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Phantom share options

Employee share ownership is an effective way of both rewarding employees and engaging them in the company's performance.

However, some employers may not wish or are not able to give their employees shares or rights over shares, but may still want to align the interest of employees with those of the company. A phantom share scheme may be suitable in these circumstances.

Phantom share options

A phantom share scheme allows the employer to achieve some of the benefits of employee share ownership without actually giving any shares to employees.

In essence, it is a cash bonus scheme. Typically, each employee is granted a number of notional share options such that bonuses are calculated by reference to the notional gain on the shares.

The phantom share option plan is linked to the performance of the company as bonuses will be linked to any increase in the value of the company.

Advantages:

- It is a cash-based plan and is therefore not constrained by legislation and financial limits.
- There is no need to issue real shares or options and no dilution of existing shareholdings.
- With careful drafting, the plan can reward employees in line with the growth in company value.
- Cash bonuses should be fully deductible for corporation tax purposes.

Disadvantages:

- There are no tax or National Insurance efficiencies for the employer.
- Regular share valuations are required.
- The plan may not necessarily enhance employee retention, as some employees might prefer to hold 'real' shares.

Most suitable for:

Employers who do not wish to dilute existing shareholdings or who cannot for regulatory reasons.

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This factsheet is based on law and HMRC practice at 1 February 2022.