TRAVERS SMITH

Employee Incentives

Spring Update

May 2010

On 12 May the Conservative-Liberal Democrat Coalition published a draft document outlining the parties' agreement on a number of issues, including tax. This was followed by a final version of the agreement on 20 May ("the Coalition Agreement"). In this briefing note we look at the Coalition Agreement from the perspective of employee incentives and consider what impact it might have.

New sharesave bonus rates: Although the bonus rates for sharesave or "save-as-you-earn" ("SAYE") plans have fallen to an all-time low, this HM Revenue & Customs ("HMRC") approved scheme remains an important incentivisation tool.

The deadline for annual share scheme returns is fast approaching…

Coalition Agreement - Implications for Employee Incentives

"Jobs Tax"

The Labour Government's proposal to increase the rates of employee and employer National Insurance contributions ("NICs") by 1% from next April came under fire throughout the election campaign. The Conservatives stated that they would reverse this so called "Jobs Tax" for those earning under £35,000 through amendments to the thresholds at which NICs become payable.

One of the measures proposed in the Coalition Agreement is to increase the income tax personal allowance in order to assist lower and middle income earners. Part of the funding for this measure will come from money that would have been used to counter balance the impact of the Jobs Tax. Accordingly, the rise in NICs rates next April will go ahead, however, the blow will be softened for employers (but not employees) through an increase in the threshold at which they start to pay NICs. The increase in NICs makes the prospect of incentives that benefit from tax and NICs relief ever more appealing to employees.

Capital Gains Tax ("CGT") reforms

The first "Coalition Budget" will take place on 22 June. There is still a lack of detail as to what the changes will be and how and when they are to take effect. Nevertheless, there are several threads that can be drawn-out from the Coalition Agreement that will be relevant for employee shareholders.

- We are told that the capital gains tax rules for "non-business assets" are to be targeted to bring rates of CGT into line with those for income tax. This is not unexpected – the gap between the top rate of income tax (of 50%) and the general rate of CGT (18%) meant a change in this area was highly likely at some stage.
- We do not know at this stage what shareholdings will be "business assets". No further detail has been given in terms of how these activities will be defined or the extent of any exemptions applicable to them. Hopefully some measure of relief will be available for employee shareholdings.

- *"Jobs Tax" to go ahead for employees*
- *Some relief proposed for employers*
- *Capital Gains Tax to rise for "non-business assets"*

- Although not mentioned in the Coalition Agreement, it is possible that the Liberal Democrat election proposal to reduce the CGT allowance (£10,100 for the current tax year) will be agreed by the Conservatives, in which case the allowance could fall to around £2,000.
- It is possible that any CGT change could take effect during a tax year and some commentators have even questioned whether the changes could have retrospective effect. Such a change would however be considerably more complicated to implement than a change from the beginning of the next tax year.
- A shareholder may be no worse off, or perhaps even better off, under the new rules if the "generous exemptions" turn out to be truly generous, at least for those able to benefit.
- Prospective sellers may be confused as to when to dispose of their shares. Employees fearing an increase in CGT rates might seek to sell now in order to take advantage of the existing 18% rate, although before doing so they would need to weigh up the possibility that future changes might make them eligible for reliefs which offer a possibly lower rate. It is also possible, though perhaps less likely, that the coalition parties will be unable to agree the details before 22 June and no change will be announced at that time. There is no one "size fits all" response to the announcements. The approach that shareholders wish to take will vary depending on their personal circumstances. It will also depend on their appetite for risk.
- A separate consultation process was announced in the March Budget to consider "the taxation of geared growth arrangements connected with employment-related securities". The interaction of that consultation with these changes is currently unknown.

For a more detailed examination of these potential changes and their impact on employee and executive share sales please contact a member of the Travers Smith Employee Incentives team.

- *There are to be "generous exemptions" for "entrepreneurial business activities"*

Change to Bonus Rates for SAYE Plans

On 14 April the internal mechanism that triggers a bonus rate change for SAYE plans was activated. A new prospectus came into effect on 14 May and (subject to what is said below) applies to savings contracts entered into on or after that date. The new bonus rates are very low indeed and fall to zero for 3 year contracts. The interest rate for early leavers also drops from 0.36% to 0%. As SAYE options are not subject to NICs, the increase in NICs rates next year will not have an impact on them.

Contracts entered into on the basis of the old rates will be valid provided the invitation was issued before 14 May and the contracts are entered into within 30 days of 14 May. The table below sets out the new rates and their annual equivalent with the old rate stated in brackets.

Contract Length	Bonus Rate (Previous Rate)	Annual Equivalent Rate (Previous Rate)
3 year	0 x monthly payments (0.3)	0 % (0.54%)
5 year	1.8 x monthly payments (2.2)	1.16% (1.42%)
7 year	4.9 x monthly payments (5.2)	1.74% (1.84%)

- *Although the bonus rates are very low, SAYE plans still have the advantage of offering a discounted option exercise price and a secure savings scheme*

Annual Share Scheme Returns

With the filing date for 2009/10 annual share scheme returns approaching, now is a good time to turn your mind to these important documents. It is essential that these returns are filed punctually and accurately, as failure to do so can trigger penalties. In the table below we have set out the various HMRC returns and the deadline for filing them.

• 2009/10 Annual Share Scheme Returns need to be filed

Plan Type	Return	Filing Deadline
SAYE	Form 34	Must reach HMRC by the date specified in the Form 34 Notice or otherwise within three months of the date on which Form 34 was issued.
Approved Company Share Option Plan ("CSOP")	Form 35	Must reach HMRC by the date specified in the Form 35 Notice or otherwise within three months of the date on which Form 35 was issued.
SIP	Form 39	Must reach HMRC by the date specified in the Form 39 Notice or otherwise within three months of the date on which Form 39 was issued.
Enterprise Management Incentives ("EMI")	Form 40	Must reach HMRC on or before 6 July 2010
Unapproved Share Incentive Arrangements	Form 42	Must reach HMRC by 6 July 2010

Although the returns have not altered dramatically since last year, please note the following changes:

• Minor changes have been made to some of this year's returns

The SAYE return (Form 34) will require an entry in section 7, box 28 (Total Number of Shares for Which Options Were Granted). Previously the notes on the form have said that this box does not need to be completed. The CSOP return (Form 35) will require more information in section 5 (Exercise of Options). For the past few years HMRC have only requested details of option exercises that give rise to a tax charge. In this year's return they require information on all option exercises. The EMI return (Form 40) has been modified so that section 8 (Summary of EMI options) only requires a statement of the number of people holding options as at 5 April 2010. In previous years this section was significantly more detailed.

You may already have been notified that HMRC's online filing service for annual share scheme returns was withdrawn on 1 April 2010. Any companies filing returns after that date need to file paper copies.

If you would like to discuss any aspect of this Spring Update then please do not hesitate to contact a member of the Travers Smith Employee Incentives team: Mahesh Varia (Partner), Victoria Nicholl, Elissavet Grout, Mark Havas, Chris Fallon and Kulsoom Hadi.

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