



# *Employee Incentives*

## *Budget 2010 Update*

March 2010

On 24 March the Chancellor of the Exchequer delivered his "workmanlike" Budget. With a general election now only weeks away, it was inevitable that Alistair Darling would put forward proposals that might appeal to voters. Many of these did not come as a great surprise, HM Revenue & Customs (HMRC) having already hinted at them in recent months or made an announcement in the autumn's Pre-Budget Report.

In this update we consider the Budget measures that impact on share-based employee incentives together with a reminder of the changes that take effect from 6 April.

### **Budget 2010 Important Developments**

#### **No Change to the Rate of Capital Gains Tax**

The rate of capital gains tax (CGT) will, for the time being, remain at 18%. This is welcome news as many had feared that the CGT rate would rise, especially given the introduction of a 50% top rate of income tax from 6 April. The discrepancy between the rate of CGT and the highest rate of income tax makes HMRC approved employee share plans (which can give rise to capital treatment) increasingly attractive. Note that the CGT annual exempt amount will stay at £10,100 for the 2010/11 tax year.

- *CGT to stay at 18%*

#### **Important Change to Approved Company Share Option Plans**

The rules governing approved Company Share Option Plans (CSOPs) require that shares used for such a plan meet certain conditions. One of these conditions is that the shares must be listed or in a company that is not controlled by another company (unless the controlling company is itself listed). HMRC is concerned that some companies have entered into tax-avoidance arrangements using CSOPs over shares in subsidiaries of listed companies. Participants in these arrangements receive options over "growth shares" that have a low initial value, thereby increasing the number of shares over which options can be granted within the £30,000 individual limit. The rights attaching to these shares grow over time so that, by the time the options are exercised, the shares are significantly more valuable than they were on grant. As the option is granted under a CSOP, the gain is subject to CGT at 18% rather than income tax and National Insurance contributions.

- *From 24 March CSOP options cannot be over shares in controlled companies*

Under legislation to be introduced in the Finance Bill 2010, it will no longer be possible to operate a CSOP over shares in a company that is controlled by another. Any options granted over such shares on or after 24 March 2010 (Budget Day) will be treated as unapproved options and accordingly will not benefit from CGT treatment on exercise. Where the rules of an approved CSOP provide that a company may grant options over shares in a subsidiary of a listed company, the rules will need to be amended as they will no longer meet the statutory requirements. HMRC is giving companies a period of grace in which to alter their rules. Any such amendment will need prior HMRC approval but is unlikely to require shareholder consent. If the rules are not changed before 24 September 2010 then HMRC will have the power to withdraw the plan's approval altogether, although this will only affect options granted on or after 24 September. Fortunately, options granted before 24 March will not be affected.

One of our concerns about the new legislation is what will happen to options granted by a private company on or after 24 September 2010 if it is taken over by a listed company. Hopefully HMRC will use its discretion in such circumstances not to withdraw approval from the target's CSOP, but more clarification on this point is required.

If you are concerned as to whether or not your CSOP needs to be amended to take account of this change then please do not hesitate to contact a member of the Travers Smith Employee Incentives Group.

### **Anti-Avoidance Measures for Share Incentive Plans**

HMRC has become aware of companies setting up approved share incentive plans (SIPs) purely to gain corporation tax deductions. Under current law, some companies can claim a corporation tax deduction from their profits when (subject to certain conditions) they pay money to the trustees of a SIP. It appears that, under avoidance arrangements seen by HMRC, certain companies have secured a corporation tax deduction and then caused the shares within the SIP trust to undergo changes that strip value from them. Legislation will be introduced to prevent such anti-avoidance practices by denying a corporation tax deduction. The new legislation (which will take effect from 24 March 2010) will also clarify the circumstances in which changes to shares in a SIP trust are disqualifying events as a result of which HMRC can withdraw the SIP's approval.

### **Future of Family Benefit Trusts and Employee Benefit Trusts**

Family benefit trusts (or FBTs) have become an increasingly popular method of tax planning. These trusts are discretionary trusts that are, in some ways, similar to employee benefit trusts (EBTs) established by many employers. Whereas EBTs tend to be used in conjunction with a company's employee share schemes, under an FBT, assets are put into sub-trusts for the benefit of an employee and his or her family members. In this way, the FBT can provide a variety of benefits not only during employment but also when the employee has left the company. We have known for some time that HMRC has been scrutinising FBTs and expressed the opinion that, in their view, they do not give the tax treatment claimed by companies. It was therefore not a great surprise to see the Government's Budget announcement that it intends to take action to tackle avoidance through the use of trusts and other vehicles to reward employees. At this stage we do not know precisely what action the Government plans to take but we understand that legislation is likely to take effect from 6 April 2011. Our concern is that any tax changes will not be limited to FBTs but will also extend to EBTs. We will continue to monitor the situation but, in the meantime, companies operating an FBT or an EBT should bear the Government's intentions in mind and seek advice where appropriate.

### **Enterprise Management Incentives - Delay on Extension to Permanent Establishments**

At the end of last year HMRC published draft legislation to widen the scope of Enterprise Management Incentives (EMI). These tax approved share options are particularly popular with private companies. It has always been a rule that EMI can only be granted by companies trading wholly or mainly in the UK. The draft legislation provided that, from 6 April 2010, this test would be modified to allow a company to offer EMI provided it had a permanent establishment in the UK (and met the other requirements applicable to EMI). In the Budget material, HMRC repeated its commitment to make this change however the amendment will not take effect from 6 April of this year but has been postponed to a later Finance Bill.

### **Amendments to Bank Payroll Tax Confirmed**

This tax on bonuses paid by banks in excess of £25,000 was stated in December's Pre-Budget Report (PBR) and applies to share based as well as cash bonuses. The draft legislation for the Bank Payroll Tax (BPT) was published at the time of the PBR followed by a series of Frequently Asked Questions.

HMRC has now announced that when the legislation appears in Finance Bill 2010 it will contain some revisions to deal with points raised since the tax was announced. An important modification is to clarify what amounts to a bank for the purposes of the tax. The list of specifically excluded companies will also be expanded. Further clarification is to be given as to when remuneration is taken to be "awarded" and there will be legislation to make it clear that payments made to employees who visited the country for no more than 60 days within the 2009/10 tax year will not trigger the tax. Finally, the legislation will include details for the assessment and collection of BPT together with provisions for penalties and interest.

If you are in any doubt as to whether or not the Bank Payroll Tax applies to you or to your employee incentive awards then do not hesitate to contact one of the Travers Smith Employee Incentives Group.

- *CT deductions for SIP payments subject to anti-avoidance rules*
- *HMRC announces future action on use of trusts for avoiding, deferring or reducing IT and NICS*
- *Delay on extension of EMI*
- *Bank Payroll Tax – some clarification to be provided*

## Government to Consult on "Geared Growth" Arrangements

The Budget documentation included an announcement that the Government is to consult on the taxation of returns from geared growth arrangements connected with employment-related securities "to ensure that income from employment is taxed correctly". By "geared growth" arrangements, the Government is referring to joint share ownership plans, growth shares, ratchet shares, flowering shares and similar structures. Other than a statement of its intention to consult on this area, the Government has not given any further information as to how it might seek to tax such arrangements. We have been told that the consultation process will begin in the summer and is likely to cover all forms of employee share incentive. Travers Smith will contribute to and monitor the consultation process. In the meantime if you are unsure as to what this might mean for your existing or proposed arrangements then please call one of the Travers Smith Employee Incentives Group.

- *Government to consult on "geared growth" arrangements*

## Changes from 6 April 2010

The start of the new tax year heralds a number of important changes relevant to employee incentives:-

- **50% income tax** rate and a new **dividend rate of 42.5%** for those earning over £150,000
- **annual personal allowance** for those with adjusted income above £100,000 to be reduced by £1 for every £2 over this threshold
- **tax bands and allowances** are held at their 2009/10 levels
- **new PAYE** rules will impose **in-year penalties** for late paid income tax and NICs, and
- the **Official Rate of Interest** (used to determine the tax payable on loans to employees and on certain shares acquired at an under value) will fall from 4.75% to 4% per annum.

- *Changes for new tax year*

If you have any queries regarding the budget report or any aspect of this update then please contact any member of the Travers Smith Employee Incentives Group:

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