Share Plans Update

mm&k

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Finance Act 2014 changes

- Tax-advantaged plans
- Unapproved plans (mainly)

Online registration, self-certification and reporting

New HMRC consultations

- Employee shareholding vehicle
- NICs treatment of internationally mobile employees
- "Marketable" securities
- Valuing employment-related shares

SAYE bonus rate change

New *ifs* ProShare and HMRC statistics

The Finance Act 2014 received Royal Assent on 17 July 2014 and made some significant changes to share plan legislation. The main changes are summarised below.

Finance Act 2014 changes to tax-advantaged share plans

Individual limits	Maximum value of SIP Free Shares increased from £3,000 to £3,600 per year. Maximum value of Partnership Share contributions increased from £1,500 (£125 per month) to £1,800 (£150 per month). The maximum match remains at 2 for 1, and so this has increased the maximum value of Matching Shares to £3,600 per year. Maximum SAYE savings increased from £250 to £500 per month.
Change in purpose test	SIP, SAYE and CSOP must not provide cash to employees as an alternative to shares and share options. However, HMRC guidelines still allow cashless exercise of CSOP options and discretionary cash payments to employees who do not accept a SIP Free Shares offer, provided that rigorous conditions are met.

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Compulsory purchase of Partnership & Dividend Shares	SIP Partnership and Dividend Shares may not be subject to forfeiture. But plans can now include a requirement for these shares to be offered for sale in certain circumstances – for example 'drag along' provisions to allow a shareholder with a specified proportion of share capital to acquire the remaining shares.
Adjustment of options	Companies no longer need to ask HMRC to approve adjustments to SAYE and CSOP options following a bonus issue, rights issue or other share capital variation. However, the total market value of the shares to be acquired and the total exercise price payable must be substantially the same as before the adjustments.
Non-UK reorganisation	SAYE and CSOP options can now be exercised or rolled-over following a company reorganisation under the laws of a territory outside the UK.
Takeover by an unlisted company	SAYE and CSOP options can now be exercised with tax relief within 20 days after a takeover by an unlisted company (including AIM), even though the shares would have ceased to meet the requirements of the legislation. Alternatively, options can be conditionally exercised before the event and exercise will only come into effect if the event actually occurs within 20 days. (See below regarding the new corporation tax relief.)
Terms of CSOP options	All the terms and conditions of CSOP options must now be specified at the time of grant. They can only be varied, or subject to discretion, if the circumstances are set out at grant and are applied in a fair and reasonable way. No company discretion is allowed on exercise rights of "good leavers". If an option holder dies, the option must now be exercisable for the next 12 months, even if this would be after the tenth anniversary of grant.

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Do plan rules need to be changed?

The new legislation states that plans which were approved by HMRC before 6 April 2014 are deemed to have been amended to implement most of the above changes. However, amendments to the rules may be needed to take advantage of the increased individual participation limits and new provisions relating to a change in control and other company events. Amendments will also be needed if companies wish to impose restrictions on the shares.

Many companies will wish to amend their plan rules to ensure that there is no ambiguity about the provisions which now apply. In any case, explanatory booklets, enrolment forms and other employee communication materials will need to be updated.

In most cases, the plan rules will allow these amendments to be made without prior shareholder approval.

Online registration, self-certification and reporting

Since 6 April 2014:

- The process for HMRC giving formal approval to new SIP, SAYE and CSOP plans has been replaced with online self-certification by the companies which establish the plans.
- All *existing and new* share plans will need to be registered online with HMRC – including EMI option arrangements and non tax-advantaged plans.
- All grants of EMI options must be reported online within 92 days of the grant date.
- The annual reporting for all share plans for the tax year 2014-15 onwards must be carried out online.

HMRC have issued some useful guidance on these requirements.

Registration

- Registration is through the PAYE Online system. Any *active or live* PAYE reference number operated by a company in the group can be used.
- Plans must be registered by the company, though subsequent reporting can be done by an external administrator or other agent.
- The deadline for registration of plans which already existed on 6 April 2014 or for which the first grant or award is during the 2014-15 tax year is **6 July 2015** – though we recommend that plans should be registered well before then.
- Each tax-advantaged plan (SIP, SAYE, CSOP and EMI) must be registered separately.
- EMI arrangements must be registered even if there are no separate plan rules.
- If a tax-advantaged plan forms a schedule to an unapproved plan, it must be registered as a separate plan.

- Non tax-advantaged plans may either be registered separately or batched together and registered as a single plan.
- Old non tax-advantaged plans do not need to be registered until the next tax year in which a reportable event occurs.
- The registered plan name must be meaningful, preferably including the name of the company and the type of plan.
- After a plan has been registered, the company will need to log back a few days later to obtain the unique registration number. This will not be the same as any HMRC reference which has been allocated to the plan in the past. It will also be different from the acknowledgement reference given at the time of registration.

Self-certification

- At the same time as a SIP, SAYE or CSOP is registered, the company must self-certify that it complies with the relevant legislation.
- If a plan was already "approved" by HMRC before 6 April 2014, and any subsequent changes before that date were also approved, the company can assume that it operates within the relevant legislation.
- Any subsequent changes to "key features" must be reported with the annual return for the relevant tax year, together with confirmation that the plan continues to meet the requirements of the legislation.

EMI grants notification

- The 92-day deadline for notification of EMI option grants to HMRC continues to apply from 6 April 2014, but all notifications must now be made online.
- EMI option arrangements must be registered *before* grants can be reported online and so the registration deadline is effectively much earlier than for other tax-advantaged share plans.
- The working time declaration by the employee is no longer part of the notification process. However, the individual is still required to sign a written declaration about their working time. There is no template or model for this employee declaration. The wording of the old form EMI1 could be used or the declaration could be incorporated into EMI option agreements.
- Where the deadline for notification of an EMI option has been missed solely because of online service issues, this will be considered as a reasonable excuse for late notification.

Annual returns

- The old forms 35 (CSOP), 34 (SAYE), 39 (SIP), 40 (EMI) and 42 (unapproved) have been replaced with online reporting for the tax year 2014-15 onwards.
- A separate annual return is required for each registered plan. So if, for example, two separate CSOPs still exist, two online returns are needed.
- If non tax-advantaged plans have been registered as separate plans, an online return must be made for each individual plan.

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- If an employer discovers that a share plan annual return it has submitted is incorrect or incomplete, a full amended return must be made.
- Once a plan has been registered, an annual online return must be made for that plan even if no reportable events have occurred.
- A notification can be given that a plan has ceased. An annual return must be submitted for that tax year but will then no longer be required.

HMRC Online Filing: How to Appoint an Agent

Online filing for employee share plans is up and running and companies should by now have received a step by step guide to registration from HMRC. It is important that you do register your plans because the annual returns from the 2014-2015 financial year onwards **must** be filed using the online service.

But what about those Companies which have appointed a third party to look after administration of their share plans? Does this mean they will now have to complete their annual returns in-house? Happily, no – it is easy to appoint a third party to act as an agent, so normal service can resume.

Step 1
The person who registers your share plans will need a user ID and a password. It is very likely that someone in your payroll department is already set up as an administrator. They can arrange user IDs and passwords for you, or they can register the share plans on your behalf.

Go to www.hmrc.gov.uk, click on 'log in' and choose 'PAYE for employers'. From the left hand menu choose 'At a glance' and then scroll down to the bottom right hand of the page and click on 'Register a Scheme or Arrangement'.

Follow the instructions and register your plans – you will need your Corporation Tax reference and the Company Registration Number. If you find yourself in a pickle, there are online FAQs and guidelines to help you navigate your way through the process.

Step 2
Contact your share plan administrator and provide them with your PAYE reference and your Accounts Office Reference (a 13 character reference number on the PAYE payment booklet or letter supplied by HMRC, printed in the format 123PA12345678). They will then log in and request permission to act as your agent.

HMRC will send you an authorisation code in the post. This will take up to 7 days and it will be sent in a white envelope, addressed to the person who logged in and registered the plan, so you may need to keep an eye out if you delegated the registration process to someone else.

When you do receive the authorisation code, email it to your share plan administrator.

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Step 3
Your administrator will use the authorisation code and add you as a client. It will be another 5 days before they can actually do anything on your behalf, but you will have successfully appointed your agent!

Many companies need to do nothing further until it comes to filing next year's employee share plan annual returns. However, for those of you who are granting or thinking of granting EMI options, HMRC will now only accept online notification, so it would be prudent to register your plans and authorise your agent now or you could run the risk of the time it takes to do all this eating into your 92 days filing deadline.

Going forwards
Once registered, your agent will be able to file notifications and annual returns on your behalf. However, the accuracy of the data is the responsibility of the company, so you should always sign off on information before it is filed.

Registering your employee share plans is a straightforward process, but it does take time, so try not to leave it to the last minute.

Finance Act 2014: other share plan changes

The following changes were made to implement some of the recommendations of the Office of Tax Simplification ("OTS") Review of unapproved employee share schemes: final report published on 16 January 2013. Mike Landon of MM&K was a member of the Consultative Committee for this review.

Tax-free rollover of restricted and partly-paid shares	If shares which are classed as restricted securities (eg subject to forfeiture) or have been issued to employees on a nil-paid or partly-paid basis are exchanged for shares in an acquiring company following a takeover, from **17 July 2014** this will no longer trigger an automatic income tax charge if specific conditions are met.
Corporation tax relief after a takeover	The conditions for corporation tax (CT) relief on acquisition of shares by employees may not be met after a company has been taken over by an unlisted company (including one quoted on AIM). From **17 July 2014**, a CT deduction is now available if the shares are acquired pursuant to an option within 90 days of the takeover.

CT relief for shares acquired by secondees	A CT deduction will now also be given to a UK company when shares are acquired from **6 April 2015** by an individual who works in the UK for that company but whose legal employment is with an overseas employer which is not subject to UK corporation tax.
Internationally mobile employees	The tax treatment of equity-based incentives for internationally mobile employees has developed over the years in a piecemeal manner. Different types of award have been treated inconsistently and there has been considerable uncertainty about which rules apply in certain circumstances. A radical change in the taxation of share and share option awards to employees whose tax residence changes between grant and vesting will apply when shares are acquired on or after **6 April 2015** (or on exercise of options granted from that date). The new provisions are complicated but, very broadly, the taxable amount will be apportioned according to the period of UK residence during the relevant period – eg the period between the grant and *vesting* of a share option. This will make the tax treatment more consistent between different types of award and with principles recommended by the OECD. The NICs treatment is also expected to be aligned – see below.
Extension of PAYE reimbursement deadline	With effect from **6 April 2014**, the deadline for an employee to reimburse the PAYE due on acquisition of shares, under section 222 of ITEPA 2003, has been extended to 90 days after the end of the tax year in which the taxable event occurred.

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New HMRC share plan consultations

Over the summer, the Government has issued consultation documents on a number of other issues which were highlighted by the OTS January 2013 report.

New 'safe harbour' employee shareholding vehicle

Employee benefit trusts ("EBTs") can provide a number of advantages for companies operating employee share plans, including:

- Enabling companies to provide existing shares purchased on the market, instead of issuing new shares.
- Providing an internal market where the shares are not traded on a stock market.
- Acting as a 'warehouse' to hold surplus shares, for example when the original founders or family members wish to dispose of them.

The OTS report identified a number of tax pitfalls which can make it difficult or expensive for some companies to set up EBTs, including inheritance tax ("IHT") charges, advance corporation tax on loans to trusts by close companies, a potential double tax charge (CGT on trustees and income tax on employees) and tax charges under the 'disguised remuneration' legislation for 'earmarking' shares for individuals.

The OTS recommended the introduction of a new 'safe harbour' EBT or other vehicle which would provide exemptions from the tax pitfalls for straightforward arrangements for providing shares to employees in their employing companies. The recommendations included strict safeguards to prevent the vehicle from being used for tax avoidance.

A Government consultation document, issued on 22 July 2014, has supported this concept in principle, though with more limited tax exemptions:

- The new vehicle could have the benefit of existing IHT exemptions in a simpler way than is currently the case for EBTs.
- Action could be taken to create a more 'level playing field' between onshore and offshore trusts regarding the CGT/income tax double charge.
- The charge on loans by close companies will continue to apply to the new vehicle.
- An exemption from stamp duty is unlikely to be given for the new vehicle (eg when it satisfies the exercise of a share option).
- A 'carve-out' from the 'disguised remuneration' charges is unlikely to be made for the new vehicle.

The safeguards likely to be applied to prevent abuse of the new vehicle include:

- The class of beneficiaries of the vehicle will include employees but not members of their families.
- Directors and major shareholders may also be excluded from benefiting.

- Only ordinary shares in the employing company (or parent) can be delivered through the vehicle – not any other kind of securities.
- There may be a minimum holding period for shares obtained by employees through the vehicle and a maximum holding period for employees who leave the company.
- There will be restrictions on the vehicle's powers to make loans to employees and to set up sub-funds for them.
- The vehicle may also be prevented from waiving dividends and voting rights.
- There will be a charge imposed if the shares are not applied for the benefit of employees within two years.

Several of these safeguards suggested by the Government show a poor understanding of how share plans and EBTs currently work in practice. So, although the 'safe harbour' vehicle is potentially a valuable way to save companies from unnecessary costs and unexpected tax charges, this will only happen if we can persuade the Government to make some considerable changes to their proposals.

Treatment of internationally mobile employees

Current NICs legislation provides that the full amount of employment-related securities income is chargeable, without the apportionment for the proportion of time spent on UK duties which applies for income tax purposes (see earlier). HMRC published draft legislation on 24 July 2014 to bring the NICs treatment more closely in line with income tax, though full alignment will not be possible under international social security treaties. These provisions should come into force on **6 April 2015**.

New concept of "marketable security"

Income tax charges usually arise when employees acquire shares (or other securities) through their employment. This can cause difficulty where the shares are in unquoted companies and employees are not able to sell any of the shares to raise the funds to pay these charges. As a result, employee share ownership can be unattractive.

The OTS recommended that the income tax charge should be delayed until the shares became 'marketable' – ie capable of being sold for their unrestricted market value. This may occur on the flotation of the company or when an EBT or other shareholder becomes able and willing to purchase the shares. The employees will then be subject to income tax on the value of the shares at that time. (Alternatively, employees can choose to be taxed at acquisition, as at present, so that any future increase in value will be subject to CGT instead of income tax.)

HMRC's consultation document, published on 17 July 2014, points out some potential practical difficulties with the OTS proposals and asks a number of questions to test their feasibility. There is no commitment for now to implement the proposals.

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Valuing shares for employment tax purposes

On 30 June 2014, HMRC published draft regulations to enact the OTS's recommendations on valuing listed shares for employment tax purposes. Currently shares listed on the main market of the London Stock Exchange are valued on a 'quarter up basis', which means the lowest recorded price for the day plus a quarter of the difference between the lowest and the highest recorded prices.

The new regulations will replace this with the closing mid-market price, which is halfway between the closing bid and offer prices for a trading day (or the most recent trading day if the London Stock Exchange is closed). The date when these regulations will come into force was not announced.

SAYE bonus changes

The bonus rates for SAYE savings contracts had been set at zero since 1st August 2012, due to low market interest rates. With effect from 28 July 2014, the bonus rate for 5-year contracts was increased to 0.6 monthly payments, which is equivalent to an annual interest rate of 0.39%. The bonus rate for 3-year contracts remains at zero.

This change is unlikely to have any material impact on employee take-up but helps to explain why 92% of companies offer a discounted exercise price, as reported in the next item.

ifs ProShare Survey

The most recent ifs ProShare SAYE and SIP Survey, published in July 2014, provided an interesting update on market practice and participation levels.

SAYE	SIP
70% of companies offer the maximum 20% discount. Only 8% offer no discount.	75% of companies offer Partnership Shares; 37.5% offer Matching Shares; 24% offer Free Shares and 43% offer Dividend Shares.
82.5% of options granted in 2013 were 3-year options and 17.5% 5-year.	93% of eligible employees were awarded Free Shares in 2013.
16.5% of eligible employees were granted SAYE options in 2013.	18% of eligible employees contributed to buy Partnership Shares.
Average monthly savings were £86 for new grants and £108 under all SAYE contracts.	Average monthly contributions were £66.

For more details, ifs ProShare can be contacted at ifsproshare@ifslearning.ac.uk.

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HMRC employee share scheme statistics for 2012-13

The share plan statistics for 2012-13, released by HM Revenue & Customs (HMRC) on 26 June 2014, provide further information about the take-up of the tax-advantaged share plans.

All-employee plans

The following two tables show how the number of companies *actually granting* awards under SAYE and SIP and the levels of participation by employees changed between 2007-08 and 2012-13.

No. of companies granting awards	SAYE	SIP		
		Partnership Shares	Matching Shares	Free Shares
2007-08	340	380	240	200
2012-13	260	400	260	160

No. of employees granted awards 000s	SAYE	SIP		
		Partnership Shares	Matching Shares	Free Shares
2007-08	500	253	141	710
2012-13	420	348	225	180

Notes:
As Partnership and Matching Shares are usually awarded monthly, we have divided HMRC's figures for number of participants for those shares by 12.

HMRC have stated that "the substantial decline in the number of SIP Free Share awards for 2012-13 is due to year by year changes in the patterns of awards amongst the largest schemes". The number of Free Share participants can be expected to rise considerably in 2013-14, when the Royal Mail offer will be included.

Although the number of companies granting SAYE options has declined, SAYE now has the largest number of participants for all types of tax-advantaged share plan.

However, these participation levels contrast sharply with 1997-98, when roughly one million employees participated in *each* of the all-employee plans - SAYE and Profit Sharing Share Schemes (which were replaced by SIPs).

Despite the efforts of the OTS, the legislation for these all-employee plans remains far too detailed and inflexible and so is unattractive for many smaller companies. Moreover, the five-year period which employees must wait until withdrawing their shares tax-free has discouraged a large number of companies from adopting SIPs.

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Discretionary plans

The following two tables show how the number of companies *actually granting* CSOP and EMI options and the number of participants changed between 2007-08 and 2012-13.

No. of companies granting options	CSOP	EMI
2007-08	440	2,850
2012-13	290	2,540

No. of employees granted options 000s	CSOP	EMI
2007-08	65	26
2012-13	25	18

Although EMI is the most widely used type of tax-advantaged share plan, it has the lowest number of total participants.

The participation levels for CSOP and EMI combined represent a substantial fall from 2000-01, when 415,000 employees were granted CSOP options.

Unfortunately, the Government seems to be deliberately letting the CSOP decline. This is a shame because it is still the simplest and most flexible way of delivering employee share participation for companies which are too big to offer EMI.

The CSOP has fallen out of favour mainly because of a trend away from companies offering market value priced share options. Also, the CSOP is no longer useful in remunerating senior executives because the £30,000 limit has been frozen since 1995.

The Government could help to reverse the downward trend in employee share ownership by bringing the CSOP into line with modern remuneration practice. As for EMI options, it should:

- allow CSOP options to be granted at a discount or with a zero exercise price; and
- remove the requirement for CSOP options to be held for three years before they can be exercised with tax relief.

Even without increasing the £30,000 limit, this would greatly enhance the usefulness of the CSOP and could increase the number of employee shareholders much more effectively than the "employee shareholder status" approach, which was introduced last year.

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.

For further information about any of the matters discussed above, please contact Mike Landon at michael.landon@mm-k.com or 020 7283 7200.

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