Budget 21st March 2012

Implications of reduction in the additional income tax rate to 45%

One of most publicised Budget announcements was the reduction of the top rate of income tax for individuals with taxable income of more than £150,000 from 50% to 45% with effect from 6th April 2013. (The corresponding tax rate for dividends will be reduced from 42.5% to 37.5%.)

The prospect of a lower tax rate for higher paid executives will encourage many companies to defer remuneration until after the new rate comes into effect. Measures which could be taken include:

- Instead of paying immediate cash bonuses, grant the executives:
  - deferred bonuses which vest on or after 6th April 2013; or
  - nil-cost (or nominal-cost) share options which can be exercised on or after that date.

  It may be necessary to make these awards subject to forfeiture on leaving employment in specified circumstances, to ensure that no tax charge is triggered before these awards vest or are exercised.

- For existing share awards due to vest before 6th April 2013:
  - delay the vesting date; or
  - replace the awards with share options of equivalent value which can be exercised on or after that date.

  In many cases, these changes may be possible without the need to obtain advance approval from shareholders, though appropriate announcements may be required for PDMRs.

Improvements to Enterprise Management Incentives (EMI)

Two significant improvements were announced for EMI share options.

First, the individual limit on the value of shares subject to qualifying EMI options is to be increased substantially from £120,000 to £250,000. This will be done as soon as possible, subject to state aid approval under European Union rules.

There was no mention of changes to the requirements that companies granting EMI options must have gross assets of no more than £30 million and fewer than 250 full-time equivalent employees or to the overall limit to the value of EMI option grants of £3 million. Therefore, although a welcome increase, only a limited number of individuals are likely to benefit.

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The second improvement is that gains made on shares acquired through the exercise of EMI options will become eligible for capital gains tax entrepreneurs' relief, potentially making gains taxable at 10% instead of 28% (for higher and additional rate taxpayers). Currently, to qualify for relief an individual must have held at least 5% of the company's share capital and 5% of the voting rights for at least a year before disposing of them.

The relief will only apply to EMI options which are exercised on or after 6th April 2012. The one-year holding requirement will still apply and so no individual will be able to benefit from the relief for share disposals before 6th April 2013 at the earliest.

In some cases, EMI options are only exercisable on the occurrence of an "exit event", such as a flotation or change in control of the company. Under the government's current proposals, entrepreneurs' relief will not normally be available in these circumstances. However, if the takeover consideration can be taken in the form of a loan note, it may be possible to qualify for the lower CGT rate by delaying the sale or redemption of the loan note until a year after the option was exercised. We are awaiting confirmation of this from HMRC.

Office of Tax Simplification (OTS) review of tax-advantaged share plans

The OTS published the final report of their review of tax-advantaged employee share plans on 6th March 2012. This contained recommendations for some useful improvements to these plans.

MM&K's detailed comments on the OTS report can be found at:

http://www.mm-k.com/content/documents/pdfs/MMK-Comments-on-OTS-recommendations.pdf

The Government has announced that it will consider the recommendations and will consult shortly on how to take a number of these proposals forward. Legislation will be in future finance bills.

We understand that HMRC will be issuing a consultation document in April 2012 and so there will be an opportunity to comment on the Government's proposals.

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