



Employee Share Option Plans (ESOPs) in Singapore

A Practical Guide to Mechanics, Tax Treatment,
Vesting Structures, and Common Pitfalls

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Introduction

Employee Share Option Plans (ESOPs) have become one of the most widely used tools for attracting, retaining, and incentivising key talent in Singapore’s startup and technology ecosystem. By granting employees the right to purchase shares at a pre-determined price, companies can align employee interests with shareholder value without requiring immediate cash outlay.

However, implementing an ESOP in Singapore involves navigating a range of corporate law requirements, tax rules, and practical structuring considerations. This guide provides a concise overview of the key legal and tax framework for ESOPs in Singapore, designed to help founders and directors of private limited companies understand their obligations and avoid common pitfalls.

What Is an ESOP?

An Employee Share Option Plan (ESOP) grants employees the right – but not the obligation – to purchase shares in the company (or a parent or holding company) at a pre-determined exercise price, on or after specified dates.

ESOPs are distinct from other forms of equity-based compensation:

Plan Type	Key Feature
ESOP (Share Options)	Right to buy shares at a fixed exercise price in the future; employee pays the exercise price on exercise
ESOW (Employee Share Ownership)/ Share Awards	Shares granted outright (or for nominal consideration) after a vesting period; no exercise price
Phantom Share Plans	Cash bonus linked to share value; no actual shares issued or transferred
Restricted Share Plans	Shares granted subject to selling restrictions (moratorium); gains taxed when restrictions lift

Alternative Equity Incentive Structures

While traditional ESOPs remain the most common form of equity-based compensation, several alternative structures have gained popularity among Singapore startups – particularly early-stage companies that may not yet be ready to issue actual shares to employees. Each alternative comes with its own trade-offs in terms of complexity, tax treatment, and employee perception.

Virtual Share Plans (Phantom Equity)

A virtual share plan (also known as a phantom equity or shadow equity plan) grants employees a contractual right to receive a cash payment linked to the value of the company’s shares, without issuing any actual shares.

The employee is entitled to participate in the economic upside of the company (and, in some plans, in dividend equivalents), but does not become a shareholder and has no voting or other membership rights.

Advantages:

- **No dilution.** No new shares are issued, so existing shareholders are not diluted. This is often the single most compelling reason for founders and investors.
- **No shareholder cap risk.** Since no shares are issued, the 50-shareholder limit for Singapore private companies is not affected.
- **Simpler corporate process.** No need for shareholder resolutions under s 161 of the Companies Act, no share allotment filings with Accounting and Corporate Regulatory Authority (ACRA), and no Securities and Futures Act 2001 (SFA) prospectus exemption analysis.
- **Clean cap table.** Employees do not appear on the share register, which simplifies future fundraising, due diligence, and exit processes.
- **Flexibility in plan design.** The terms are purely contractual, giving the company broad latitude to set vesting, valuation, and payout mechanics. Plans can be adapted without amending the company's constitution or shareholder agreements.

Disadvantages:

- **Cash liability.** The company must fund the payout in cash when the virtual shares vest or are settled. For fast-growing companies, this can become a significant cash obligation, especially on exit.
- **Tax treatment.** Payouts under a virtual share plan are treated as employment income and are fully taxable. Unlike a traditional ESOP, there is no opportunity for the employee to benefit from capital gains treatment on a subsequent sale of shares (since no shares are ever acquired).
- **Weaker employee alignment.** Employees do not become actual shareholders and have no voting rights. Some employees perceive virtual shares as less meaningful than real equity, which may reduce the retention and motivational effect.
- **Accounting impact.** Virtual share plans are typically classified as cash-settled share-based payments under FRS 102, requiring the company to recognise a liability (rather than equity) that must be remeasured at fair value at each reporting date. This can introduce P&L volatility.

Share Appreciation Rights (SARs)

SARs are similar to virtual share plans but are structured to mirror the economics of a traditional stock option: the employee receives a cash payment equal to the increase in share value between the grant date and the exercise date (i.e., the "appreciation"), without acquiring actual shares. SARs share the same advantages and disadvantages as virtual share plans, with the additional feature that the employee only participates in the upside above a baseline value, creating an economic profile closer to a conventional ESOP.

Convertible Virtual Shares

A hybrid approach gaining traction among Singapore startups is the convertible virtual share plan: employees receive virtual shares that convert into real equity upon a qualifying event (typically a trade sale, IPO, or specified funding round). This gives the company the administrative simplicity and cap table cleanliness of a virtual plan during its growth phase, while providing employees with the prospect of real equity participation on exit. The conversion mechanics, valuation methodology, and dilution impact should be clearly defined in the plan document.

Restricted Share Awards (RSAs)

Under a restricted share award plan, actual shares are granted to the employee (typically for free or at nominal consideration) subject to vesting conditions and a moratorium (selling restriction). Unlike an ESOP, there is no exercise price – the employee receives shares outright. The IRAS tax treatment differs from an ESOP: if there is a vesting period, gains are taxable when the shares vest; if there is a moratorium, gains are taxable when the moratorium is lifted. RSAs may be preferred for senior hires who are already committed to the company and where the founders want to grant immediate (subject to vesting) equity ownership.

Which Structure to Choose?

For early-stage startups that want to preserve a clean cap table and avoid the corporate mechanics of issuing actual shares, virtual share plans offer the simplest path. As the company matures and approaches a funding round or exit, converting to a traditional ESOP – or using a convertible virtual share plan – provides employees with real equity upside and potential capital gains treatment. The right approach depends on the company's stage, cap table complexity, investor expectations, and the seniority of the employees being incentivised. In practice, many companies use a combination: virtual shares for the broader team and traditional ESOPs or RSAs for senior executives and key hires.

Alternative Equity Compensation Structures

While ESOPs are the most widely used equity incentive tool for startups, they are not the only option. Several alternative structures have gained popularity in Singapore, particularly among early-stage companies and those with cross-border teams. Each carries distinct advantages and trade-offs.

Virtual Share Plans (Phantom Equity)

Under a virtual share plan (also known as a phantom equity plan or stock appreciation rights plan), employees receive a contractual right to a cash payment linked to the value of the company's shares, without any actual shares being issued or transferred. The payout is typically triggered by a liquidity event (e.g., a sale, IPO, or funding round) or on a defined schedule.

Advantages:

- **No dilution.** No shares are issued, so existing shareholders are not diluted and the cap table remains clean.
- **No corporate law complexity.** There is no need for shareholder approvals under s 161 of the Companies Act, no 50-shareholder limit concerns, and no SFA prospectus exemption analysis.
- **Simplicity for cross-border teams.** Virtual share plans are purely contractual and do not require share transfers across jurisdictions, making them simpler to administer for companies with employees in multiple countries.
- **No deemed exercise complications.** Since no actual share options or shares are involved, the deemed exercise rule for departing foreign employees does not apply.

Disadvantages:

- **Cash outflow.** Payouts are in cash, which requires the company to have sufficient liquidity at the trigger date. This can create a significant cash burden, especially on a trade sale where not all proceeds may be immediately available.

- **No actual ownership.** Employees do not become shareholders. This means no voting rights, no dividend entitlement, and – critically for some employees – a weaker sense of ownership alignment than actual equity.
- **Taxed as employment income.** Payouts are taxable as ordinary employment income when they vest (if vesting crystallises a cash entitlement) or when paid out. There is no opportunity for capital gains treatment on subsequent appreciation (since no shares are held).
- **Investor perception.** Some investors prefer real equity incentives (ESOPs) because they provide stronger retention and alignment. A phantom plan may be viewed as less committed to long-term employee ownership.

Convertible Notes / SAFEs with Employee Allocation

Some early-stage companies allocate a portion of a SAFE (Simple Agreement for Future Equity) or convertible note to key employees, giving them the right to receive equity on conversion at the next priced round. This approach is rare in Singapore and raises complex tax and securities law questions. It is generally not recommended as a substitute for a properly structured ESOP or virtual share plan.

Profits Interest / Carried Interest Arrangements

In fund management and partnership-based structures, key employees may receive a profits interest or carried interest entitlement rather than share options. This gives the employee a right to a share of future profits or investment returns above a hurdle, without an upfront equity grant. The tax treatment depends on the structure and whether the profits interest is treated as employment income or partnership income.

Which Structure to Choose?

Consideration	ESOP	Virtual Shares	Share Awards
Shares actually issued?	Yes (on exercise)	No (cash only)	Yes (on vesting/granting)
Dilution	Yes	No	Yes
Shareholder approval required?	Yes (s 161)	No	Yes (s 161)
Cash cost to company	None (employee pays exercise price)	Cash payout on trigger	None (shares granted)
Deemed exercise rule applies?	Yes	No	Yes
Capital gains upside?	Yes (post-exercise (& - moratorium, if applicable) appreciation is tax-free)	No (all income is taxed as employment income)	Yes (post-exercise (& - moratorium, if applicable) appreciation is tax-free)
Best suited for	Funded startups, companies planning IPO or exit	Early-stage, bootstrapped, cross-border teams, cap table simplicity	Mature companies, senior hires, retention-focused

Legal Framework

Companies Act Requirements

ESOPs for Singapore private limited companies must comply with several provisions of the Companies Act 1967:

- **Shareholder approval (s 161).** Directors require an ordinary resolution from shareholders authorising the allotment and issue of new shares. This can be granted on a per-issuance basis or as a “blanket” mandate valid until the next AGM.
- **Section 76 – Financial assistance.** A company is generally prohibited from providing financial assistance for the acquisition of its own shares. However, a statutory exception exists for bona fide employee share schemes, permitting companies to fund or subsidise share acquisitions by employees.
- **Treasury shares (ss 76H–76K).** As an alternative to issuing new shares, companies may use treasury shares (previously repurchased shares) to fulfil ESOP obligations. Treasury shares carry no voting or dividend rights while held by the company.
- **50-shareholder limit.** Private companies are limited to 50 shareholders. ESOP participants who exercise their options become shareholders. Companies must monitor this limit carefully, as exceeding it may result in the company being reclassified as a public company with significantly more onerous regulatory obligations.

Securities and Futures Act

Under the SFA, any offer of securities – including share options – generally requires a prospectus. However, the SFA provides an exemption for offers of securities made to employees of the company or a related corporation, provided certain conditions are met. Companies should ensure their ESOP falls within this exemption to avoid inadvertently triggering prospectus requirements.

Practical Tip

Always have a formal ESOP plan document. This should set out the eligibility criteria, option pool size, exercise price methodology, vesting schedule, exercise window, treatment on termination/departure, and any transfer or selling restrictions. A well-drafted plan protects the company and provides clarity to employees.

Vesting Structures

Vesting determines when an employee’s options become exercisable. The most common vesting structures for Singapore startups are:

Time-Based Vesting

The most widely used structure. Options vest over a fixed period, typically four years, with a one-year “cliff” (i.e., no options vest during the first 12 months; 25% of the total grant vests on the first anniversary; the remainder vests monthly or quarterly thereafter).

Performance-Based Vesting

Options vest upon achievement of specified milestones – for example, revenue targets, product launches, or successful funding rounds. This structure is more complex to administer but can be effective for senior hires.

Hybrid Vesting

A combination of time and performance conditions. For example, options may vest over four years but only if the company achieves certain annual revenue thresholds.

Accelerated Vesting

ESOP plans may provide for accelerated (or “double-trigger”) vesting on a change of control, such as an acquisition. Single-trigger acceleration vests all unvested options immediately on the change of control event. Double-trigger acceleration requires both a change of control and a qualifying termination of the employee (e.g., termination without cause within 12 months of the acquisition).

Practical Tip

A four-year vesting schedule with a one-year cliff is the market standard for Singapore startups. Investors expect to see this structure, and deviating from it (e.g., immediate vesting) may raise governance concerns during due diligence.

Tax Treatment

Employee Tax – Income Tax on ESOP Gains

ESOP gains are treated as employment income and are subject to income tax in Singapore. The key rules are:

- **Taxable event.** Gains are generally taxable in the year in which the employee exercises the share options (i.e., purchases the shares). If the ESOP imposes a moratorium (selling restriction) on the acquired shares, the gains are instead taxable in the year when the restriction is lifted.
- **Taxable amount.** The gain is calculated as the open market price of the shares at the date of exercise (or the date the moratorium is lifted, if applicable) minus the exercise price paid by the employee.
- **Nexus to Singapore employment.** ESOP gains are taxable in Singapore if the options were granted in connection with employment exercised in Singapore, regardless of where the options are actually exercised.
- **Subsequent sale of shares.** If the employee sells the shares after exercise at a price higher than the market price at the date of exercise, the additional gain is a capital gain and is not subject to income tax in Singapore (as Singapore does not impose capital gains tax).

Deemed Exercise Rule for Foreign Employees

When a foreign employee (i.e., not a Singapore citizen) ceases employment in Singapore, any unexercised options or unvested shares granted during Singapore employment are “deemed exercised” one month before the date of cessation. The employer must report and withhold tax on the deemed gain. This rule applies to options granted on or after 1 January 2003.

As an alternative, the employer may apply to IRAS for the Tracking Option, which allows the employer to track and report the actual gains when the options are eventually exercised. The Tracking Option requires the employer to meet certain qualifying conditions, including being a Singapore-incorporated company with adequate systems to track the share plans.

Tax Deferral

Employees may apply to defer the payment of tax on ESOP gains for up to five years from the first day of the year of assessment for which the ESOP gains are assessed, subject to an interest charge imposed by IRAS. For ESOPs with staggered vesting, only the proportion of shares that have not yet vested at the date of exercise qualifies for deferment.

Important

The Equity Remuneration Incentive Scheme (ERIS), which previously provided partial tax exemptions (up to 75%) on ESOP gains for qualifying startups, has been fully phased out. Starting from YA 2025, no ERIS exemptions are available. All ESOP gains are now fully taxable as employment income.

Employer Tax – Corporate Tax Deductions

For the company granting the ESOP, the key corporate tax considerations are:

- **Treasury shares.** When a company transfers treasury shares to employees under an ESOP, it may claim a tax deduction equal to the cost of the treasury shares less any amount paid by the employee. The deduction arises at the point the shares are transferred (i.e., when the options are exercised).
- **New shares under EEBR (from YA 2026).** Following Singapore Budget 2025, companies whose holding company issues new shares under an Employee Equity-Based Remuneration (EEBR) scheme may also claim a corporate tax deduction, based on the lower of the amount paid by the holding company for the shares issued or transferred to its employees and the open market value (or if such is indeterminable, the net asset value) of the shares at the time of issue or transfer to employees, in all instances less any amount paid by employees.
- **FRS 102 accounting.** Under Singapore Financial Reporting Standards, ESOPs are accounted for as equity-settled share-based payments under FRS 102. The company recognises an expense equal to the fair value of the options over the vesting period, creating potential temporary differences under FRS 12 (Income Taxes).

Employer Reporting Obligations

Employers must report ESOP gains on Appendix 8B, which is filed together with the employee's Form IR8A. Key points:

- Appendix 8B must be completed for each employee who derived gains from an ESOP/ESOW plan during the year.
- For employers on the Auto-Inclusion Scheme (AIS), data is to be submitted electronically to IRAS by 1 March each year.
- For departing foreign employees, the employer must file Form IR21 (tax clearance) at least one month before the employee's cessation date and withhold all monies pending IRAS clearance.
- Open market value of unlisted shares should be based on net asset value if market value cannot be determined.

Key Terms to Get Right in the ESOP Plan

The ESOP plan document should address the following terms clearly:

Term	Considerations
Option Pool Size	Typically 10–15% of issued share capital for early-stage startups. Consider future dilution from funding rounds.
Exercise Price	Can be set at fair market value (FMV), a discount to FMV, or nominal value. The exercise price directly affects the employee’s taxable gain. For unlisted private companies, FMV is typically based on the most recent funding round valuation or a net asset value assessment.
Vesting Schedule	Four-year vesting with a one-year cliff is market standard. Specify whether vesting is monthly or quarterly after the cliff.
Exercise Window	The period during which vested options may be exercised. Typically 10 years from the date of grant, subject to earlier lapse on termination.
Leaver Provisions	Distinguish between “good leavers” (resignation, redundancy) and “bad leavers” (termination for cause, breach). Good leavers typically retain vested options with a limited post-termination exercise period (e.g., 90 days). Bad leavers typically forfeit all options, including vested ones.
Change of Control	Specify whether unvested options accelerate on a sale, merger, or IPO. Double-trigger acceleration is increasingly preferred by investors.
Transfer Restrictions	Options are typically non-transferable. Shares acquired on exercise may be subject to lock-up periods, rights of first refusal, or drag-along/tag-along provisions in the shareholders’ agreement.

Common Pitfalls

1. Failing to Obtain Shareholder Approval

Share allotments without a valid s 161 resolution are void. This is a surprisingly common oversight, particularly in founder-led companies where corporate formalities may not be closely observed in the early stages.

2. Exceeding the 50-Shareholder Limit

Each employee who exercises options becomes a shareholder. If the company exceeds 50 shareholders, it may be reclassified as a public company. Plan the option pool and exercise mechanics carefully to manage this risk.

3. Ignoring the Deemed Exercise Rule

When foreign employees leave Singapore, the employer must report deemed gains and withhold tax. Failure to do so can result in penalties for the employer and departure delays, travel restrictions or difficulties re-entering Singapore for the employee. This is commonly missed, especially when departing employees hold unexercised options.

4. Unclear or Missing Leaver Provisions

If the ESOP does not clearly address what happens to vested and unvested options on termination, disputes are almost inevitable. The plan should distinguish between different types of leavers and specify forfeiture, exercise windows, and clawback mechanisms.

5. Underestimating Dilution

Founders should model the dilutive impact of the ESOP across multiple funding rounds. A 15% option pool at the seed stage will dilute significantly through Series A and beyond. Investors will often require the ESOP pool to be “topped up” before a round, which dilutes existing shareholders (including the founders).

6. No Valuation Methodology for Unlisted Shares

For private companies, determining the open market value of shares is essential for calculating the taxable gain and the exercise price. Without a clear valuation methodology (e.g., net asset value, discounted cash flow, or the most recent priced funding round), disputes can arise with both employees and IRAS.

7. Assuming ERIS Exemptions Still Apply

The ERIS tax exemption schemes have been fully phased out from YA 2025. Companies and employees should no longer factor ERIS exemptions into their planning. All ESOP gains are now fully taxable as employment income.

Useful Resources

- **IRAS – Gains from the Exercise of Stock Options:** <https://www.iras.gov.sg/taxes/individual-income-tax/basics-of-individual-income-tax/what-is-taxable-what-is-not/employment-income/gains-from-the-exercise-of-stock-options>
- **IRAS e-Tax Guide – Tax Treatment of ESOP and Other Forms of ESOW Plans (Sixth Edition, January 2026):** https://www.iras.gov.sg/media/docs/default-source/e-tax/etaxguides_iit_esop_2026-01-30.pdf
- **IRAS e-Tax Guide – Tax Deduction for Shares Used to Fulfill Obligations under an EEBR Scheme (Fourth Edition, September 2025):** https://www.iras.gov.sg/media/docs/default-source/e-tax/etaxguides_iit_tax-deduction-for-shares-used-to-fulfill-obligations-under-an-employee-equity-based-remuneration-scheme.pdf
- **Companies Act 1967:** sso.agc.gov.sg
- **Securities and Futures Act 2001:** sso.agc.gov.sg

Disclaimer

This guide is intended for general informational purposes only and does not constitute legal, tax, or professional advice. The legal and tax rules summarised in this guide are subject to change. Companies and individuals should seek independent professional advice tailored to their specific circumstances before implementing an ESOP or making decisions based on the contents of this guide.

Questions? Get in touch.

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