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CHANGES TO:

Tax-advantaged share plans

The Office of Tax Simplification (OTS) has published a report setting out recommendations for extensive changes to the UK's four types of tax-advantaged employee share schemes:

- Share Incentive Plans (known as SIPs).
- Savings-Related Share Option Schemes (also known as SAYE or Sharesave).
- Company Share Option Plans (also known as CSOPs or HMRC-approved share option schemes).
- Enterprise Management Incentive Scheme options (known as EMI options).

The recommendations arise from work done over the last year by the OTS, which was given an extremely wide brief to examine the highly complex rules for tax-advantaged employee share schemes and to suggest improvements.

It is expected that a full consultation process will take place to enable interested parties to suggest how the proposals can be improved and implemented.

What are the proposed changes?

We have set out below a summary of the recommendations, starting with generally-applicable changes and then moving on to changes for specific types of scheme:

General

- Self-certification (as currently exists for EMI) to be extended to SIPs, SAYE and CSOPs, rather than the current HMRC prior approval process. This will eliminate the current delays in gaining approval to new plans.
- A single electronic annual return form for all a company's option grants and share awards for tax-advantaged schemes is to be created, enabling downloading of information rather than manual input.
- Less prescription as to how companies and trustees operate share schemes, including the ability to make online communications and removing the requirements for employee communications to be submitted for approval of a scheme.
- Common treatment of retirement situations across all schemes, other than EMI. However, this will not be necessary if the recommendation as to "good leavers" is adopted (see next paragraph).
- Extend the category of "good leavers" who can exercise their options or receive shares early without losing the tax advantages.
- Allow tax-free early exercise of options (or withdrawal of shares from a SIP) in the event of a takeover of the company.
- Introduction of simple prohibitions of unacceptable practices (such as using salary sacrifice in conjunction with the schemes) instead of the more general provisions that currently exist.
- Removal of the prohibition on "restrictions" applying to shares used for SIP, SAYE and CSOP.
- Allow companies with more than one class of share to operate CSOP and SAYE.

Share Incentive Plans (SIPs)

This is a multi-faceted "all-employee" plan which enables:

- Employers to give tax-free shares to their employees; and/or
- Employees to buy shares in their employing company out of pre-tax income and for the employer to make matching contributions of additional free shares.

Notable issues with this plan are the low monetary limits on the value of shares that can be acquired and the fact that tax-free status is conditional on retaining the shares in the plan for five years.

There are a number of helpful recommendations in relation to SIPs. As many of these would involve a potential loss of tax revenue to the Treasury and it remains to be seen if the Chancellor will adopt these.

Recommendations specific to SIPs include:

- Reduce the period that shares must be held in a SIP before they can be released tax-free to employees from five years to three years.

- Allow all dividends earned on SIP shares to be reinvested (that is, remove the current limit of £1,500 per year on dividend shares).
- Providing more flexibility on the price at which partnership shares can be acquired at the end of an accumulation period in order to allow companies to hedge the commitment to provide shares.
- The elimination of the retrospective withdrawal of tax relief (including employer's National Insurance contributions) on a takeover within five years of acquisition of the shares.

Company Share Option Plans (CSOPs)

This is a rather inflexible scheme under which companies can grant market-value options to employees. It was originally intended for executive share options, but the £30,000 limit on the value of shares that can be placed under option has curtailed its use.

Recommendations specific to CSOPs include:

- Merger of CSOP and EMI requirements (see below). This would remove many of the restrictive features of CSOPs and could revive their popularity with both large and small companies. In particular, this change could allow share awards under performance share plans/LTIPs to be made on a tax-advantaged basis. However, the £30,000 individual limit would remain for companies that do not qualify to grant EMI options.
- Further investigation to be carried out to determine whether the CSOP is still relevant for businesses and to gain a clearer picture of which companies use this scheme and why.

Savings-Related Share Options Schemes (SAYE/Sharesave)

The original purpose behind this scheme was to give all eligible employees the opportunity to save money, in a tax-free environment, with which to exercise an option with a market value or discounted exercise price. It has been popular in the past but has more recently been somewhat undermined by low interest rates (currently zero).

Recommendations specific to SAYE schemes include:

- Abolishing the seven-year savings period (leaving a simple choice between three and five years).
- Allowing companies to administer SAYE schemes themselves, without the need for an "approved savings carrier". These banks and building societies impose significant charges on smaller companies so this change could make SAYE schemes attractive to a much larger range of employers.

Enterprise Management Incentive Scheme options (EMI)

This is a highly flexible scheme that can be used to improve the tax treatment of share options or share awards. There are significant restrictions on the type of company that can use it – in particular the company or group must have less than the equivalent of 250 full-time employees and gross assets of no more than £30 million.

The proposed merger of the CSOP and EMI regimes would not have much effect on existing EMI schemes as for the most part the merged scheme would operate on the basis of the current EMI regime.

Recommendations specific to EMI include:

- Extending the type of companies who can offer EMI by reducing the list of non-qualifying trading activities.
- Simplifying the documentary requirements so that the practice of attaching the company's articles of association to an EMI option agreement would no longer be required.

Merger of EMI and CSOP

It is proposed that this is done in a two-stage process.

First, merge the two schemes into one discretionary scheme, based broadly on the current EMI regime. Some of the existing limitations of the CSOP legislation would remain for companies that do not qualify to grant EMI options.

Second, amend the merged scheme to remove some of the limitations on non-EMI qualifying companies and allow further flexibility for all companies. The CSOP limit of three years before options can be exercised in a tax-advantaged manner would be removed. The limit of £120,000 on the value of EMI options and £30,000 for non-EMI options under the merged scheme will be applied on a rolling three-year basis (so there will be no requirement to take into account any options granted outside the three-year period).

Essentially, under the new merged scheme, options over shares worth up to £120,000 in value at grant would be able to be granted whilst the company remains small enough to award EMI options, whilst the limit on non-EMI qualifying options would match the current limit on CSOP options of £30,000.

In particular, the merged scheme could allow limited nil-cost share awards under performance share plans/LTIPs to be made on a tax-advantaged basis.

When will these changes take effect?

It is anticipated that the Chancellor will respond to the recommendations in the Budget on 21 March. However, it is unlikely that any changes will take effect before 2013.

What action should companies take?

No action is required at this time as more detail on the likely changes and timelines are expected on 21 March as part of the Budget announcements. At that point companies should consider the proposed changes and:

- reach preliminary conclusions on what impact the proposed changes would have on their schemes and what changes they may want or need to make to the operation of their schemes;
- review their employee/participant communications strategy to ensure that it is consistent with the changes that may be made to their schemes; and
- consider whether to submit comments to any consultation processes that are announced.

Additional information

For additional information about these changes please contact one of the Squire Sanders lawyers listed below or one of the Squire Sanders lawyers with whom you routinely work.

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