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Share Plans Update

January 2014

'Autumn Statement' announcements

The Government announced valuable improvements to both tax-advantaged and unapproved share plan legislation in the Autumn Statement on 5 December 2013 and in the draft Finance Bill clauses which were published a week later. Apart from the welcome increase to the individual limits for SIP and SAYE, the changes for tax-advantaged plans were mainly related to the replacement of the HMRC approval process with self-certification. The modifications to unapproved share plans implement some of the recommendations of the Office of Tax Simplification (OTS), to which Mike Landon of MM&K contributed as a member of the Share Plans Consultative Committee.

Tax-advantaged plans:

- Increased limits for SIP and SAYE
- Uncertainty about cash alternatives
- Automatic enrolment for SIP Free Shares
- Possible forfeiture of Partnership & Dividend Shares
- Limits to exercising discretion for CSOPs
- Tax relief for option exercise after change in control

Registration, self-certification and online reporting:

- Self-certification for all SIP, SAYE and CSOP plans
- Registration for all plans, including EMI and unapproved
- Online reporting and penalties for missed deadlines

Unapproved plans:

- Significant changes for internationally mobile employees
- Rollover relief for restricted and partly-paid shares
- CT relief after a takeover
- Extension to section 222 PAYE deadline
- Quarter-up valuation to go

Do your share plans need updating?

Increased individual limits for all-employee share plans

The limits to individual participation for the all-employee Share Incentive Plans (SIPs) and SAYE Share Option Schemes will increase from 6 April 2014 as follows.

Plan	Existing limit	New limit	Increase
SIP Free Shares	£3,000 per year	£3,600 per year	20%
SIP Partnership Shares	£1,500 per year (£125 per month)	£1,800 per year (£150 per month)	20%
SIP Matching Ratio	2 for 1 (£3,000 per year)	2 for 1 (£3,600 per year)	-
SAYE/Sharesave	£250 per month	£500 per month	100%

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Most companies are expected to take advantage of the higher SIP limits as soon as possible. Although the SAYE increase is the first one since 1991, many companies will be implementing it gradually because they are concerned about breaching their headroom share dilution limits. One possible approach is to retain the £250 limit for each individual savings contract, while allowing up to £500 for all outstanding contracts.

To take advantage of these increases, companies will need to amend their plan Rules, unless the Rules are already worded to adjust automatically for changes in the statutory limits. In any case, administration systems and communication materials, including enrolment forms and Free and Partnership Share Agreements, will need updating.

Simplification of 'purpose test': possible impact on discretionary cash payments

The current legislation requires that a SIP, SAYE or CSOP plan:

- *must not contain features that are neither essential nor reasonably incidental to the purpose of providing benefits for employees in the nature of shares or share options.*

MM&K had pointed out to HMRC that it would be difficult for companies to certify that their share plans met this extremely vague requirement. The replacement 'purpose test' is that a plan:

- *must not provide benefits to employees otherwise than in accordance with the legislation set out in the relevant schedule for that plan.*

In our view, this is not any more helpful than the previous wording.

A possible concern for some companies is that the new provision includes a specific example that "*the plan must not provide cash to employees as an alternative to shares*".

Some companies which offer Free Shares under a SIP are prepared to make a discretionary cash payment to employees who do not accept the offer. This has been a longstanding practice accepted by HMRC provided that this was not presented to employees as an explicit choice between shares and cash. The new wording of the legislation does not appear to prevent the current practice, as any cash benefits are paid *outside the provisions of the share plan*. However, we will need to await further guidance from HMRC (to be issued at the time of the Budget on 19 March) as to whether or not their policy on this issue has changed.

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The new provision should not prevent 'cashless exercise' of CSOP options, provided that the participants have the choice to pay the full exercise price instead and that they actually acquire ownership of the shares, albeit momentarily, before the shares are sold.

SIP Free Shares: automatic enrolment

HMRC have confirmed that companies may require employees to opt *out* of an offer of Free Shares if they do not wish to participate. The usual practice up to now has been only to award Free Shares to employees who have opted *in* by signing a Free Share Agreement (or electronic equivalent).

Automatic enrolment will be allowed if employees are sent a letter (or presumably an electronic equivalent) which sets out the full terms of the Free Shares offer and they do not opt out by a deadline which is at least 25 days after the offer letter.

Requirement to sell SIP Partnership and Dividend Shares

The Finance Act 2013 removed the prohibition on companies imposing restrictions on shares which employees acquire through the 'approved' share plans. However, it continued to prevent SIP Partnership Shares or Dividend Shares from being forfeitable.

The new Finance Bill will allow companies to force employees to offer their Partnership and Dividend Shares for sale on leaving employment, provided that the amount payable is not less than the *lower* of:

- the amount originally paid for the shares; or
- the then current market value, if the share price has fallen.

This is only likely to be relevant for private companies.

Varying terms of CSOP options

The new legislation will require that all the terms and conditions of CSOP options, including any performance conditions, must be specified to the participant at the date of grant. Variations in these terms will be allowed, as will the exercise of discretion, but only if the circumstances are specified at grant and they are applied in a fair and reasonable way. A CSOP option must be capable of exercise at some time between the third and tenth anniversaries of the date of grant (ie while income tax relief is normally available).

These changes are broadly consistent with the approval conditions which HMRC have specified for many years, but with what may be an important exception. HMRC have not permitted companies to exercise discretion as to whether or not options can be exercised in the statutory "good leaver" circumstances; but the new legislation appears to allow discretion in these cases.

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SAYE and CSOP exercise on a change in control

If a SAYE option is exercised after a company has come under the control of an unlisted company (including an AIM company) or a CSOP option is exercised after the company has come under the control of any other company, income tax relief for the option exercise may be lost because the shares being acquired no longer qualify under the legislation.

Under the new provisions, this problem can be solved in one of two ways for SAYE and CSOP options. Tax relief will still be given if the options are exercised:

- either within seven days *after* the change in control;
- or within seven days *before* the change in control, on condition that the exercise only has effect if the change in control occurs.

The corporation tax relief changes mentioned later in this Update will also benefit companies in these circumstances.

If there is a scheme of arrangement under the UK Companies Act, SAYE and CSOP options can either be exercised immediately or tax relief can be retained by exchanging the options for options over shares in a new holding company. The definition of scheme of arrangement is to be changed so that one made under equivalent overseas legislation will also qualify.

Registration, self-certification and online reporting

Self-certification of SIP, SAYE and CSOP

From 6 April 2014, the process for HMRC to give formal approval to new SIP, SAYE and CSOP plans is to be replaced with self-certification by the companies which establish the plans. Companies will need to send notices to HMRC with some basic information about their plan and containing a declaration that the requirements of the relevant legislation are met.

The notices will not need to be given in advance. Instead, the deadline is the 6 July following the tax year in which the first award of shares is made under SIP or the first options are granted under SAYE or CSOP.

Companies must also self-certify *existing* SIP, SAYE and CSOP plans, which have already been approved by HMRC before 6 April 2014, by no later than 6 July 2015 **otherwise they will lose their tax advantages**. This can be done as part of the registration process – see below.

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Amendments to key features of these formerly 'approved' plans (and apparently to any part of SIP trust deeds) will need to be reported under the annual online filing process – see below. Companies must make a declaration to confirm that the requirements of the legislation for the relevant plan continue to be met.

Adjustments made to SAYE and CSOP share options to take into account a variation in the company's share capital will no longer require HMRC approval, but will have to meet strict conditions.

HMRC enforcement of self-certification

HMRC will be able to investigate plans either within one year of the original deadline for their self-certification or at any time if they have reasonable grounds for believing the requirements of the legislation are not being met.

If HMRC decide that the plan contains a fundamental error, the plan will lose its tax advantages and the company will have to pay a penalty of up to twice the amount of income tax and NICs which had not been paid.

For less serious errors, companies will be able to continue to operate the plans with tax advantages; but they will have to correct the error within 90 days and pay a penalty of up to £5,000.

Registration of all tax-advantaged and unapproved plans

In future, all share plans will need to be registered with HMRC. This includes Enterprise Management Incentives (EMI) and unapproved plans. Each unapproved plan may need to be registered separately. Moreover, if a plan contains both 'approved' and 'unapproved' parts, these will need to be reported as separate plans.

As mentioned above, existing 'approved' share plans can be self-certified as part of the registration process. The existing HMRC reference number will be replaced with a new number.

Before registering, the company must already be registered with the PAYE Online service.

The deadline for registration will be 6 July 2015. However, HMRC will be encouraging companies to register their plans as early as possible.

Online reporting for all share plans

The last 'paper' annual share plan returns (including Form 42 for unapproved share plans), in respect of the tax year ending 5 April 2014, must be submitted by 6 July 2014. The forms can be found at:
http://www.hmrc.gov.uk/shareschemes/ann-app-schemes.htm

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From the tax year ending 5 April 2015 onwards, the paper returns will be replaced with online reporting for all registered share plans. As at present, these will give details of share awards and option grants and other taxable events; though HMRC are currently reviewing the exact content. The deadline of 6 July following the end of the tax year will remain. This deadline will also apply to 'nil returns', where there has been no activity during the tax year.

Facilities will be made available for plan administrators and other agents to complete part of the online returns. This may include separate schedules in a format which HMRC will be specifying.

The legislation includes penalties if the deadline for online returns is not met. If a return is not received by 6 July, there will be an automatic penalty of £100. Further automatic penalties of £300 are payable if the return is still outstanding after three months and six months. Daily penalties will apply after nine months. A more draconian penalty of up to £5,000 will be imposed if a return is on time but submitted in the wrong format!

EMI online reporting starts much earlier

The Form EMI 1, which reports details of grants of EMI options, must be submitted to HMRC within 92 days of the date of grant. With effect from 6 April 2014, the deadline will remain the same but companies will be able to submit the information online. Online submission will become compulsory as soon as the Finance Bill receives Royal Assent (expected to be in July 2014).

Companies will no longer need to include a declaration signed by the employee (concerning the hours he works) with the option grant notice; but they must confirm that the individual has signed this written declaration.

Changes mainly affecting unapproved share plans

Awards granted to internationally mobile employees

There is currently considerable confusion about the tax treatment of share and share option awards to employees whose tax residence changes between the date of grant and the vesting or exercise of their awards. The treatment varies between different types of share award and depending on whether or not an award is considered to be a 'legal option'.

Legislation in the draft Finance Bill will introduce more consistency and is intended to align the apportionment of gains between different jurisdictions on the basis of guidelines issued by the OECD. Also, the NICs position will be aligned more closely with the income tax rules. This will apply for awards granted on or after 1 September 2014.

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Tax-free rollover for restricted, nil-paid and partly-paid shares

When the company which grants a share option or conditional share award is taken over, the awards can usually be exchanged for new awards over shares in the acquiring company without triggering an income tax charge. However, the exchange of shares which are classed as 'restricted securities' (eg subject to forfeiture) or shares which have been issued to employees on a nil-paid or partly-paid basis generally results in an immediate income tax charge because the shares are deemed to have been sold. The tax rules will be amended to allow rollover on a takeover for these other types of shares without a tax charge. The changes will be effective from the date when the Finance Bill receives Royal Assent.

Corporation tax (CT) relief following a takeover

The conditions for CT relief on the acquisition of shares by employees do not currently apply after the company has been taken over by an unlisted company. Relief is now to be made available for shares acquired within 90 days of the takeover.

CT relief is also to be given when the shares are acquired by an individual who is seconded to the company.

These changes will also apply from Royal Assent.

Extension of deadline for employees to make good PAYE payments

When shares are acquired through vesting or exercise of share and share option awards, there will usually be an income tax liability under PAYE. In many cases, the employee will have insufficient salary in the relevant month from which to deduct this tax; though the employer needs to account for it. Under current rules, if employees do not reimburse the PAYE to the employer within 90 days they will incur an additional income tax charge (under section 222 of ITEPA 2003).

This deadline has been difficult to meet in some cases and so, for taxable events from 6 April 2014, it is to be extended until 90 days after the end of the tax year in which the taxable event occurs.

Calculation of market value of listed shares

The market value of shares of listed companies for tax purposes is currently deemed to be the *lower* of:

- the lower of the two share prices shown on the Official List on the relevant date plus one-quarter of the difference between the two figures; and
- halfway between the highest and the lowest prices at which bargains were recorded for that date.

This formula has widely been regarded as very complicated and the OTS recommended it should be replaced. With effect from Royal Assent, the market value of shares is to be defined as the closing price of the shares for the relevant trading day.

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Capital gains tax annual exempt amount

In line with previous announcements, the CGT annual exemption is to be increased as follows over the next two tax years.

2013-14	2014-15	2015-16
£10,900	£11,000	£11,100

Findings of ifs ProShare Survey

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

SAYE	SIP
81% of companies offer the maximum 20% discount. Fewer than 1% offer no discount at all	76% of companies with SIPs offered Partnership Shares; 50% Matching Shares; 25% Free Shares and 44% Dividend Shares
78% of options granted were 3-year options and 22% were 5-year options	Only 40% of eligible employees were awarded Free Shares
19% of eligible employees were granted options	18% of eligible employees contributed to buy Partnership Shares
Average monthly savings were £95 for new grants and £106 under all SAYE contracts	Average monthly contributions were £83.

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

Are your share plan documents up to date?

When we are asked to review plan documents for new clients we often find that they need to be updated. This applies in particular to SIPs, which tend to be reviewed less frequently.

Has your plan terminated?

Many share plans automatically terminate after 10 years, to comply with institutional investor guidelines. Although this is less usual for SIPs, these do sometimes have a 10-year life. In other cases, UK plans are set up as sub-plans to a foreign parent company plan. If the parent plan is replaced, then it will usually be necessary for a new UK sub-plan to be created.

We recently came across an example of a SIP which had been operated for more than a year after it had passed its termination date. Although HMRC were prepared to allow the plan to continue to be approved, it required the Company to refund the PAYE income tax and NICs which should have been deducted. This was a substantial unexpected extra cost for the company.

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Have you taken advantage of changes in legislation?

We sometimes find that companies have not updated their plan rules even to take advantage of the improvements in the Finance Act 2003, yet alone those enacted last year. In some cases, the legislation will have automatically updated the plan rules; but this may not be the case, for example for the new change of control provisions for CSOPs in the Finance Act 2013. In any case, explanatory booklets and other ancillary documents will need to include the new provisions.

Participating companies

If a new participating company is added to a SIP, this will usually require a deed of adherence. In some other plans, the addition of a new subsidiary company will need specific approval by the Board of Directors.

More minor details

Some plans still refer to the Inland Revenue, Schedules D, E and F and legislation which has been replaced (such as Income and Corporation Taxes Act 1988). These can conveniently be updated at the same time as other changes.

MM&K can carry out a share plan 'health check' to ensure that your plan design, documentation, communication materials and administration systems are in line with current best practice, the company's own objectives and recent changes in the tax legislation.

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.

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