

# *Employee Incentives*

## *Budget 2009 Update*



June 2009

Although Budget 2009 was something of a "damp squib" for share plans, the shock announcement of a 50% income tax rate from April 2010 should spark a renewed interest in share-based incentives.

Bonus rates for save-as-you-earn ("SAYE") plans will fluctuate more frequently due to recent changes. We look at how these share schemes will be affected.

Executive remuneration has endured a great deal of press scrutiny over the last six months. We consider the emerging trends.

July 6 is an important deadline for annual share plan returns. We remind you of your filing obligations.

Significant changes have been announced to the tax treatment of employee share incentives in Australia. We summarise the new rules.

### **Budget 2009: Up-date**

Apart from the administrative changes to SAYE plans (discussed below), we were disappointed by the lack of share scheme content in this year's Budget. In some respects, no news is good news, however certain HMRC approved plans are in need of improvement in order to be more useful to companies in the long term. For example, representations had been made to increase the monthly SAYE savings limit from £250 to £400. Companies might be forgiven for thinking that current share prices makes this less of an issue, but it is high time the threshold was increased for when market conditions improve. Many take the view that Share Incentive Plans ("SIPs") would prove more attractive to employees if the minimum holding period for shares was reduced from five to three years, thereby aligning SIPs with other HM Revenue & Customs ("HMRC") approved plans. Finally, Enterprise Management Incentives ("EMI") would be available to more of the companies at which they were originally aimed if the rules on control were modified for those with significant venture capital or private equity investment. Although the Government has not dismissed reforms to deal with these points out of hand, it seems unlikely that we will see any changes in the short term.

*Administrative changes in store for SAYE plans*

*How to beat the 50% tax rate*

*New trends in remuneration*

*Annual returns for share incentives*

*Important changes for Australian share plans*

We were particularly surprised that specific income tax changes announced in the 2008 Pre-Budget Report ("PBR") will not appear in the 2009 Finance Act. Current tax legislation works in such a way that, in some circumstances, employees can be treated as having bought shares at a discount, even though they have paid market value for them. Employees then suffer a charge to income tax on the amount of the "undervalue". A typical example of when this can occur is where an employee buys shares at their market value but on terms that payment of the purchase price is deferred. In the PBR the Government acknowledged that this income tax charge was too wide and that amendments would be tabled in 2009. Although we have yet to see any draft legislation on the point, we understand that changes will be made in this area and will be proposed for inclusion in the 2010 Budget.

One important point to note is that from April 2010 all companies will be subject to in-year penalties for late-paid PAYE. These changes will be relevant for companies operating share plans where recovery of PAYE is often an important issue. PAYE for a tax month should be paid by a company to HMRC by the 19<sup>th</sup> of the following month (22<sup>nd</sup> if payment is made electronically). At the moment it is only larger companies that risk penalties if the payments are not made on time. Small and medium-sized companies will only face such charges and interest if they have failed to account for all the PAYE they owe within 14 days of the end of the tax year (17 days if payment is made electronically). Changes announced in the Budget will mean that all companies will be subject to in-year penalties. The level of penalty will depend upon the number of times a company defaults in paying the tax in question during a tax year. The initial default will not trigger a charge, however, the Finance Bill states that a second late payment will trigger a penalty of 1% of the PAYE that should have been paid, rising to 4% for 10 or more defaults during the tax year. A penalty of 5% will be imposed for any tax which is more than six months late and a further 5% penalty is due after twelve months. It is also proposed that in-year interest will be charged for late paid PAYE. The dates from which the new provisions apply are yet to be announced.

### Administrative Changes to SAYE Plans and New Bonus Rates

Last November the Government announced a series of proposals to ease the administration of SAYE plans. The most practical change is that companies will be able to use the old bonus rates for SAYE offers which straddle a rate change. Before the changes were announced a company might go to the trouble and expense of printing documentation for its SAYE launch and issue invitations only to find that, due to a bonus rate change in the interim, the subsequent applications are invalid because they refer to the old rates. From now on, when HMRC announces a bonus rate change, it will be able to specify that invitations issued before the rate change will still be valid and the old bonus rate can be used provided savings contracts are entered into within a set period of time. This new power is particularly important given that bonus rates are likely to change more frequently in future as the annual review of rates has been dispensed with in favour of a formula that will trigger bonus rate changes throughout the year. If you issue SAYE invitations around the time of a bonus rate change then it is important to check that the old bonus rate is available. This will depend on the way in which the new bonus rates are introduced.

HMRC have already issued a new SAYE prospectus that took effect from 29 May 2009. The terms of the prospectus allow companies to use the old bonus rates where invitations were issued before 29 May provided savings contracts are entered into within 30 days of that date. The new bonus rates from 29 May are as follows:

Savings Contract	Bonus Rate stated as monthly payments (old rates in brackets)	Equivalent % (old rates in brackets)
3 years	0.3 (0.6)	0.54% (1.08%)
5 years	2.2 (2.6)	1.42% (1.67%)
7 years	5.2 (5.6)	1.84% (1.98%)
Early leaver interest rate		0.36% (0.5%)

- *HMRC can allow SAYE invitations to "straddle" a bonus rate change*
- *More frequent bonus rate changes likely*

## The 50% Tax Rate – Changes on the Horizon for Employee Remuneration?

The shock announcement of a 50% income tax rate from 2010 combined with the 0.5% increase in National Insurance Contributions from 2011 means that companies will increasingly be looking for tax efficient ways to remunerate their employees. Inevitably this will lead to greater use of incentives that escape income tax charges, either because they are tax exempt or because they fall within the capital gains tax regime. We expect to see an increase in the following:

- Use of HMRC approved plans (CSOP, EMI, SAYE and SIP) either on their own or in conjunction with an unapproved plan. Note that with share prices generally low, the financial limits within approved schemes currently stretch a lot further than before
- Share ownership plans such as joint ownership plans that seek to bring employees within the charge to capital gains tax as opposed to income tax
- Acceleration of existing entitlements so that they vest before the changes take effect (subject to plan rules and, in the case of listed companies, regulatory constraints and institutional investor guidelines)
- Bonuses paid on deferred terms (so that tax and NICs only become due if the bonus is actually paid)
- Individuals working through the medium of service companies (although the application of IR35 needs to be considered carefully)

If you would like more information on any of the above or to discuss ways in which you can maximise the tax efficiency of your share plans then please do not hesitate to contact your usual Employee Incentives Group contact.

## Emerging Trends in Executive Remuneration

The current economic climate has put executive remuneration under the spotlight. It seems that hardly a week passes without the revelation of a hefty bonus payment or a generous pension provision. Not surprisingly this has given rise to an array of reports and guidelines issued by various interested parties on the structure of "post credit crunch" remuneration. Many of these focus principally on the financial and regulated sectors but some of the themes are starting to filter down to other companies.

One of the strong messages is that there should be no reward for failure. Companies are being encouraged to defer a proportion of each bonus payment that they make to senior employees with future payment dependent upon the satisfaction of performance conditions. Such conditions should discourage short term risk taking and be capable of measurement. A number of groups favour the use of non-financial performance indicators such as the recruitment of employees or customer satisfaction. There is also support for claw-backs where bonuses can be recovered from employees in circumstances where the information giving rise to the bonus subsequently turns out to be unrepresentative (i.e. the company's performance was not as good as originally thought).

The European Commission recently published a recommendation on the remuneration of directors of listed companies which included a number of the points set out above but also stated that shares and options should not vest earlier than three years and that, after vesting, directors should be encouraged to retain a fixed number of shares in the company until the end of their tenure.

There has been some debate over whether basic salaries should be increased and variable components of remuneration packages reduced. We support the view that share based incentives play an important part of a well balanced remuneration package, provided they are well structured and subject to appropriate performance conditions.

## Annual Returns for Share Incentives

Don't forget that the filing date for your annual share scheme returns is fast approaching and for most share plans the deadline is 6 July 2009. It is essential that you file your returns on time and accurately in order to avoid the risk of penalty charges.

• *Use HMRC approved plans to beat the 50% tax rate*

• *Incentives should not reward failure*

• *Share incentives have an important role in well-balanced remuneration packages*

The following table sets out the forms (which have not changed significantly since last year) that you will need to complete:

Plan Type	Return
SAYE	Form 34
Approved Company Share Option Plan ("CSOP")	Form 35
SIP	Form 39
EMI	Form 40
Unapproved Share Incentive Arrangements	Form 42

Remember that HMRC no longer issues companies with paper returns for completion. If you operate an HMRC approved plan then HMRC should have sent you a notice to file a return. The return date for SAYE, SIP and CSOP plans is expressed to be the date specified in the notice. If you did not receive a notice the filing date is three months from the date on which the return was issued (as shown on the return itself). EMI option returns must be received by HMRC on or before 6 July 2009. Form 42 (for unapproved share incentive arrangements) must also be with HMRC on or before 6 July 2009 (unless the form was sent to you on or after 8 June 2009 in which case you have 30 days from the date of issue). A Form 42 must be filed in respect of unapproved share incentive arrangements whether or not you have been sent a notice to file. By way of a reminder, you will need to file Form 42 to report specified transactions in securities held by employees, office holders and certain of their relatives. These include details of non-HMRC approved share options, the acquisition of shares by such individuals and certain events that take place after the shares have been acquired.

The explanatory notes to Form 42 now include a section on the "remittance basis" which may apply where an individual acquires shares on or after 6 April 2008 and is resident but either not ordinarily resident in the UK or not domiciled here. Note 4 states that if you know that any part of such a person's income is taxable on the remittance basis, then you must list the employee's name and NI number in the Additional Information section on page 12. HMRC has confirmed that this merely requires you to report income that is potentially taxable if there is a remittance rather than requiring you to report actual remittances of foreign income.

Forms 34, 35, 39 and 42 (but not the EMI return, Form 40) can be filed online. To do this you must first be registered for the PAYE Online-Internet Service. Information about this is available from the HMRC website at:

<http://www.hmrc.gov.uk/online/index.htm>

Once it has registered a company needs to use specified third party software to submit share scheme information online. Further details are available at:

<http://www.hmrc.gov.uk/ebu/ess-online.htm>

If you do not wish to use the online service then it is still possible to obtain paper copies of the annual returns from:

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

All the HMRC forms contain guidance and Form 42 is accompanied by a detailed set of explanatory notes. However if you have any queries in relation to your reporting obligations then please do not hesitate to contact any member of the Travers Smith Employee Incentives Group.

### **Important Changes to Australian Share Schemes**

Unlike the UK, the Australian Budget announced significant changes to the tax treatment of employee shares and share rights. The new provisions have yet to be approved by the Australian Parliament but are stated to have effect from 12 May 2009 (shares and rights granted on or before 7.30 p.m. AEST on 12 May 2009 are not altered).

In summary, the amendments abolish an employee's ability to defer the tax due on discounted options and shares. They also limit the AUS\$1,000 tax exemption for the discount on such rights to those with annual, taxable income of less than AUS\$60,000.

If these changes become law then companies with Australian employees will need to revisit their share incentives arrangements to assess whether they continue to be effective.

- *6 July is an important deadline for share incentive returns*

- *Review Australian share incentives in light of recent tax changes*

If you have any queries on this edition of Employee Incentives, please contact any member of the Employee Incentives Group.

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