

Employee Incentives

Autumn Bulletin



November 2009

Press frenzy over the alleged bank "bonus culture" has brought attention to share incentives in recent months. Many regard these as an appropriate alternative to large cash payments since they link executive reward with the interests of shareholders more closely. In any event, for those employers feeling the effects of recession, share plans can offer a cost effective and flexible means of incentivising their work force. With an election beckoning in 2010 we do not expect any great surprises in the Pre-Budget Report on 9th December. However, this Bulletin considers a number of interesting, recent developments in the field of employee incentives.

EMI Gets the Green Light!

Many employers will be familiar with Enterprise Management Incentives ("EMI"), the tax approved share option plan introduced in 2000. EMI was heralded as a flexible form of incentive and aimed particularly at start-ups although it can be offered by a wide range of small and medium-sized companies. In August the European Commission granted State Aid approval for the EMI regime until April 2018. HM Treasury expressed the view that this would provide a boost to the 9,000 companies currently offering EMI and the hope that the news would encourage take-up amongst high-growth, small firms. The Government also announced that it would relax the requirement for companies to trade wholly or mainly in the UK. Instead, any company with a permanent establishment in the UK and which meets the other EMI requirements will be able to offer these incentives. It is likely that the change will be introduced in the 2010 Budget and is expected to take effect from 6 April 2010. The amendment will be particularly useful for companies with both UK and overseas operations.

Prospectus Directive Turnaround

Whenever a company decides to offer employees shares, one of its considerations should be whether or not a "prospectus" is required. In broad terms, a prospectus is a document prepared in accordance with the EU Prospectus Directive which contains detailed information about a company. Understandably most companies wish to avoid the need to publish a prospectus as this can be a time consuming and costly process. They therefore look for an exemption from the prospectus requirement within the Directive itself. One such exemption applies to companies when they issue shares to their employees. This is, however, currently limited to those companies with shares traded on a regulated market. Accordingly, private companies and companies with shares traded on AIM have not been able to rely on the exemption. Following a great deal of lobbying from within the share scheme industry, we were delighted when the European Commission announced a proposed amendment in September. This would have extended the employee exemption to offers by any company, regardless of whether or where its shares were listed. Unfortunately, in October the Council of the European Union published a revised

- *EMI granted State Aid approval until April 2018*
- *Trading in the UK requirement to be relaxed from April 2010*

- *Prospectus Directive exemption for employee shares not extended to private and AIM listed companies*

amendment which is much narrower than that put forward by the European Commission. The Council's proposal is simply to extend the exemption to non-EEA companies whose shares are traded on exchanges equivalent to an EEA regulated market. This is a disappointing return to square one for private and AIM listed companies. It is not clear at this stage why the Council has taken such a restrictive approach and whether it can be persuaded to change its mind through further lobbying.

In-Year PAYE Penalties

It was announced in this year's Budget that from May 2010 companies may incur a penalty if they do not pay their PAYE each month on time and in full. These "in-year" penalties are a new development for small and medium sized companies. Under the new rules, penalties may be due if a company makes more than one PAYE payment late. The level of the penalty will be based upon a percentage of the amount paid late, starting at 1% and increasing to 4% depending upon the number of late payments in a year. There are further penalties of 5% if any of the PAYE due is still not paid after six months and again after twelve months. It is therefore important that companies have effective procedures in place for the payment of PAYE, particularly as regards share incentives. It is in the interests of employees to put the employer in funds to meet a PAYE liability arising on share incentives promptly as failure to do so can result in additional penalty tax liabilities for them.

Annual Returns for Share Incentives

It is never too early to start thinking about your annual share scheme returns for 2009/10, all of which (apart from EMI) were published by HM Revenue & Customs last week. We are already aware of changes to two of the returns for next year. The first relates to the SAYE Return (Form 34). From the current tax year, companies will need to make an entry in section 7, box 28 ("total number of shares for which options were granted"). Form 34 has contained this box in previous years but the accompanying notes stated that it did not need to be completed. This will now change. The return for approved executive share option schemes (Form 35) will also require additional information. Historically, HMRC have not required information regarding options exercised between 3 and 10 years from grant at a time when the scheme remains approved (i.e. "regular" approved exercises). In section 5 of this year's return you will need to give details of all option exercises, including these regular approved exercises. We would strongly advise that you collect the information needed to prepare your share scheme returns throughout the year as this makes the process at the end of the year much more painless.

Family Benefit Trusts

Some companies have chosen to operate Family Benefit Trusts ("FBTs") as part of their remuneration packages. An FBT is essentially an employee benefit trust under which assets are appointed on sub-trusts for individual employees and their families. The advantage of FBTs is that they are a flexible way in which to provide benefits both during and after employment. HMRC have recently commented on FBTs and expressed the opinion that some of them do not achieve the tax results for which they say they are designed. They have hinted that legislation might be introduced to restrict the use of FBTs and cases are being taken to tribunal on the inheritance tax charges that can arise where the company is a close company for tax purposes. It is hoped that if the Government chooses to legislate that any such changes will be carefully drafted so as to not impact on employee benefit trusts generally.

Filing Requirements for US Employees

Companies with US employees might not be aware that they have a filing requirement in respect of employee share incentives administered in the UK. A US Treasury Form "TD F 09-22.1 Report of Foreign Bank and Financial Accounts" (commonly known as an "FBAR") has to be filed by any US person who has a financial interest in a non-US financial account where the aggregate value of those accounts is more than \$10,000 at any time in a calendar year. The IRS has recently taken a broader view of what constitutes a "financial account", which could encompass shares and monies held by brokers, administrators or trusts for an individual, even if this is for only a short period. The report usually has to be filed by 30 June after the calendar year in which the threshold is met and failure to do so can lead to civil and/or criminal penalties. US citizens and residents (wherever they are based) who participate in UK share plans should therefore be encouraged to check their personal US filing obligations at the earliest opportunity.

- *In-Year PAYE penalties for all companies from May 2010*

- *Changes to the 2009/10 annual share scheme returns*

- *HMRC probe Family Benefit Trusts*

- *Important filing requirement for US employees*

If you would like to discuss any aspect of this Autumn Bulletin then please do not hesitate to contact a member of the Employee Incentives Group. Members of the team are also very happy to come and talk to you and your colleagues about the forms of share incentive that are currently available.

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