Published on 17 October 2023

EMPLOYEE SHARE OPTION PLANS IN SINGAPORE

[2023] SAL Prac 19

NG Han Qian, Sam[1]
LLB (Hons) (National University of Singapore);
Advocate and Solicitor (Singapore);
Of Counsel, CMS Holborn Asia.

I. Introduction to employee share option plans

1 An employee share option plan ("ESOP") is a form of incentive plan which grants participants options ("Options") to acquire shares in a company (usually the company which employs a relevant participant or its parent company) at a pre-determined price or based on a pre-determined calculation, within an agreed timeframe, and/or subject to certain performance conditions. The adoption of an ESOP by a company signals an intention to attract, motivate, and retain talent, and to align the interests of its participants with that of its investors and shareholders through a sense of ownership and stake-holding, all through a common goal of enhancing the value of the company.

2 From an employer's perspective, having an ESOP helps attract talent by providing another means of (potentially lucrative) compensation. Start-ups often find themselves cash-strapped during early stages of growth and therefore may not be able to offer cash remuneration at a level that is comparable to more mature and well-established companies. Building in Options to a remuneration package can entice otherwise "out of reach" talent by motivating employees towards the growth ambitions of the company while putting less strain on the company's cashflow.

1 The author would like to thank Toby Grainger, Leslie Tay, and Jill Lim for their assistance and contributions towards the preparation of this article. All views expressed in this article remain the author's own.

© 2023 Contributor(s) and Singapore Academy of Law.
No part of this document may be reproduced without permission from the copyright holders.

3 An ESOP structure typically provides for a vesting period (*ie*, the period to earn the Options) and a cliff period (effectively a period prior to commencement of the vesting period) to ensure that participants work for the company for a minimum duration before they are able to exercise their Options to purchase ESOP shares. In some instances where an ESOP is a late addition to a founder and early stage employee structure, some Options may be granted and vested earlier to ensure there is "back-dated" recognition of the formative work done for the business.

4 If a participant leaves the company (or terminates any relevant arrangements with the company) prior to his/her Options vesting in full, depending on the circumstances under which he/she leaves, it would not be uncommon for an ESOP to provide that the participant's Options (or at least the unvested part of such Options) lapse, and the participant thereby relinquishes any potential benefits under the ESOP.

5 From a participant's perspective, being granted Options under an ESOP may help to motivate their work performance given that an increase in the value of the company should directly correlate to a corresponding increase in the value of the ESOP shares that they may ultimately hold as well as providing an "allegiance" effect of tightening the bond between participants and company along the way. Fostering a sense of shared ownership and responsibility could provide some relief to founders and lessen their burden of running a start-up on their own. Such sense of ownership may, in turn, be advantageous towards employee retention as there should be a stronger incentive for an employee to commit longer term to the company.

6 This article seeks to detail some of the key legal and practical considerations relating to ESOPs in Singapore by providing an overview of some of the more important ESOP terms and provisions used by Singapore-incorporated private companies. This article does not purport to discuss non-legal matters (including tax, accounting, or commercial considerations) or any non-Singapore law matters (for example, whether there are any foreign laws or regulations that may restrict or prohibit

© 2023 Contributor(s) and Singapore Academy of Law.
No part of this document may be reproduced without permission from the copyright holders.

the issuance of shares to foreigners, or the taxable impact of Options issued to non-Singaporean residents).

7 For completeness, this article will also briefly explore phantom option plans as an alternative to ESOPs.

8 This article is intended for general information purposes only, and therefore its contents do not (and are not intended to) constitute legal advice. This article also does not purport to contain a comprehensive list of all considerations that may be relevant or material to ESOPs in general.

II. Key considerations and provisions

9 An ESOP consists of a set of terms and conditions (often referred to as rules, and hereinafter will be referred to in this article as "Rules"). This section sets out some key considerations and provisions which are typically found in Rules.

A. Option pool

10 The Option pool is a reserve of shares set aside by the company to be issued to participants on a valid exercise of their Options. Typically, there are two key considerations in relation to structuring the Option pool:

(a) the maximum number or percentage of shares in the Option pool; and

(b) the type of shares in the Option pool.

(1) Size of Option pool

11 There is generally no statutory maximum or minimum limit as to the size or percentage of an Option pool. Instead, it is a commercial decision to be made by the board typically in conjunction with the shareholders and/or key investors of a company. The author has observed that the size of Option pools in the market ranges from as low as 5% to as high as 25% of a company's fully diluted share capital, though these figures are by no means definitive, as ultimately any limits should be decided

© 2023 Contributor(s) and Singapore Academy of Law.
No part of this document may be reproduced without permission from the copyright holders.

based on the distinctive circumstances of each company, taking into account, among other things, the size, maturity, dilutive considerations, key contributors, and business needs of the company. It is also possible to prescribe a maximum limit of the Option pool based on a specific number of shares (rather than a percentage).

12 At the earlier stages of a company's lifespan (*eg*, for start-ups), the Option pool may typically comprise a larger percentage of the company's total issued share capital if there is a need to rely on Options to boost overall incentive and compensation levels to address cashflow concerns. As a company grows and matures, increased cashflow may allow it to better handle salary expectations, and therefore there may be less of a need for Options to be used for the purpose of employee retention from an overall compensation perspective. That said, it is also not uncommon for the Option pool to expand as a company matures and grows to cater for a larger pool of employees to be incentivised. As a company undergoes one or more fundraising rounds, incoming investors may seek to review and propose revisions to the maximum Option pool given its impact on dilution and valuation. Overall, the maximum Option pool is generally a fluid matter to be decided commercially.

(2) Types of shares in Option pool

13 Companies wishing to issue Options will have to decide whether a participant will receive ordinary or preference shares upon the exercise of his/her Options. Where preference shares are to be granted, further considerations arise as to the rights attached to such shares, such as voting rights, dividend rights, liquidation preferences, and whether such shares are convertible into ordinary shares. That said, in the author's experience, from a Singapore market perspective, currently it is more common for Options over ordinary shares or non-voting preference shares to be issued pursuant to an ESOP.

© 2023 Contributor(s) and Singapore Academy of Law.
No part of this document may be reproduced without permission from the copyright holders.

B. *Eligible participants*

14 Notwithstanding the term "*employee share option plan*", a company can still create scope to award Options to non-employees such as directors (including executive and non-executive directors), advisors, consultants, or independent contractors of the company. The eligibility criteria for an ESOP is typically a commercial matter for the company to decide, but that said, sufficient consideration should be given to the commercial benefit to and interests of the company in granting Options to certain persons who are not employees. The directors of a company would also have a general responsibility and duty to consider the best interests of the company when awarding Options.

15 A Singapore company that intends to award Options to its foreign employees, or to the employees of any foreign-incorporated subsidiary, should consider whether there are any underlying foreign law restrictions or prohibitions to be accounted for (including tax considerations). Where bespoke provisions need to be made for certain nationalities or jurisdictions, it is not uncommon for Rules to include jurisdiction-specific supplements which apply to specific categories of participants.

16 One consideration for Singapore-incorporated private companies limited by shares to note is the limit on the number of shareholders it can have to remain as a private company. This limitation is set out in s 18(1)(*b*) of the Companies Act 1967[2] (the "Companies Act") as follows:

> **18.** —(1) A company having a share capital may be incorporated as a private company if its constitution —
>
> > …
> >
> > (b) limits to not more than *50* the number of its members (counting joint holders of shares as one person and *not counting any person in the employment of the company or of its subsidiary* or *any person who while previously in the*

2 2020 Rev Ed.

© 2023 Contributor(s) and Singapore Academy of Law.
No part of this document may be reproduced without permission from the copyright holders.

employment of the company or of its subsidiary was and thereafter has continued to be a member of the company).

[emphasis added]

Where ESOP participants are limited to employees, the aforementioned 50-shareholder limit is of less concern, save in circumstances where the Rules allow a participant to retain his/her unexercised Options after leaving the employment of the company (given that such participant could be counted towards the 50-shareholder limit if he/she exercises his/her Options only after leaving the employment of the company). A company that grants Options to non-employees such as consultants, advisors, and independent contractors should also bear in mind the 50-shareholder limit rule.

17 To deal with the 50-shareholder limit rule, it is not uncommon for special purpose vehicles to be established to hold ESOP shares for and on behalf of ESOP participants, with the relevant ESOP participants being shareholders of such special purpose vehicles and entering into shareholders' agreements relating to the same. Equally, it is also possible (and not uncommon) for a professional trustee to hold the ESOP shares on trust for ESOP participants to ensure that the company remains as a private company, and in such cases, the applicable Rules should expressly provide for any trust, proxy and/or attorney provisions required to facilitate such manner of holding. The company should of course bear in mind any non-legal considerations (including tax and accounting considerations) in the structuring of any such arrangement.

18 With respect to private limited companies in Singapore, the offering of Options and issuance of shares under an ESOP generally will not trigger any offering of securities implications under Singapore securities law. However, issues may arise if certain prerequisites for any applicable exemptions are not carefully monitored. An offering of securities to persons in Singapore is generally subject to prospectus requirements under the Securities and Futures Act 2001,[3] though there are general

3 2020 Rev Ed.

© 2023 Contributor(s) and Singapore Academy of Law.
No part of this document may be reproduced without permission from the copyright holders.

exemptions which are available,[4] including when offers are made under an ESOP to a company's qualifying persons.[5] Such qualifying persons include a *bona fide* director or equivalent person, a former director or equivalent person, a consultant, an advisor, and an employee or former employee of the entity or of a related corporation of that entity (being a corporation).

C. Exercise price

19 The exercise price for an Option is the amount to be paid by an ESOP participant to the company in order to exercise such vested Options. There are generally no legal restrictions or requirements regarding exercise price, and this would typically be determined at the discretion of the ESOP administrator. The exercise price can be fixed at the time of grant of the relevant Option(s), or pegged to a subsequent value at the time of exercise. The exercise price may also be fixed at a nominal value, or be based on the fair value (or with a prescribed discount) of the shares of the company (whether as at the date of exercise or at the date of the grant). Different ESOP participants may also be subject to different exercise prices where the applicable Rules and Option grant documents provide for the same.

20 A nominal exercise price or an exercise price that is lower than the fair value of the shares may benefit the ESOP participants given that they are able to gain substantially more from any increase in the valuation of the company subsequent to the time of exercise, and this could be more attractive to the employees and therefore aid talent acquisition and retention. Over time, the granting of significant "in the money" Options may become less appealing to investors and existing shareholders where the company has scaled up, and retention or recruitment for certain job positions may be less acute where the company has been substantially de-risked. The company should consider the financial and tax (including, where applicable, employee

4 See s 273 of the Securities and Futures Act 2001 (2020 Rev Ed) for a list of exempted offers made under certain circumstances.

5 See s 273(4) of the Securities and Futures Act 2001 (2020 Rev Ed) for the definition of a "qualifying person".

© 2023 Contributor(s) and Singapore Academy of Law.
No part of this document may be reproduced without permission from the copyright holders.

income tax) implications of low exercise prices, as well as its overall dilutive effects when the Options are exercised. For longer term considerations, the company should also consider how its structuring of its ESOP (and prevailing exercise prices) would impact its valuation and attractiveness from a fundraising perspective.

21 It is common for Rules to contain provisions regarding a variation of an exercise price in certain scenarios. These typically include circumstances where there are variations in the issued share capital of the company (for example, by way of capitalisation or rights issue or a reduction, subdivision, consolidation, or distribution of shares), but would exclude prescribed matters such as an issuance of securities (a) as consideration for an acquisition or for an initial public offering; (b) as a consequence of the exercise of Options or other convertibles issued from time to time by the company; or (c) pursuant to any share dividend scheme.

22 As a general observation, ESOPs are typically not viewed as a fundraising mechanism but it is not unusual for Rules to be drafted flexibly to enable the administrator the opportunity to re-balance the scheme and adjust the pricing terms in future funding rounds if the company is exhibiting high growth and/or has been substantially de-risked. Adjustments could be made to exercise prices by tying the same to the company's last funding round or at a specified discount to fair market value. Giving the administrator flexibility around pricing may also allow a company to better manage the interests of new joiners on the one hand, and on the other, longer-term participants who have shouldered comparatively more risk.

D. Administration

23 ESOP administration powers are usually granted to an "administrator" or "administrators" who are responsible for managing and implementing the Rules. The administrators generally start off as the board of directors (or a committee of directors with investor shareholder representation) and/or other

© 2023 Contributor(s) and Singapore Academy of Law.
No part of this document may be reproduced without permission from the copyright holders.

senior officers in the company. As the company grows, the oversight of the ESOP can migrate to a remuneration committee.

24 Given Singapore's generally employer-friendly environment, it is common for Rules to provide a wide degree of discretion to administrators to manage the ESOP, allowing them to make and vary certain regulations of the Rules as they think fit (and for those variations to be binding on the participants). Whilst discretion can allow administrators to react to certain events or situations, overly liberal discretionary provisions without certain basic safeguards can lead participants to doubt the security of the ESOP, and can potentially have a detrimental impact when it is intended to act as an incentive. Therefore, finding a balance in the drafting of Rules with respect to the discretion of administrators is important.

25 In order to avoid potential conflicts of interest in relation to administrators, Rules should expressly state that where a relevant administrator or decision-maker has the power to grant Options, such person should abstain from deliberating on or being involved in any decision for the grant of Options to himself/herself or any of his/her affiliates or connected parties.

26 Directors of a company should also bear in mind their duty to avoid conflicts of interests when administering an ESOP. Where a grant of Options could result in any conflict of interest (whether actual or potential), it is recommended to make full disclosure to the board (and where required, shareholders) for their information and approval. In *Scintronix Corp Ltd v Ho Kang Peng*,[6] the defendants, Ho Kang Peng ("Ho") and Chow Weng Fook ("Chow"), were previously the chief executive officer and executive director respectively of the plaintiff, Scintronix Corp Ltd ("Scintronix"). Chow stepped down from his position as executive director on 23 November 2007 but remained in the employment of Scintronix as an advisor until 14 April 2008. Ng Hock Ching ("Ng") was formerly an executive director of Scintronix who resigned from his position with effect from 27 April 2007 and was employed as an advisor to Scintronix on the same day. Scintronix

6 [2013] 2 SLR 633.

© 2023 Contributor(s) and Singapore Academy of Law.
No part of this document may be reproduced without permission from the copyright holders.

claimed that Ho had breached his fiduciary duties as a director on the basis of, *inter alia*, Ho employing Chow and Ng as advisors to Scintronix on the same remuneration packages that had been given to Chow and Ng while they were executive directors. This included, among other things, an option to subscribe for 2,000,000 new ordinary shares under Scintronix's employee share option scheme. The Singapore High Court held that Ho was found to be in breach of his duty to avoid conflicts of interest in determining the remuneration packages of the advisors as he had not obtained the board's approval with full disclosure.[7] The court further found that Ho's conduct in putting himself in a position where he was in effect the sole decision-maker in relation to Ng's and Chow's terms of employment as advisors – as part of a prior agreement that he had made with Ng and Chow – gave rise to a reasonable perception of a conflict of interest, and that Ho could reasonably be regarded as being influenced by ulterior considerations of Ng's and Chow's interests.[8]

27 In the case of more mature companies with third party investors, it is common for certain decisions or amendments relating to an ESOP (for example, matters relating to Option grants to certain founders or key management members, or amendments relating to the maximum size or term of an ESOP) to be subject to shareholder approval as a reserved matter or to key investors' approval.

28 To facilitate the administration of an ESOP, the Rules and/or applicable grant documents would typically encompass the grant of a power of attorney by a participant in favour of an attorney (which could either be the administrator(s), a founder or other officer of the company) to deal with the ESOP shares or Options and to exercise certain rights granted in connection with the same.

---

7 *Scintronix Corp Ltd v Ho Kang Peng* [2013] 2 SLR 633 at [32].
8 *Scintronix Corp Ltd v Ho Kang Peng* [2013] 2 SLR 633 at [33].

© 2023 Contributor(s) and Singapore Academy of Law.
No part of this document may be reproduced without permission from the copyright holders.

E. Vesting schedule and conditions

29 ESOPs (as opposed to share grants) typically come with vesting schedules and conditions. An Option is said to vest when it becomes exercisable. Conditions for vesting are normally time-based and/or performance-based, and participants would have to satisfy such conditions attached to their Options before vesting and/or exercise. The terms on which Options are granted to ESOP participants can be uniform across all participants, or differentiated between participants (and detailed in individual grant letters).

30 With respect to time-based vesting, most vesting schedules are tied to a period of time that a participant needs to remain in employment with the company. Vesting may occur in a single tranche on a particular vesting date (*eg*, 100% of all Options to vest on a specified date), or split over different tranches with different vesting dates (*eg*, all Options to vest over a four-year period, with 25% of the Options vesting in each year). An ESOP may also include a cliff period, which is a prescribed period from the date of grant and after which period an Option will vest (for example, an Option with a six-month cliff period would start vesting only after six months from the date of grant). In terms of time-based vesting of Options, the author, in his experience, has seen time-based vesting periods that may be as short as six months or as long as five years – though these figures are by no means definitive, as ultimately any vesting periods should be decided based on the individual needs and circumstances of each company (including but not limited to a participant's seniority, skills, and relevance to the current and future business needs of the company).

31 The Rules may provide for Options to be subject to accelerated vesting, for example, in the context of certain liquidity events, such as an initial public offering, takeover, and/or trade sale of the company. From a practical perspective, in a merger and acquisition ("M&A") context, a purchaser of shares looking to take over all or a material proportion of shares in a company should bear in mind the implications of the proposed transaction on the target's Options, and where required, address

© 2023 Contributor(s) and Singapore Academy of Law.
No part of this document may be reproduced without permission from the copyright holders.

their treatment in the transaction documents. For example, a purchaser may wish to ensure that the deal covers the purchase of accelerated and exercised Option shares (or a specific payment in lieu), and/or seek appropriate indemnifications from the sellers to ensure that all ESOP shares are delivered and that any outstanding Options lapse upon completion.

32 As the scope and drafting of vesting provisions can differ between ESOPs, there is a need to ensure proper interpretation to ascertain whether a participant is entitled to exercise his/her Options. For example, in the case of *Tan Ging Hoon v MMI Holdings Ltd*,[9] certain participants under share option schemes granted by MMI Holdings Ltd ("MMI") were precluded from exercising options that had not vested. The participants who had been granted options under MMI's scheme included former employees of MMI's Malaysian subsidiary, Alliance Contract Manufacturing Sdn Bhd ("ACM"), which was a joint venture entity previously owned by MMI and the plaintiff ("Tan"). Under the options granted to Tan, the rights therein would vest in January 2006 and January 2007; and under the options granted to the rest of the plaintiffs, the rights therein would vest in January 2006. Tan subsequently entered into an agreement to acquire MMI's shares in ACM through a Malaysian entity, Alliancecorp Manufacturing Sdn Bhd ("Alliancecorp"). The share sale and purchase agreement contained the following provision:[10]

> For the avoidance of all doubt, all rights accruing to the staff/employees of [ACM] pursuant to the [defendants'] Employee Share Option Scheme (hereinafter referred to as 'the ESOS') shall continue to be governed by the by-laws of the [defendants'] ESOS scheme and shall lapse one (1) month after the end of the completion period.

The plaintiffs attempted to exercise the options in July 2005 but were denied on the basis that they were only entitled to exercise those options that had already vested. The court held that on a plain and purposive reading of the rules of the share option scheme, the options must first have vested in the grantee

9 [2008] 3 SLR(R) 807.
10 *Tan Ging Hoon v MMI Holdings Ltd* [2008] 3 SLR(R) 807 at [19].

© 2023 Contributor(s) and Singapore Academy of Law.
No part of this document may be reproduced without permission from the copyright holders.

before the remuneration committee of MMI could exercise its discretion in favour of the grantee, and therefore it did not have any discretion to allow the plaintiffs to exercise the unvested options.[11] Further, cl 9 of the share sale and purchase agreement was found not to have referred to unvested options due to the phrase "all rights *accruing* to the staff/employees of [ACM] pursuant to the [defendants'] Employee Share Option Scheme" [emphasis in original],[12] as no rights could have accrued to the plaintiffs unless the options were already vested.[13] The court also remarked that Tan and/or his lawyers overlooked the issue of the unvested options in the negotiations for Alliancecorp's purchase of ACM, and despite Tan's denial that he had not done so, it was clear from the evidence that he and/or his lawyers had made a mistake in not clarifying the issue of unvested options.[14]

33 While time-based conditions are generally straightforward to implement, they may not always be effective when implemented as a standalone measure unless the company has an active system of managing non-performers. Performance-based conditions on the other hand tend to offer a better reward mechanism. Performance-based conditions can have diverse criteria and may include revenue-, project- or expansion-oriented targets or individual role-based performance targets that must be achieved before Options can be exercised. Vesting of performance-based Options could either take an all-or-nothing approach (*ie*, a failure to meet all performance conditions results in no vesting), or a proportionate approach (*ie*, tiered performance milestones resulting in tiered vesting, and possibly with an opportunity to "catch up" in subsequent performance review milestones). In any case, to ensure proper incentivisation, any establishment of performance conditions should be realistic and achievable.

---

11 *Tan Ging Hoon v MMI Holdings Ltd* [2008] 3 SLR(R) 807 at [83]–[85].
12 *Tan Ging Hoon v MMI Holdings Ltd* [2008] 3 SLR(R) 807 at [87].
13 *Tan Ging Hoon v MMI Holdings Ltd* [2008] 3 SLR(R) 807 at [87].
14 *Tan Ging Hoon v MMI Holdings Ltd* [2008] 3 SLR(R) 807 at [86].

© 2023 Contributor(s) and Singapore Academy of Law.
No part of this document may be reproduced without permission from the copyright holders.

F. *Forfeiture, cancellation, good leaver, and bad leaver*

34 There are certain scenarios whereby the Rules should cater for the forfeiture or cancellation of Options. Commonly, forfeiture events could include scenarios where a participant is a "bad leaver", which typically occurs due to, but not limited to, (a) a failure to perform duties and responsibilities owed to the company; (b) breaches of obligations under any agreement or covenant with the company; or (c) involvement in any fraud, embezzlement, dishonesty, or any other forms of misconduct or moral turpitude. In contrast, participants may be entitled to retain their vested Options if they are "good leavers", who include, but are not limited to, those who leave due to (a) termination without cause; (b) retirement; (c) certified ill health; or (d) retrenchment. That said, we note that the aforementioned are non-exhaustive common examples, and ultimately it is for a company and its board or shareholders to decide what should constitute good leaver or bad leaver events, and the appropriate treatment of Options in connection therewith. Regard should also be had, if necessary, towards aligning leaver provisions in an employee's employment contract with those in Rules.

35 It is also important that the Rules provide for any differences in the treatment of vested and unvested Options upon a good leaver or bad leaver event. In bad leaver scenarios, it would not be uncommon to provide for the cancellation of all Options held by the bad leaver, whether vested or unvested. In contrast, in good leaver scenarios, vested Options are usually permitted to be retained (and only unvested Options will lapse).

36 It is also possible for Rules to include "claw back" provisions for bad leaver scenarios. A "claw back" allows the company to reduce the number of shares that employees can purchase under their existing or remaining Options (to the extent these are not forfeited or cancelled), or even repurchase the ESOP shares held by the participant at a nominal (or discounted) value. Any such repurchase and/or cancellation of shares by the company would be subject to the requirements of the Companies Act, including any obligations and limits on carrying out share buybacks or capital reduction exercises. Consideration should also

© 2023 Contributor(s) and Singapore Academy of Law.
No part of this document may be reproduced without permission from the copyright holders.

be had as to whether any proposed claw back would be subject to pre-emption provisions under any shareholders' agreement relating to the company, in which case existing shareholders of the company may have a right to purchase a *pro rata* portion of clawed back ESOP shares (though in some cases it may be simpler for the company to reduce the relevant ESOP shares rather than undertake a disproportionate and time-consuming pre-emption process with what may be small quantities of relevant ESOP shares).

37 The Rules should also clarify whether any cancelled or forfeited Options should be disregarded for the purposes of counting towards the maximum Option pool limit (assuming one exists).

G. *Restrictions*

38 An ESOP may also include restrictions on participants dealing in ESOP shares. In some cases, this could take the form of a moratorium period within which a participant may not sell his/her ESOP shares after vesting. In other cases, there could be a complete prohibition on such sales, whereby a participant is expected to hold his or her ESOP shares until such time there is an exit event (*eg*, winding up) or liquidity event (*eg*, takeover or an initial public offering), or whereby the participant is required to first offer the ESOP shares to the company for repurchase (or for the company to find a buyer for the same). Restrictions often exist to preclude the transfer of ESOP shares to competitors of the company. Some Rules may also provide for ESOP participants to grant a proxy in favour of certain founders to make voting decisions on ESOP shares (and this option could be helpful to founders in retaining an added degree of control over the voting process and to avert extra administrative issues and costs, particularly where there is a large number of voting ESOP holders). Ultimately, any restrictions should be carefully considered and appropriately reflected in the Rules.

© 2023 Contributor(s) and Singapore Academy of Law.
No part of this document may be reproduced without permission from the copyright holders.

H. Formalities

39 The section sets out some general legal formalities to note when implementing an ESOP for a Singapore incorporated private company.

40 There is no general statutory requirement in Singapore for companies to prepare Rules in a particular format or language.

41 The requisite corporate approvals and/or waivers (if required) as provided under the constitutional documents of the company (and where applicable, any shareholders' agreement relating to the company) should be obtained for the approval of an ESOP. Board and shareholder resolutions adopting the ESOP should also include approvals to approve the issuance of shares under the ESOP (including the requisite shareholders' approvals pursuant to s 161 of the Companies Act). The approvals should, for clarity, mention who would be the administrators of the ESOP.

42 Basic contractual law rules would apply with respect to the terms of the ESOP that are applicable to a participant's grant of Options:

(a) It is generally recommended that grant letters (containing the clear terms and conditions of the grant of Options, and appending a copy of the Rules) be issued to participants by the company. The participants should thereafter execute an acceptance letter or form to acknowledge and accept the terms of the ESOP as set out in the Rules. Any other documents which should form the contract between the company and each participant will also have to be clear.

(b) Such letters or agreements can be entered into electronically, including by way of electronic signatures. However, if there are any attorney provisions set out in the Rules or the grant documentation, then the ESOP grant acceptance documentation should be executed in wet ink as a deed and attested to by a witness.

© 2023 Contributor(s) and Singapore Academy of Law.
No part of this document may be reproduced without permission from the copyright holders.

(c) There is no specific notarisation requirement in Singapore for an ESOP of a Singapore company to be legally binding in Singapore.

43 Companies should not underestimate the importance of maintaining accurate record-keeping and efficient document management processes which will ensure the proper administration of an ESOP. This is critical as a company grows and expands the pool of participants in its ESOP. To assist with administration, there are various ESOP management tools available in the market that provide a range of technology-based solutions, such as automating the tracking of issued share Options, vesting schedules and payments. Such tools may be useful from the design phase of the ESOP through to its implementation and later administration.

I. Tax considerations

44 Options issued under ESOPs (and shares issued therefrom) naturally involve Singapore tax considerations (whilst foreign participants may need to take into account tax laws of their home jurisdiction). Regard should be had to applicable tax legislation and any relevant tax guides issued by the Inland Revenue Authority of Singapore ("IRAS").[15]

45 In general, gains from Options may be assessed for income tax purposes where an individual is granted the Options while he/she is exercising employment in Singapore (and even so if the Options are exercised after the employee's employment ends). For Options granted on or after 1 January 2003 under any ESOPs with vesting imposed:

(a) Where the ESOP does not have any selling restrictions, gains are taxable in the year the individual exercised the Options. The taxable gains are computed

15 Examples of tax guides which may be relevant as at the date of this article include the IRAS e-Tax Guide on Tax Treatment of Employee Stock Options And Other Forms of Employee Share Ownership Plans (Third Edition) (published on 25 February 2022), and the IRAS e-Tax Guide on Equity Remuneration Incentive Scheme (ERIS) (Second Edition) (published on 26 April 2013).

© 2023 Contributor(s) and Singapore Academy of Law.
No part of this document may be reproduced without permission from the copyright holders.

as the open market price of the shares on the date of exercise, less the exercise price paid by the individual for the shares.[16]

(b) Where the ESOP contains selling restrictions, gains are taxable in the year the selling restriction is lifted. The taxable gains are computed as the open market price of the shares on the date the selling restriction is lifted, less the exercise price of the shares.[17]

Where the open market price of the shares is not readily available, the net asset value of the shares will be used to determine the market price of the shares.[18]

46 For foreign employees employed in Singapore, generally a "deemed exercise" rule is applied when such an employee ceases employment in Singapore. In accordance with this rule, the employee is deemed to have derived a final gain from unexercised Options or restricted Options where a selling restriction has not been lifted. The final gains are deemed to be income derived by the individual one month before the date of cessation of employment or the date the right or benefit is granted, whichever is the later.

47 From a drafting perspective, it is common to see provisions in the Rules stipulating that any income taxes arising from the exercise of any Options granted to any participant shall be borne by that relevant participant.

J. Phantom share option plans

48 While not the main focus of this article, for completeness, a brief summary of phantom share option plans is set out in this section.

---

16 IRAS e-Tax Guide on Tax Treatment of Employee Stock Options And Other Forms of Employee Share Ownership Plans (Third Edition) (published on 25 February 2022) at pp 5–6.
17 IRAS e-Tax Guide on Tax Treatment of Employee Stock Options And Other Forms of Employee Share Ownership Plans (Third Edition) (published on 25 February 2022) at pp 5–6.
18 IRAS e-Tax Guide on Tax Treatment of Employee Stock Options And Other Forms of Employee Share Ownership Plans (Third Edition) (published on 25 February 2022) at p 6.

© 2023 Contributor(s) and Singapore Academy of Law.
No part of this document may be reproduced without permission from the copyright holders.

49 Phantom share option plans are an alternative form of compensation plan to ESOPs which award eligible participants with "phantom share units", which are usually measured as a proxy of the value of the underlying shares in the company. Unlike ESOPs, the phantom share units are notional forms of calculations and do not confer any actual equity ownership to participants. A phantom share option plan may be preferred in scenarios where the company or its founders wish to avoid equity dilution, but still wish to provide some form of incentivisation which aligns with the value of the company (albeit there will be indirect financial dilution upon encashment of such units when permitted).

50 Similar to ESOPs, there are generally no legal restrictions in Singapore as to the maximum or minimum value of awards that can be granted as a pool of phantom share units.

51 Furthermore, phantom shares and cash-settled awards are not limited to just employees, leaving companies free to grant them to non-executive directors, consultants, advisors, and independent contractors. That said, while these are commercial matters for the company to decide on, there should be sufficient consideration given to the commercial benefit to and interests of the company, and the rationale for granting phantom share units to certain persons. The directors of a company would also have the responsibility and duty to consider the best interests of the company.

52 Phantom shares or cash-settled awards can be subject to performance-based or time-based vesting conditions in the same way ESOP options are.

III. Conclusion

53 ESOPs have become a common feature in the start-up and scale-up corporate ecosystem, offering, in some cases, an equivalent or potentially more lucrative upside to the mainstream stock options long the domain of mature companies. Founders and early-stage investors nevertheless need to tread carefully as there is a myriad of considerations to be had in the adoption

© 2023 Contributor(s) and Singapore Academy of Law.
No part of this document may be reproduced without permission from the copyright holders.

of an ESOP, as well as in its subsequent management and administration. The drafting of any Rules should be as clear and precise as possible to reduce any potential conflicts or uncertainties that can cause significant issues down the road. From an M&A perspective, incoming investors or purchasers should also be aware of a target company's ESOP and its implications (if any) on the broader transaction and whether any issues need to be addressed appropriately in deal documentation.

© 2023 Contributor(s) and Singapore Academy of Law.
No part of this document may be reproduced without permission from the copyright holders.