Savings-Related Share Option Scheme

A Sharesave or Save-As-You-Earn (SAYE) share option scheme combines a share option with a savings contract, so employees can save the funds to buy shares in their company. These plans have valuable tax advantages. They need to be approved by HM Revenue & Customs (HMRC) before the options are granted.

How they work

Savings contract

Employees are invited to save a regular amount with a bank or building society by deduction from their pay for a period of three or five years. At the end of the savings period, they are paid a tax-free bonus, whose amount is fixed at the start. In the case of a five-year savings contract, employees may choose to leave their savings in their account for another two years but do not make any further contributions.

The current bonus rates, effective from 1st August 2012, are zero due to low market interest rates.

Share option

At the time when employees start the savings contract they are granted options over the maximum number of shares which can be bought with the total prospective savings, including the bonus, at the end of three, five or seven years. The price to be paid for the shares (the exercise price) must be at least 80% of the share price at the date of grant of the option.

Tax advantages

Employee

- No income tax is payable on grant of the option
- No income tax is payable on exercise of the option (except in certain exceptional circumstances)
- There is no national insurance contributions (NICs) liability
- On disposal of the shares there is a potential capital gains tax (CGT) liability on the difference between the market value of the shares on disposal and the price paid for the shares. However, for many employees the gain will come within the annual CGT exemption (£10,600 for 2012-13)
- There is no tax on any bonus payable through the savings contract.

Employer

- No employer's NICs are payable on grant or exercise of the option
- The employing company can claim a deduction for corporation tax purposes for the difference between the market value of the shares at the exercise date and the amount paid by the employee
- The costs of setting up the plan are also allowable deductions.

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Example

An employee agrees to save £50 per month for a five-year period.

The total savings, including the bonus, at the end of the period will amount to 60 monthly contributions:

£50 x 60 = £3,000.

At the time of grant of the share option, the market price of the shares is £10.00. The exercise price offered is 80% of this - that is £8.00 per share. The total number of shares under option is therefore:

£3,000 ÷ £8.00 = 375 shares (rounded down to whole number).

The employee is granted an option to buy 375 shares at £8.00 per share. This option can be exercised within a six-month period starting five years after the start of the savings contract.

If the share price has grown to £12.50 on the date of exercise, the employee will be able to purchase shares worth:

£12.50 x 375 shares = £4,687.50

but will only pay:

£8.00 x 375 = £3,000.

The employee will therefore make a gain of £1,687.50, assuming the shares are sold immediately.

Main conditions for HMRC approval

Eligibility

All UK resident employees of participating companies who meet a length of service requirement (not exceeding five years), including part-timers, must be invited to participate in each offer on similar terms.

Minimum and maximum savings

Each employee may save between £5 and £250 each month. The £250 limit applies to all of the employee's savings contracts existing at any time.

Exercise price

The price payable for the shares on exercise of the option must be stated at the date of grant and cannot be less than 80% of the share price at grant. The number of shares and exercise price can be adjusted for any variations in share capital.

Timing of exercise

Options can be exercised during a six-month period starting on the bonus payment date – ie three, five or seven years after the start of the savings contract. (The employee must decide the length of the option at the start.)

Early leavers

If the employee leaves employment because of injury, disability, redundancy or retirement or on the employing company or business leaving the group, options can be exercised, with tax relief, within six months of the leaving date, but only to the extent of the employee's savings up to the exercise date.

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