

Share Plans Update – August 2012

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- Recommendations of Nuttall Review of Employee Ownership
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Improvements to Enterprise Management Incentives (EMI)

A number of significant improvements to EMI were announced in the Budget on 21st March 2012.

Increase in limit to £250,000

The limit to the value of shares subject to EMI options granted to an individual was increased from £120,000 to £250,000 with effect from 16th June 2012. This will give extra flexibility for companies which qualify for EMI to attract key people. In some cases an amendment to plan rules will be needed.

The increase will also help companies which have granted EMI options in the past but which now exceed the £30 million gross assets or 250 employee limits. They will now be able to grant approved CSOP options, over shares worth up to £30,000, to employees who already have £120,000 worth of EMI options without losing the qualifying status of those EMI options.

<http://www.legislation.gov.uk/uksi/2012/1360/contents/made>

Extending EMI to academic employees

In a Consultation Document dated 27th June 2012, the Government proposed to allow employees who work partly for a company and partly in an academic field for a research organisation to be granted EMI options even though they do not meet the normal requirement to work at least 25 hours per week (or, if less, 75% of their working time) for the company. The consultation period ends on 18th September.

http://customs.hmrc.gov.uk/channelsPortalWebApp/channelsPortalWebApp.portal?_nfpb=true&_pageLabel=pageVAT_ShowContent&propertyType=document&columns=1&id=H MCE_PROD1_032131

EMI options to qualify for Entrepreneurs' Relief

Gains made on shares acquired through EMI options will become eligible for capital gains tax Entrepreneurs' Relief, potentially making the gains taxable at only 10%. Currently, to qualify for the relief, an employee must have held at least 5% of the company's ordinary share capital and 5% of the voting rights for at least a year before disposing of shares.

The new relief will apply to EMI options exercised on or after 6th April 2012, regardless of the number of shares held. The one-year holding period will still apply and so no individual will benefit from the relief for share disposals before 6th April 2013 at the earliest.

In many cases, EMI options are only exercisable on the occurrence of an exit event, such as a change in control of the company. Under the Government's current proposals, Entrepreneurs' Relief will not be available if the shares have to be disposed of immediately. The Government is being lobbied to allow the one-year holding period to start with the grant of EMI options, instead of on the exercise date, as used to be the case for business assets taper relief.

Employment-Related Shares and Securities Bulletin

HM Revenue & Customs (HMRC) issued the first edition of this bulletin on 10th May 2012. It gives some useful insights into how they interpret the legislation for approved Share Incentive Plans (SIPs). For example:

- **Notification of awards.** The SIP legislation requires the trustees to give notice of share awards to participants as soon as practicable after the award date. HMRC have confirmed that they will accept that notifications made once every six or 12 months will meet this notification requirement. We understand that it is not good enough merely to record awards on an online portal which is accessible to employees: HMRC require written notice of awards to be given to participants at least once a year.
- **Associated company status following demerger.** When a company whose shares are held in a SIP demerges, the employee participants who move to the demerged company will be regarded as 'good leavers' and must remove their shares from the SIP when the two companies are no longer 'associated companies'. However, as the companies will initially have the same shareholders, they may remain associated for many months, or even years, and this can be costly to monitor. To remove the uncertainty about when the departing employees' shares cease to be subject to the plan, HMRC have accepted that, provided both companies remain listed, they can be deemed for the SIP legislation to cease to be associated on the demerger date.

<http://www.hmrc.gov.uk/shareschemes/erss-bulletin.htm>

The second edition of the Bulletin, issued on 16th July 2012, has confirmed that:

- elections under section 431 ITEPA (to ignore restrictions on shares when determining their taxable value) can be made electronically; and
- for the purpose of an approved SIP, the market value of listed shares can be based on the opening price on the relevant day (as an alternative to the mid-market or closing price).

Nuttall Review of Employee Ownership

The report of the review by Graeme Nuttall on overcoming obstacles to employee ownership was published on 4th July 2012. It was launched on the same day at a summit attended by Nick Clegg, the Deputy Prime Minister, and two other Government ministers.

The report recommends a number of initiatives for raising awareness of employee ownership, increasing the resources available to support it and reducing its complexity.

Mr Clegg responded enthusiastically to the recommendations and announced the Government's support in particular for:

- the creation of a new institute for promoting employee ownership;
- employees being given a statutory right to request employee ownership; and
- development of 'off-the-shelf' employee ownership toolkits.

The review puts particular emphasis on employees acquiring either control of the business or a substantial stake (at least 25%), through direct ownership or collectively, for example in an employee benefit trust.

<http://www.bis.gov.uk/assets/biscore/business-law/docs/s/12-933-sharing-success-nuttall-review-employee-ownership.pdf>

Government's response to OTS's recommendations

On 6th March 2012, the Office of Tax Simplification (OTS) recommended a number of detailed improvements to the tax legislation for the four tax-advantaged share plans – SIP, SAYE, CSOP and EMI.

HMRC responded on 27th June with a Consultation Paper. Considering the Government's enthusiastic reaction to the Nuttall Review, it is a major disappointment. It contains very few commitments and rejects some recommendations, including the popular proposal to reduce the period before shares can be withdrawn tax-free from a SIP from five to three years.

Abolition of the approval process

The Government has decided in principle to replace the requirement for formal approval of SIP, SAYE and CSOP plans with self-certification, as currently applies for EMI. Most companies will be pleased that the current long delays in the approval process will be removed. But many will be concerned about the resulting uncertainty about whether their plans meet the requirements of the legislation, when HMRC's interpretation of these requirements in the past has not always been predictable. The potential penalties for non-compliance may even discourage some companies from implementing the all-employee share plans.

Future of approved Company Share Option Plans (CSOP)

The Government is to "investigate the current relevance of CSOP" for UK businesses. There is a real threat that tax relief for CSOP will be removed, even though CSOP is the most flexible and popular of the three approved share plans and the only one which some companies are able to operate.

The OTS's alternative proposal of increasing the flexibility of CSOP by merging it with EMI has been rejected for now. In our view, the most effective way of making CSOP more relevant for UK business would be to allow nil-cost options and/or conditional share awards to be granted. As for EMI options, income tax relief would only be given for any increase in the share price over the market value at the date of grant.

If you agree that the correct approach is to improve the CSOP, and not to abolish it, please write to HMRC at shareschemes@hmrc.gsi.gov.uk to explain your reasons before the deadline of 18th September 2012.

Proposals for which further views and evidence are sought

The Government is seeking further views and evidence before deciding how to proceed on the following OTS recommendations.

- Making the retirement provisions for SIP, SAYE and CSOP consistent.
- Removing or reducing the income tax and NICs liability when shares held in a SIP are acquired on a cash takeover.
- Simplifying the provisions which prevent employees with a 'material interest' in the company from participating in approved share plans.
- Allowing shares with restrictions to be acquired through approved plans.
- Removing references to redundant legislation.
- Allowing more flexibility on the price payable by SIP participants where there is an accumulation period.
- Giving companies more time to account for PAYE which arises when SIP participants cease employment.
- Removing the £1,500 cap on the dividends which can be reinvested in a SIP in any tax year.

- Removing the choice of 7-year options for SAYE.
- Increasing the 40-day limit during which EMI options can be exercised with tax relief after a 'disqualifying event' has occurred.

Again, please make your views known to HMRC on any of these issues. Alternatively, please send your comments to MM&K, which will be preparing a detailed response.

Proposals rejected by the Government

The Government has decided not to consult at this time on the following OTS recommendations. These are mainly because of the potential "Exchequer impact".

- Relaxing the provisions that prevent companies with more than one class of shares from operating SAYE and CSOP.
- Allowing employees of associated companies which are not subsidiaries to participate.
- Reducing the period before SIP shares can be withdrawn tax-free from five to three years.
- Removing the EMI working time eligibility requirement for employees who are not directors.
- Reducing the number of 'excluded activities' which prevent companies from qualifying for EMI.

OTS review of unapproved share plans

The OTS are now carrying out a review of unapproved share plans. They have attended a large number of meetings with companies and professional advisers and conducted an online survey to identify key areas of complexity. An interim report was issued on 1st August 2012 which set out the findings to date and ask for comments and further clarification of these findings. **The OTS are particularly keen to hear from private companies about the obstacles they come across when trying to implement and administer share plans – please contact them at ots-ess@ots.gsi.gov.uk or on 020 7270 6432 if you would like to make your views known.**

http://www.hm-treasury.gov.uk/d/ots_unapproved_employee_share_schemes_interim.pdf

The final report, with recommendations for simplification, is expected to be published in December or January.

PAYE and share plans

OT code

From 6th April 2012, the OT (zero T) tax code has applied to share-based payments made to employees after cessation of employment and which have not been included in Form P45. In June 2012, HMRC updated their Questions and Answers on the topic. These confirm the following.

- If more than one share-based payment is made to an individual in the same payment period, where administratively practicable to do so, the OT tax code should be applied to the total amount, even if the payments are made from different sources – eg the employer, an employee trust or the parent company. However, where this is not administratively practicable, the OT code can be operated separately on individual payments.
- Similarly, cash and share-based payments only need to be added together if this is administratively practicable.
- Where the employee's code immediately before leaving employment was NT, then the NT code should continue to be used for payments after cessation.

<http://www.hmrc.gov.uk/thelibrary/tax-payee/share-payments.pdf>

PAYE penalties

The introduction of penalties for late payment of PAYE has caused problems for companies with share plans, in particular SIPs, because of potential delays in notifications that employees have left employment. The forthcoming introduction of Real Time Information (RTI) is likely to increase the number of penalties incurred.

In HMRC's Consultation Document on the OTS report (see above), the Government has asked for further views and evidence regarding the proposal to remove penalties for late payment of PAYE when a SIP participant leaves employment, provided that the PAYE is actually paid within 90 days of the due date. There is therefore some hope of more flexibility on this issue.

EU Prospectus Directive changes (don't) come into effect

The EU Prospectus Directive, which was implemented in July 2005, sets out rules for prospectuses which must be issued when companies make public offers of transferable securities (including shares) within the European Union (and this has been extended to countries in the European Economic Area). The requirements to issue a prospectus can be onerous and expensive for companies.

Fortunately, there are some useful exemptions for employee share plans, including for share options and awards of free shares for no consideration. In addition, an exemption applies to employee share plans operated by companies with shares listed on an EEA stock exchange. A condition of the exemption is that a document should be made available containing information on the nature and number of the shares being offered and reasons for and details of the offer. As much of this information is normally included in an employee booklet or other explanatory materials, and it does not need to be approved by or filed with the regulator, this condition can be easily met.

Companies whose shares are unlisted (including AIM) or are listed only outside the EEA (eg on the New York Stock Exchange) did not qualify for the employee share plans exemption. This created a particular problem for private and non-EEA companies which operate employee share purchase plans, including the offer of partnership shares under a SIP.

Under an amending directive, the employee share plans exemption is being extended to:

- any company which has its head office or registered office in the EEA, even if its securities are not traded; and
- other companies whose securities are traded on a market outside the EEA, provided that the European Commission has decided that the legal and supervisory framework in the relevant market has equivalent requirements to those in the EEA.

The amending directive also improves two further exemptions from the prospectus requirements:

- an exemption for offers to fewer than 100 persons in an EEA member state has increased to 150 persons; and
- an exemption for offers where the total consideration across the EEA is less than 2.5 million Euros has increased to 5 million Euros.

The UK incorporated all these amendments into its domestic law, through amendments to the Financial Services and Markets Act 2000 and the FSA Handbook, by the deadline of 1st July 2012. However, this may not solve the problem for some companies because:

- the extension of the employee share plans exemption to companies with shares traded outside the EEA has not come into effect as the European Commission has not yet certified that any other markets have equivalent requirements to those in the EEA; and
- many of the other EEA countries have not yet incorporated the amendments into their domestic law.

ifs ProShare SAYE and SIP Survey findings

The 2011 SAYE and SIP Survey was published by ifs ProShare on 3rd July. The findings include the following.

SAYE (2011 new grants)

- 95% of companies offered 3-year options
- 55% offered 5-year options
- 17% offered 7-year options
- Average participation was 37% of eligible employees
- Average employee savings were £102 per month
- 22% of participants save the maximum £250 per month (under all grants)

SIP (2011 offers)

- 26% of companies offered free shares
- 7% offered partnership shares with a 2 for 1 match
- 20% offered partnership shares with a 1 for 1 match
- 22% offered partnership shares with a match of less than 1 for 1
- 30% offered partnership shares with no matching shares
- average employee contributions were £72 per month

For more details, and to order a copy of the survey report, please contact ifsproshare@ifslearning.ac.uk.

SAYE Bonus Rates fall to zero

The Bonus Rate for 7-year SAYE/Sharesave contracts was reduced from 1.6 monthly contributions down to zero with effect from Wednesday 1st August 2012. The 3-year and 5-year Bonus Rates and the Early Leavers' Rate all remain at zero.

This change will help to accelerate the demise of 7-year options, which are likely to be abolished in any case as a result of the OTS review. The recent ifs ProShare SAYE Survey found that fewer than 1% of outstanding SAYE options last for seven years.

The survey found that 75% of companies offer the full 20% discount on the share price at grant and over 90% offer some discount. While in the past the bonuses were a major attraction of SAYE, companies are now putting more emphasis on potential option gains.

This Share Plans Update is intended to give readers an overview of recent share plan developments. Companies should take appropriate professional advice on their particular circumstances before taking action on any of these issues.