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Disguised Remuneration

The "disguised remuneration" legislation, implemented by the UK Government in the Finance Act 2011, was designed to block certain arrangements which use employee benefit trusts (EBTs) to defer or avoid income tax or national insurance contributions (NICs). The legislation was mainly targeted at family benefit trusts and some employer-financed retirement benefit schemes (EFRBS).

Income tax (PAYE) and NICs charges will arise on the value of a sum of money or an asset if a third party (eg an EBT trustee):

- pays or transfers it to an employee, including as a loan;
- makes it available to an employee; or
- "earmarks" it for an employee, with a view to it being transferred or made available in the future.

It is the "earmarking" provision which has caused most concern to companies. Many share plans include arrangements for shares to be delivered to employees through an EBT. There is a risk that income tax and NICs charges will be triggered at the time when the trustees allocate shares which they hold to specific employees in anticipation of the shares being delivered when share awards vest or share options are exercised. Employees may be taxed on the full value of the shares at the time of this "earmarking", even though they may not become entitled to the shares until some years later – and they may even forfeit their rights in the meantime.

Following representations by MM&K and other share plan practitioners, the Government added a large number of exceptions to the "earmarking" charge. The following arrangements are now unlikely to result in tax charges under the "disguised remuneration" provisions:

- Any plan which involves new shares or treasury shares being issued directly to employees by the employing company (or another group company).
- Any of the tax-advantaged share plans – Share Incentive Plans (SIPs), Savings-Related (SAYE) Share Option Schemes, Company Share Option Plans (CSOPs) and Enterprise Management Incentives (EMI).
- Standard unapproved Performance Share Award and Deferred Share Award Plans, provided that the awards vest on a specified date and the employees become entitled to the shares (and liable to income tax) on the vesting date.
- Awards of Restricted Securities, including under standard Joint Share Ownership Plans (JSOPs).
- Standard unapproved Share Options, if they became exercisable on a specified date and will expire if not exercised within 10 years of their date of grant.
- Share Awards and Share Options which vest on the occurrence of an "exit event", such as flotation on a stock exchange or a change in control of the company.
- "Phantom" Share Plans which provide cash payments in similar circumstances.
- "Cashless exercise" arrangements provided that the loan used to exercise Share Options is repaid within 40 days.

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The relevant exceptions are detailed and complex. We therefore recommend that the plan rules and grant documents, for both existing and new share plans, should be reviewed carefully to ensure that they come within one of the exceptions.

Some unapproved plans will not be covered by any of the exceptions. These may include:

- Conditional Share Awards where the employee does not become entitled to the shares on a fixed date, but only when the Remuneration Committee or trustee exercises its discretion to release them.
- Share Awards and Share Options where vesting occurs only when specified performance targets are first met.

Where there is some doubt about whether or not a share plan comes within one of the exceptions, some companies have changed their procedures so that the companies themselves, not the EBT trustees, grant the awards. The companies do not give the trustees details of the employees who were granted awards until the shares actually need to be delivered to them. Guidance issued by HM Revenue & Customs has confirmed that "earmarking" will not occur if the trustees only know the total number of shares subject to the awards but do not know how many of those shares have been allocated to particular individuals.

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