

Proposal to amend the retirement provisions for approved SAYE Option Schemes

Overview

In July 2010, the Government proposed in a Consultation Document¹ to remove the Default Retirement Age (DRA) of 65. One consequence of this proposal could be to prevent certain employees who retire from exercising share options granted under all-employee approved SAYE Option Schemes.

This paper recommends that the legislation for SAYE Option Schemes should be amended in order to allow employees who retire on or after an age specified in the scheme rules to exercise their share options.

Background on SAYE Option Scheme retirement provisions

SAYE Option Schemes were introduced in the Finance Act 1980 (FA 80). This contained two provisions relating to retirement age.

1. Exercise on retirement (paragraph 8 of Schedule 10 to FA 80)

Schemes had to provide that an option holder who left employment by reason of retirement on:

- reaching pensionable age (then 65 for men and 60 for women); or
- any other age at which he was bound to retire in accordance with his contract of employment

could exercise his share option within six months of retirement. Relief from income tax was given when a share option was exercised in these circumstances.

2. Exercise on reaching pensionable age (paragraph 9 of Schedule 10 to FA 80)

Schemes also had to provide that an option holder who reached pensionable age but continued in employment could exercise his share option within six months of that date. Such exercise was also eligible for income tax relief.

These two provisions were subsequently re-enacted in paragraphs 19 and 20 of Schedule 9 to the Income and Corporation Taxes Act 1988.

However, they were amended by section 38 of the Finance Act 1991, to avoid breaching European Community law, specifically Article 119 of the Treaty of Rome, because they discriminated between men and women. Under the amended provisions, the term "pensionable age" was replaced with a "specified age", set out in the scheme rules, which must be:

- the same for men and women, and
- not less than 60 and not more than 75.

The current legislation, in paragraphs 33 and 34 of Schedule 3 to the Income Tax (Earnings and Pensions) Act (ITEPA) 2003, contains the same provisions as those introduced in 1991.

In practice, most companies operating approved SAYE Option Schemes choose 60 as the specified age, partly to maximise the opportunity for employees who retire to exercise

¹ "Phasing out the Default Retirement Age", Department for Business Innovation & Skills and Department for Work and Pensions, issued on 29 July 2010

their share options and partly to minimise the possibility of a claim under the age discrimination regulations which came into effect in 2006.

Provisions for approved CSOP Schemes

The equivalent provisions for discretionary approved Company Share Option Plans (CSOPs) are significantly more flexible than those which apply for SAYE Option Schemes.

Since their introduction in the Finance Act 1984, it has been possible for CSOP Schemes to allow share options to be exercised at any time. It has been usual for these schemes to allow option holders who retire at any age to exercise their share options.

Originally, there was no income tax relief if CSOP options were exercised within three years of the date of grant in any circumstances. However, the Finance Act 2003 provided relief where the options are exercised before the third anniversary of grant but within six months of the option holder retiring on or after reaching a retirement age specified in the scheme (section 524 of ITEPA 2003).

Under paragraph 35A of Schedule 4 to ITEPA 2003, the retirement age specified in a CSOP Scheme must be:

- the same for men and women; and
- not less than 55.

The provisions for discretionary CSOPs are therefore already more favourable than those for all-employee SAYE Option Schemes, in that the specified age can be five years earlier and exercise is permitted (and income tax relief given) following retirement even if this occurs after the specified age.

Provisions for approved SIPs

The retirement provisions for all-employee approved Share Incentive Plans (SIPs) are also more favourable than for SAYE Option Schemes.

Under section 498 of ITEPA 2003, a participant is not liable to income tax on his shares ceasing to be subject to the plan (and, under paragraph 32 of Schedule 2, his free shares and matching shares cannot be forfeited) if he has left employment on or after reaching a retirement age specified in the plan, which (under paragraph 98 of Schedule 2 to ITEPA 2003) must be:

- the same for men and women; and
- not less than 50.

It is unclear why the minimum age of 50 was chosen for SIPs while the equivalent minimum age for SAYE Option Schemes was 60.

Impact on SAYE Option Schemes of removal of DRA

As discussed above, an option holder who retires can currently exercise a SAYE share option if his retirement date is:

- either the specified age (between 60 and 75) contained in the scheme rules;
- or any other age at which he is bound to retire in accordance with his contract of employment.

Under the current Employment Equality (Age) Regulations 2006, an employer can compulsorily retire an employee at the age of 65 (the DRA) or above without that being deemed to be unfair dismissal or age discrimination provided it follows a set retirement

procedure. However, in its July 2010 Consultation Document, the Government has proposed to phase out the DRA from 6 April 2011.

When the new provisions come into effect, for most employees there will not be any "age at which they are bound to retire in accordance with their contract of employment". An option holder who retires will therefore only be able to exercise his option if he retires on reaching the specified age. If he chooses to retire on any other day, and this is before the normal maturity date for his SAYE contract, his share option will lapse.

Given that the Government's main justification for removing the DRA is to encourage people to work for longer, this would be an extremely unfair way of treating employees in this position.

How many employees would be affected?

We have investigated the extent to which this is a real potential problem or merely theoretical.

Computershare, one of the leading providers of SAYE option contracts, has provided the following statistics for the last five years in respect of the SAYE Option Schemes which they administer. During that period:

- 1,230 individuals (of whom 355 were men and 875 were women) exercised SAYE options on reaching the specified age.
- 5,055 individuals (of whom 3,777 were men and 1,278 were women) exercised these options on reaching contractual retirement age.

Equiniti, another leading provider of SAYE option contracts, has provided the following analysis of their records of SAYE option exercises as a result of retirement:

- 26% exercised having reached the specified age and retired.
- 2% exercised having reached the specified age and remained in employment.
- 72% exercised on reaching contractual retirement age.

It is therefore clear that a substantial number of SAYE option holders will be disadvantaged unless the legislation relating to retirement in the SAYE Option Scheme legislation is amended.

Proposed amendment to SAYE Option Scheme legislation

We recommend that this potential problem should be dealt with by means of a simple change to the SAYE Share Option Scheme legislation, so that the retirement provisions are aligned with those which currently apply for discretionary CSOP Schemes.

Sub-paragraph 34(2)(b) of Schedule 3 to ITEPA 2003 should be replaced with the following:

"retirement on or after reaching the specified age".

We also recommend that the minimum specified age, in paragraph 31 of Schedule 3, should be reduced to 55, for consistency with the equivalent CSOP provision (paragraph 35A of Schedule 4).

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