

PETT, FRANKLIN & CO. LLP

HELPING *SHARE* GROWTH



TAX, INCENTIVES AND
EMPLOYEE SHARE PLANS

Incentives and Reward Schemes

ICSA Annual Conference 2017

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Who are we?



- ▶ A multi-disciplinary firm of lawyers and accountants specialising in all forms of employee/management share incentives, employee share schemes and employee-owned companies
- ▶ Members of Share Plan Lawyers Group, ESOP Centre, and *ifsProShare*
- ▶ Ranked as a Leading Firm for Employee Share Schemes and Incentives in Chambers & Partners 2017.
- ▶ William Franklin & Stephen Woodhouse are leading employee share scheme specialists each with over 25 years of experience in the field.

Incentives and Reward Schemes

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- ▶ Key contractual provisions companies should include in any long-term share incentive plan
 - ▶ Malus and clawback
 - ▶ Employment aspects
 - ▶ Tax indemnities
 - ▶ Planning for the future
- ▶ Tax and compliance issues
 - ▶ Reporting
 - ▶ MAR
 - ▶ Employees' share trusts
 - ▶ Anti-avoidance
 - ▶ Other practical points

LTIPs

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▶ Key terms

- ▶ What is the form of award? (Usually, a share option or restricted share award.)
 - ▶ What are the performance conditions? (Set by Remco on advice of remuneration consultants.)
 - ▶ When and how does the executive receive the award?
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- ▶ So what is the rest of the document for...?

LTIPs

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- ▶ Dilution limits: newly-issued shares should not exceed 10% of share capital (or 5% for discretionary executive share plans)
 - ▶ How are you measuring this? What about reorganisations and changes to the share capital? Leavers?
 - ▶ So, you have a spreadsheet...
- ▶ Malus and clawback
 - ▶ What are the circumstances in which this applies? What counts as “gross” misconduct? Don’t rely too much on discretion.
 - ▶ How do you claw monies back from an executive who may already have left?
 - ▶ What is the treatment of tax already paid on awards? *Julian Martin* case - but what about taxable specific earnings?

Employment aspects

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- ▶ “Micklefield” clauses
 - ▶ *“The rights or obligations of an individual under an individual’s office or employment with any member of the Group...will not be affected by participation in the Plan...A Participant waives any and all rights to compensation or damages under the Plan in consequence of the termination of the Participant’s office or employment...”*
- ▶ Does this work?
 - ▶ Can exclude damages for wrongful dismissal or breach of contract - but
 - ▶ An option is a contract subject to normal contractual principles
 - ▶ Must sign documents *or* sufficiently draw terms to participant’s attention
 - ▶ Does the clause exclude liability for improper exercise of discretion? (*Watchfinder*)
 - ▶ Mutual duty of trust & confidence (*Keen v Commerzbank AG*)
- ▶ What about awards granted by ESOTs?

Tax indemnities

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- ▶ Indemnity against liability of company to account for tax
 - ▶ PAYE liabilities fall on the employer in the first instance, *not* the employee
 - ▶ Tax on listed shares is always due under PAYE - but there is no cash from which the PAYE can be deducted
 - ▶ If the employee does not make up the PAYE amount to the company in time, additional tax charges under s.222 “tax on tax” - but fortunately not more PAYE!
 - ▶ Leavers, internationally mobile employees and sales of group companies can lead to difficulties
- ▶ Employer NICs indemnity/transfer of liability - legal for share awards
 - ▶ Has there been provision in the accounts for the employer NICs?
- ▶ Section 431 elections

BEIS corporate governance report

- ▶ “We conclude that LTIPs should be phased out as soon as possible. No new LTIPs should be agreed from the start of 2018 and existing agreements should not be renewed”. (Paragraph 90)
- ▶ So instead, proposal is to use “deferred stock options”
 - ▶ Shares which can only be sold after set periods
 - ▶ No performance targets
 - ▶ Value determined by share price at time of vesting
- ▶ How much impact will this have in practice?
- ▶ At minimum, new plans should include the flexibility to use this approach

Brexit



- ▶ The great unknown
- ▶ Awards currently being made are likely to vest post-Brexit
- ▶ The jurisdiction of the ECJ will (probably) no longer apply and plans should be future-proofed for potential legislative changes to the extent possible

Reporting requirements

- ▶ Directors' remuneration reporting
 - ▶ Can this become too complex and legalistic?
 - ▶ Commercially sensitive information (e.g. performance targets) should still be disclosed after the fact
- ▶ HMRC annual share scheme reporting
 - ▶ Reporting by employees in Self Assessment returns - should share awards be reported even where all tax has been deducted under PAYE?
- ▶ Need to notify PDMR transactions to the market (and their closely associated persons)
- ▶ Gender pay gap reporting - use taxable amount
 - ▶ May need to give some extra narrative about share plans to provide realistic view

Market Abuse Regulation

- ▶ Interpretation has evolved
 - ▶ Reducing numbers of “insiders”
 - ▶ Fewer permanent insiders - sometimes not even the CEO
 - ▶ Increasing number of confidential projects and price sensitive information
- ▶ Don’t deal in a close period - this is nothing new
- ▶ So what if you have no choice?
 - ▶ Vesting in close period - how to pay tax? Can only sell shares if plan provides for this to happen automatically with no choice element on executive’s part
 - ▶ In particular, be careful about asking ESOTs to enter into trading plans

ESOTs

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- ▶ Routinely used for warehousing shares for awards - do not count towards IA limits on newly issued shares and allow hedging
- ▶ Trustee is independent of the company and has to exercise their discretion - though professional trustees will accept reasonable recommendations
 - ▶ Talk to the trustee at an early stage to pull out any issues
 - ▶ Must have linking agreement in place *before* awards granted by company
 - ▶ But don't tell them the specific awards being made to specific employees...
- ▶ Who are the beneficiaries? Subsidiaries but *not* normally parent companies - particular point to check after takeovers/group reorganisations
- ▶ How do you fund your ESOT to acquire shares?
 - ▶ Are you a close company? Can you demonstrate the company is *not* close?
 - ▶ “Loans to participators” tax charges apply to all ESOTs post Finance Act 2013

Anti-avoidance

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- ▶ Disguised remuneration legislation has been in force since 2011
- ▶ Immediate tax charges on “payments” (including loans) from third parties and “earmarking” by third parties - very widely defined but with a slew of specific exemptions and reliefs
- ▶ Expansion of rules - expected in Finance Act 2017 but delayed by election
 - ▶ Close company directors
 - ▶ 2019 loan charges - if you have a cash-based EBT still in existence, now is the time to sort it out
- ▶ DOTAS rules on “financial products” hallmark in force from 23 February 2016
 - ▶ Share arrangements where tax treatment a main benefit and term included for tax reasons (or contrived/abnormal, etc)
 - ▶ Acknowledged to catch arrangements which are not “avoidance”

Some other practical points

- ▶ IMEs can be a minefield - especially in relation to share plans where an employee works in different countries over the vesting period
- ▶ What about movements in the foreign exchange rate?
- ▶ Non-executive directors - not employees but treated like employee directors for tax purposes
 - ▶ Shouldn't normally participate in share plans, but be very careful as none of the normal "employee share scheme" exemptions will apply
- ▶ Financial assistance - can only provide out of distributable reserves
- ▶ When do share transfers/issues actually happen and what is the tax date?

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Questions?

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