6.5 Options

6.5.1 Introduction

Options are an asset in their own right and their disposal is the disposal of a chargeable asset and not a part disposal of an underlying asset. As a result, an option is unlikely to have any allowable expenditure other than any associated costs incurred by the option holder relating to the grant.

An option may be a "call" option, which (if exercised) gives the option holder the right to purchase an asset from the grantor at a price fixed by the option agreement (the exercise price). Alternately, a "put" option gives the holder the right to sell an asset to the grantor at a price fixed by the exercise agreement.

Options are frequently granted over company shares or securities, but in theory can be granted over any asset. The agreement will contain a date specifying how long the option is available for. If it is not exercised before that date, the option simply expires.

Options which have an expiry date within 50 years of grant will be wasting assets, except for:

- quoted options to subscribe for shares in a company;
- traded options;
- financial options; and
- options where the underlying asset is intended to be used for the purposes of a trade by the option holder.

6.5.2 Disposal before exercise

if an option holder disposes of the option without exercising it, any gain or loss is calculated according to general CGT principles. If the option is a wasting asset the allowable expenditure (if there is any) will need to be restricted in accordance with the rules discussed in **6.2.3**.

It is possible that an option holder may receive a capital sum in exchange for abandoning an option as opposed to disposing of it. In general, abandonment of an option will not be a disposal. However, where a capital sum is received this will be treated as consideration for a disposal.

Law: TCGA 1992, s. 144

6.5.3 Exercise of an option

Where an option is exercised, the CGT of the grantee and the grantor differ, and the consequences depend on whether the option is a call option or a put option.

When an option is exercised, the granting of the option and the transaction undertaken by the grantor (i.e. the sale or purchase of the asset subject to the option) are treated as a single transaction.

Call options – grantor implications

Here the transaction is a sale of the asset by the grantor. The consideration brought into the CGT calculation is any amount received in respect of the grant of the option plus the consideration received in respect of the underlying asset (usually the exercise price, but this may be substituted for market value if the bargain is not on arm's length terms).

Call options – grantee implications

There are no immediate CGT consequences for the grantee (i.e. the option holder). The allowable expenditure for a future disposal will be the sum of the exercise price and any amount paid for the grant of the option, as well as any associated costs and subsequent enhancement expenditure in respect of the asset.

Put options – grantor implications

Here the transaction is a sale of an asset to the grantor. The acquisition cost for the grantor is the consideration for the acquisition (usually the exercise price, unless market value applies) less the consideration received for the grant of the put option.

Put options – grantee implications

With a put option, it is the grantee who is making the disposal of the asset and for whom a CGT computation is therefore required. The consideration will be the full amount for the asset (i.e. the exercise price or market value as applicable). If there was a cost incurred when the option was granted, this will be treated as an incidental disposal cost, i.e. it will increase the allowable cost of the underlying asset.

Law: TCGA 1992, s. 144

6.5.4 *Cash-settled options*

Where the grantor is required to make a payment to the grantee in full or partial satisfaction of their obligations under the option agreement, the option is said to be "cash-settled" and the general rules described above are modified. There are useful examples in CG 12321 and 12322 respectively.

Law: TCGA 1992, s. 144A

6.5.5 *Employee share options*

Options over shares acquired and exercised by reason of an employment are subject to different rules, under the employment-related securities regime. A detailed discussion of employee share schemes is beyond the scope of this book, but broadly the rules work to prevent the conversion of income to capital subject to lower tax rates.

Generally, where the exercise price of the option is less than the market value of the underlying share, the shortfall is subject to income tax. For example, if an option is granted with an exercise price of £2 per share and is exercised when the shares are worth £5, an income tax charge will arise on an amount equal to £3 per share. For CGT purposes the base cost of the shares is the amount paid (£2) plus any amounts charged to income tax (£3). This usually means that the base cost of the shares is equivalent to the market value at the exercise date (£2 + £3 = £5) and this is a useful shortcut.

If the option is successfully exercised under an approved share option scheme (such as the enterprise management incentive), no income tax charge arises on the £3 difference. This is charged to CGT on a subsequent disposal instead. The base cost here would therefore be the price paid, i.e. £2.

This brief summary is an extremely simplified overview of the employment-related securities regime. For further information and detailed commentary, reference should be made to *Employee Share Schemes* from Claritax Books.

Law: TCGA 1992, s. 119A-120, 144, 144A

6.6 Debts

6.6.1 *Ordinary debts*

In general, the disposal of an "ordinary" debt (a debt which is not a debt on a security (see **6.6.2**)) will not give rise to a chargeable gain or an allowable loss. However, where the debt is acquired from the original creditor and subsequently disposed of, this subsequent disposal is a chargeable disposal for CGT purposes.

Example 1

In March 2020, Bert lent £100,000 to Barry. In 2022-23, Bert sold the debt to Hopper for £80,000. Barry pays Hopper in full in 2023. For CGT purposes, the sale of the debt by Bert is not a chargeable event. However, Barry's satisfaction of the debt gives rise to a £20,000 gain in the hands of Hopper.

Any loss arising is an allowable loss.

If the original creditor disposes of a debt to a connected person, any gain realised by the connected person on subsequent disposal of the debt will be a chargeable gain. However, if there is a loss it will not be an allowable loss.

If property, rather than cash, is received in satisfaction of a debt the transfer is treated as being made for a consideration that cannot exceed the market value of the asset at the time of the disposal. If the person receiving the property is the original creditor, any subsequent gain on a disposal of the property is restricted to the gain that would have arisen if the person had acquired the property for an amount equal to the outstanding debt.

Example 2

John owes a creditor £100,000. After negotiation, the creditor agrees to accept a parcel of land worth £80,000 in full satisfaction of the debt. John is treated as making a disposal of the land for consideration of £80,000, not £100,000.

The creditor's position depends on whether the debt was a chargeable asset. See HMRC's guidance for detail.

Law: TCGA 1992, s. 251

Guidance: CG 53513, 53514

6.6.2 Debts on securities

A "debt on a security" is not defined in the legislation, despite the wording in s. 251(1) implying that it is. HMRC's guidance acknowledges that the legislation is of limited use in this respect but does state that a debt does not have to be secured to be a debt on a security, and therefore the term “debt on a security” must be distinguished from the term “secured debt”.

However, there are certain characteristics that distinguish a debt on a security from an ordinary debt. The case of *Ramsay* highlighted that a debt on a security should be capable of being:

- held as an investment; and
- realised at a profit.

HMRC’s guidance at CG 53426 states that for a debt to be held as an investment, it should either:

- carry a commercial rate of interest;
- carry a premium on repayment, equivalent to the interest which would have been paid; or
- be issued at a discount, so that repayment at face value reflects the interest which would have been paid on the debt.

Failure to meet any of these benchmarks is likely to see a debt being classified as an ordinary debt instead of a debt on a security.

The level of premium, or rate of interest which the debt carries, will be an important factor when considering if a debt can be realised at a profit. However, a debt carrying an attractive rate of interest may still not be regarded as a worthwhile investment, for example due to terms which favour the borrower rather than the debtholder. HMRC’s guidance gives the example of a loan which carries the right to repay early. Each case will need to be judged on its own merits.

Where the status of a debt is established as a debt on a security, a disposal by the original creditor will give rise to a chargeable gain or allowable loss.

For these purposes, “securities” excludes mortgages, charges or other debts in respect of securities given. However, it can include loan stock (including government loan stock) as well as debentures issued by a company after 15 March 1993 if they are issued in respect of reorganisation or a qualifying scheme of reconstruction (see **5.3**).

Law: TCGA 1992, s. 132, 251

Case: *W T Ramsay Ltd v IRC* (1981) UKHL 1

Guidance: CG 53426