withholding obligations for the employing company if at exercise the shares under option are in a listed company or if there are arrangements for that company to be sold.

The shares are regarded as 'readily convertible assets' ('RCAs'). If the shares are in a privately owned company, there are no arrangements for it to be sold and it is not under the control of a non-listed company, then there should not be a withholding obligation.

Withholding takes place by the employing company under the PAYE system and, if the employee option holder does not ensure that

the employing company is funded for the income tax within 90 days of the end of the relevant tax year, the employee can have a tax on tax charge through the employee's tax return. It is usual to provide a mechanism for withholding in the option documentation.

The exercise of options must be reported by 6 July following the end of the relevant tax year to HMRC using an online form.



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Exercise of option – national insurance contributions ('NICs')

There will also be a NICs liability for the employee and the employer on the amount of the option gain if the shares are RCAs.

The rate of employee's NICs is also graduated. Above £50,270 it is 2% and below that limit (with an exemption for lower earnings) it is currently 8%.

The rate of employer's NICs is currently 13.8% on the amount of the option gain. From 6 April 2025, the rate will increase to 15%.

It is possible for the employer's NICs liability to be transferred to, or reimbursed by, the employee. This will increase the overall tax liability for the employee on the exercise of the option, but an income tax deduction is available in respect of the amount of the gain on which the employee pays the employer's NICs.

Where an employee pays the employer's NICs and is a 20% taxpayer, this means that the effective rate of income tax and NICs is 40%. The effective rate of tax and NICs is 51% for individuals paying the 40% rate and 55.25% for individuals paying the 45% rate.

Exercise of option – where shares are restricted – section 431 election

Often, the shares acquired on exercise of the option will be restricted shares.

This means that the shares are subject to any restriction which has the effect of reducing their value as against what their value would be if there were no restrictions. A common restriction, for example, is the requirement that the employee sell back shares for a low value in the event of termination of employment.

If nothing is done, the proportion by which the value of the shares is depressed by the presence of restrictions will be carried forward and applied to the sale proceeds on the eventual sale of the shares. A corresponding proportion of the sale proceeds would be subject to income tax and possibly NICs, rather than the potentially more favourable capital gains tax ('CGT') regime (as set out below).

To avoid this tax treatment, the employee can enter into an election under section 431 of the Income Tax (Earnings and Pensions) Act 2003, whereby the employee elects to pay tax on the acquisition of the shares as though they were not restricted. Provided this is done, all further increases in the value of the shares should be subject to CGT (as below).

A section 431 election must be entered into no later than 14 days after the acquisition of the shares. It is common practice to provide that a section 431 election must be made before the option can be exercised.

Sale of shares

On the sale of shares there will be a charge to CGT on the difference between the price received for the sale of the shares and the aggregate of the market value on the date of exercise of the option.

If a non tax-favoured option is exercised and the shares sold on the same day, there will normally be no CGT to pay.

The employee can use their CGT annual allowance (£3,000 for the UK tax year 2024/25) so that only gains in excess of this amount will then be subject to CGT. Gains are taxed at 24% to the extent the individual's total income and gains exceed £50,270. Gains below that threshold (but above the annual allowance) are taxed at 18%.

An employee may be eligible for Business Asset Disposal Relief (formerly Entrepreneurs' Relief) provided certain conditions are met. This means that the first £1 million of lifetime gains can be taxed at a 10% rate (increasing to 14% for disposals on or after 6 April 2025 and to 18% for disposals on or after 6 April 2026). To qualify, an employee must hold at least 5% of the voting rights and 5%

of the ordinary share capital and the employee must hold the shares for at least two years prior to disposal. In addition, the employee must satisfy **one** of the following two tests:

1. The employee must be beneficially entitled to at least 5% of the company's distributable profits and assets available for distribution on a winding up, **or**
2. The employee must meet **one** of the following two conditions:
 - a. be entitled to both 5% of the profits available for distribution and assets available for distribution in a winding up, **or**
 - b. in the event of a disposal of the ordinary share capital of the company the individual would be entitled to 5% of the disposal proceeds.

In reality, this relief may be of limited use for employees who have been granted non tax-favoured options.

Corporation tax deduction

The employing company may be able to claim a corporation tax deduction for the amount of the option gain in certain circumstances.



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Ann is super knowledgeable and capable of simplifying complex matters for clients.

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Claire provided specialist knowledge and advice in an effective and efficient manner.

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Katie Lewis is phenomenally good.

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