MM&K Share Plans Update

7th March 2011

Introduction

A lot has been happening recently affecting employee share plans. This Share Plans Update discusses the following developments and their implications for companies and their employees.

Draft legislation on "disguised remuneration": update

On 9th December 2010, the Government published draft legislation which is designed to block certain arrangements which use employee benefit trusts (EBTs) to defer or avoid income tax or national insurance contributions (NICs). The legislation is mainly targeted at family benefit trusts and some employer-financed retirement benefit schemes (EFRBS).

An income tax charge will arise on the value of a sum of money or an asset when it is:

- "earmarked" for an employee;
- transferred to an employee, including as a loan; or
- otherwise made available to an employee.

The new provisions will take effect from 6th April 2011, but there are anti forestalling provisions which apply to payments made between 9th December 2010 and 5th April 2011.

The proposed legislation was drafted much too widely to be workable. There are exemptions for tax-favoured approved and Enterprise Management Incentive (EMI) share plans, for grants of unapproved share options and other rights over shares and for loans made on ordinary commercial terms; but these may not cover deferred bonuses and some types of conditional and phantom share awards. There may also be income tax and NICs charges, for example, at the time when an EBT acquires shares in advance to satisfy awards for any type of share plan. There would be no reversal of the charges if the awards were subsequently forfeited.

PAYE and NICs will normally be due when a tax liability arises under the new legislation. This will be the responsibility of the employer, even if another party has taken the relevant action. As there are now substantial penalties for late payments, companies should ensure that they are made aware when an EBT (or other intermediary) "earmarks", transfers or makes available money or shares to any of its employees.

MM&K has participated in representations to the Government through ifs ProShare, the ESOP Centre and the Quoted Companies Alliance to suggest improvements to the proposals.

The Government has now recognised the need to make refinements to the draft legislation and on 18th February published some Frequently Asked Questions which set out its intended policy. One of these FAQs confirms that share allocation arrangements with the following characteristics will not give rise to an "earmarking" charge:

- the payment of shares must be subject to conditions which will result in the employee losing the entitlement if the conditions are not met;
- a vesting date must be specified, ending at most five years from the date of grant, and entitlement must be lost if vesting does not occur by then;
- if vesting does occur on or before the vesting date, a charge to tax as employment income must arise; and
- the deferral or avoidance of tax must not be one of the main purposes of the arrangement.

MM&K attended a meeting with HMRC on 2nd March, hosted by ifs ProShare, in which we asked for some further clarification of these FAQs. However, we will have to wait until the Finance Bill is published at the end of March before we can be sure how different types of share plan will be affected.

Impact on share plans of the removal of the Default Retirement Age

The Default Retirement Age (DRA) of 65 was introduced in the Employment Equality (Age) Regulations 2006. It allows employers to set retirement ages of 65 or higher. They are required to give employees six months' notice of retirement.

Following a consultation period between July and October 2010, the Government announced on 13th January 2011 that the DRA will be phased out between 6th April and 1st October 2011. Employers will only in future be able to operate a compulsory retirement age if they can objectively justify it. It is probable that most employers will not be able to do this and will therefore cease to specify a compulsory retirement age.

Many employee share plan rules refer to a "contractual retirement date" or the date on which an employee is "bound to retire" as part of their provisions for employees who leave employment. The plan rules may now need to be amended to change the definition of retirement. Plans referring to "normal retirement age" should also be reviewed, as it is likely that this will become less meaningful in the future.

The removal of the DRA will cause a particular problem for Savings-Related Share Option (SAYE) Plans. The SAYE legislation requires plans to allow option holders to exercise their SAYE options within six months of retirement if the retirement date is:

1 Bengal Court, Birchin Lane, London, EC3V 9DD
T 020 7283 7200 F 020 7283 4119 E info@mm-k.com
www.mm-k.com

- at a "specified age" (between 60 and 75) set out in the plan rules; or
- any other age at which the option holder is bound to retire in accordance with his contract of employment.

After the removal of the DRA, it is likely that many SAYE option holders will no longer have a contractual retirement age. Those who retire at any time other than exactly on the day on which they reach the "specified age" will lose their options. This would be an extremely unfair way of treating employees in this position.

MM&K has made representations to HMRC about this issue and has recommended that it should be dealt with by a very simple change in the SAYE Plan legislation. Option holders should be allowed to exercise their SAYE options within six months of their retirement date provided that they retire on or after the "specified age". This would bring the SAYE legislation into line with that for the two other approved share plans: CSOPs and SIPs.

We have also recommended that the minimum "specified age" for SAYE Plans should be reduced, either to 55 (to match the CSOP legislation) or to 50 (which applies to SIPs).

At the meeting with HMRC on 2nd March, mentioned above, they expressed a preference for seeking an administrative solution, through re-interpreting the meaning of "bound to retire". If you agree that our proposal to change the legislation would be better, please consider writing to the government to ask for this.

Relaxation of the EU Prospectus Directive confirmed

The Prospectus Directive, which was implemented in July 2005, sets out rules requiring companies to issue a prospectus when they make public offers of securities, including shares, within the European Economic Area (EEA). The requirement to issue a prospectus can be onerous and expensive for companies.

Fortunately there are some useful exemptions, including one specifically for employee share plans. Companies which wish to rely on the employee share plan exemption must make available a document which contains information on the number and nature of the shares being offered and the reasons for and details of the offer; but this is relatively simple to prepare.

The exemptions do not, however, include larger employee share purchase plans, including offers of Partnership Shares under an approved SIP, unless the shares are listed in the EEA. The directive has therefore discouraged many unlisted and foreign-owned companies from operating this type of plan.

Recent amendments to the directive, effective from 31 December 2010, will potentially extend the exemptions from prospectus requirements to many more companies. The employee share plan exemption will include:

- all companies whose head office or registered office is in the EEA, even if their shares are not traded; and
- companies whose shares are listed on stock exchanges outside the EEA, provided that the local regulatory requirements are equivalent to those in the EEA.

In addition, the current exemption for offers where the total consideration does not exceed 2.5 million Euros in any 12-month period is to be increased to 5 million Euros and the exemption for offers to fewer than 100 persons in any EEA state is to be increased to 150 persons.

EEA member states are required to amend their domestic law to implement the changes to the directive no later than 1st July 2012. The UK government has stated that it intends to implement early the increases in the 2.5 million Euro and 100 person limits.

New Sharesave bonus rates

New bonus rates for Sharesave/SAYE share option plans came into force on 27 February 2012. The new and old rates are as follows.

Savings period	New rates from 27 Feb 11		Old rates from 12 Sep 10	
	Monthly payments	Equivalent annual interest rate	Monthly payments	Equivalent annual interest rate
3 years	0.1	0.18%	0	0%
5 years	1.7	1.10%	0.9	0.59%
7 years	4.8	1.70%	3.2	1.15%
Early leaver interest rate	-	0.12%	-	0%

It is good to see that the rates for 3-year options and early leavers have risen above zero; but they remain well below the rate of inflation. Companies offering SAYE options are therefore placing more emphasis on possible gains from the share option element of the offers. Most companies still offer the full 20% discount on the share price at the invitation date.

Share Incentive Plans (SIPs): new HMRC guidance for employees

HMRC have updated their leaflet for employees: "IR77 – Share Incentive Plans and Your Entitlement to Benefits". The leaflet explains what may happen to certain state benefits if an employee contributes from pre-tax and NICs earnings to acquire Partnership Shares under a SIP. The leaflet should be made available to all employees who are eligible to participate in a SIP, but it is particularly important for those whose earnings may be reduced below the lower earnings limit (LEL) for NICs as a result of their contributions. The leaflet can be found at:

http://www.hmrc.gov.uk/pdfs/ir177.htm

Changes to EMI legislation finally come into effect

The previous government's proposal to allow more international companies to grant tax-favoured EMI options to their employees was finally enacted on 16th December 2010 and has effect for options granted on or after that date. The requirement that a company granting EMI options must carry on a trade "wholly or mainly" in the UK has been changed so that the company is now only required to have a "permanent establishment" in the UK.

EMI options can only be granted by smaller companies. The gross assets of the group must not exceed £30 million and there must be fewer than 250 employees.

1 Bengal Court, Birchin Lane, London, EC3V 9DD
T 020 7283 7200 F 020 7283 4119 E info@mm-k.com
www.mm-k.com

MM&K Share Plans Update

7th March 2011

New form for notifying grants of EMI options

The grant of EMI options must be notified to HMRC's Small Company Enterprise Centre within 92 days: otherwise the tax advantages are lost. Notification is through Form EMI 1, which includes separate declarations which must be signed by the employee and on behalf of the company.

Companies should no longer use the older version of the form. The updated form can be found at:

http://www.hmrc.gov.uk/shareschemes/emi/appendix1.htm

PAYE change: termination of employment

Under current regulations, payments made to employees after they have left employment (and after a form P45 has been issued) are subject to PAYE deductions at the basic rate of tax, using the "BR" PAYE code. From 6th April 2011, employers will instead have to use a "0T" code for post P45 payments. They must then withhold income tax at 20%, 40% and 50%, as appropriate, as if the employee is not entitled to any allowances.

This will have a particular impact where employees acquire shares on the exercise of options or the vesting of share awards after leaving employment (provided these shares count as readily convertible assets). Their employer may have to deduct some higher or additional rate tax on these notional payments which, in practice, could mean that a greater proportion of the shares will need to be sold to meet the PAYE obligations.

Employers will also have additional NICs to deduct, following the one percentage point increases in employers' and employees' NICs from 6th April.

Changes to taxation of Irish share plans

The recent Budget in the Republic of Ireland announced measures that will make both approved and unapproved share plans less attractive and imposed new withholding obligations on employers.

- A new universal social charge (USC) has replaced the income levy and health levy.
- The ceiling on employees' pay-related social insurance (PRSI) has been abolished.
- Tax relief for Approved Share Option Plans was abolished from 24th November 2010, even for options which had already been granted before then.
- Both USC and PRSI have applied since 1st January 2011 to Approved Profit Sharing Schemes, Approved SAYE Share Option Schemes and other share options and share awards.
- PAYE tax withholding has also applied to employee share awards from 1st January 2011.

New name for our share plan administration services

On 1st March 2011, The Share Option Centre (TSOC) changed its name to MM&K Share Plan Administration. The new name accurately reflects our ability to provide a wide range of share plan administration services for our clients, from discretionary plans to the all-employee Share Incentive Plan, whether on a full outsource, co-source or ad hoc basis.

It also highlights our role within the MM&K family. Our share plan administrators work closely with our team of share plan consultants, giving MM&K Share Plan Administration unique access to expert advice and support.

End of year share plan reporting

New versions of the following forms, for the tax year ending 5 April 2011, can be found on HMRC's website at:

http://www.hmrc.gov.uk/shareschemes/ann-app-schemes.htm

Form 34: SAYE Share Option Plans
Form 39: Share Incentive Plans
Form 35: Company Share Option Plans
Form 40: EMI
Form 42: unapproved share plans.

These forms must be completed and returned to HMRC Employee Shares and Securities no later than 6th July 2011 at the Nottingham address shown on the forms.

Companies should note that the deadline for the equivalent Irish forms, in respect of the calendar year 2010, is **31st March 2011.**

MM&K Share Plan Administration prepares HMRC Share Plan returns for our clients. If you are not an existing client and would like our assistance this year, please call us to discuss how we can help you.

This Share Plans Update has been written in general terms to give the reader an overview of recent share plan developments and their possible implications. No action should be taken on the issues raised without taking appropriate professional advice on specific plan provisions.

1 Bengal Court, Birchin Lane, London, EC3V 9DD
T 020 7283 7200 F 020 7283 4119 E info@mm-k.com
www.mm-k.com