Simplification of Approved Share Schemes

In March 2012, the Office of Tax Simplification made various recommendations to the Government in relation to the simplification of approved (tax-advantaged) employee share schemes. HMRC conducted a consultation process on its response to these recommendations over the summer of 2012, and has also consulted on draft legislation on the implementation of some of the recommendations. The Finance Bill 2013, published on 28 March, contains draft legislation, in what is likely to be close to final form, for the changes to be implemented by legislation this year.

This update summarises these changes, and considers the impact they will have on the operation of approved share schemes. Generally, the changes should make the operation of schemes easier, and extend the circumstances in which tax relief is available.

The changes primarily concern approved Company Share Option Plans (CSOPs), Save As You Earn Share Option Schemes (SAYE schemes) and Share Incentive Plans (SIPs), although there is also a relatively minor provision affecting Enterprise Management Incentive (EMI) options.

Whilst the legislation has been drafted with the effect that existing approved share schemes will be automatically amended to reflect the bulk of the changes, to avoid confusion we would strongly recommend that companies consider amending their approved schemes once the legislation is in force.

Retirement provisions

Currently, the CSOP, SAYE and SIP legislation allows early leavers to remove their SIP shares, or exercise their CSOP or SAYE options, when the participant leaves by reason of retirement, without losing the tax benefits. However, the legislation defines retirement by reference to retiring on reaching an age specified in the plan rules, and the requirements are slightly different for each type of plan.

The proposed amendments will remove the requirement for scheme rules to contain a specified age, and provide simply that no tax will be due if SIP shares are removed from a SIP following the participant ceasing to be an employee by reason of retirement, nor if CSOP or SAYE options are exercised within six months of ceasing employment by reason of retirement.

The revised legislation does not contain any definition of retirement. In the summary of responses to the consultation, dated December 2012, HMRC stated that the Government proposes to allow businesses to apply their own definition of retirement. They go on to say "HMRC guidance will set out the circumstances in which a presumption can be made that an individual is retiring. This guidance will make clear the general principle that, for the purposes of the tax advantaged employee share schemes, retirement must take its normal and natural meaning. Moreover, it should not be possible for an employee to have retired for the purposes of a scheme, but not for any other purpose." We have not yet seen the guidance, although it will be published in draft before the changes are implemented.

Since 2011, employers have no longer been able to specify a default retirement age, at which they can compel employees to retire without the risk of an age discrimination claim. In light of this, removing the specified age requirement from the share plan legislation makes good sense. However, it does mean that businesses will be faced with the problem of defining (or possibly just identifying) retirement without reference to age (in order to avoid potential age discrimination considerations). This is an issue that many will have faced in relation to unapproved schemes when the default retirement age provisions were first removed. How to deal with this in relation to approved schemes should become clearer when HMRC publish their guidance. Our current expectation, based on the draft legislation, is that companies will not be required to include their own definition of retirement in scheme rules.

Other "good leavers"

The proposed changes provide that any CSOP or SAYE options exercised within six months of the participant ceasing to be in relevant employment by reason of a change of control of the employing company, or the transfer of the participant's employment under the Transfer of Undertakings (Protection of Employment) Regulations 2006 (TUPE), will be tax free, even if within three years of the date of grant. This will primarily affect the sale of the participant's employer out of the group of companies which contains the company establishing the scheme. In most cases cessation due to TUPE transfer would be tax free in any event as this would also count as redundancy, which is already included as a good leaver provision. However, having the express provision in relation to TUPE should reduce confusion around this point.

The changes align the tax treatment for CSOP and SAYE options with that applicable for SIPs, as SIP shares can already be removed from the SIP tax free on these events.

For SAYE schemes, the changes will also require that options must be exercisable during the six months following those events (but not so as to extend the latest exercise date).

Takeovers

Some welcome improvements have been made to the provisions relating to takeovers.

In particular, CSOP and SAYE options may be exercised tax-free, and SIP shares may be withdrawn from the SIP tax-free on the occasion of a cash takeover (subject to detailed conditions to prevent tax avoidance) regardless of the time from the date of grant or award. For these purposes a cash takeover is where the participant is only offered cash for his shares, and (for options) no roll-over option over shares of the acquirer is offered. Previously such exercises or withdrawals could have been taxable.

In addition, the amended rules for SAYE plans have been extended to cover takeovers structured by way of scheme of arrangement under the Companies Act 2006. Previously, the legislation only allowed exercise in relation to schemes of arrangement "proposed for the purposes of or in connection with a scheme for the reconstruction or amalgamation of the company" (unless it could be argued that the scheme of arrangement was also a general offer).

Restrictions on shares

One of the issues which has previously caused problems with the implementation of approved schemes is the requirement that, subject to certain exceptions, the shares used cannot be subject to any restrictions which do not apply to all the shares (or all the shares of the class used in the scheme). This provision is now being removed, and replaced with a requirement that participants are notified of the restrictions on the shares at the time the award is made.

Increasingly, listed companies, in particular in the financial sector, are looking to impose clawback provisions, so that in certain circumstances shares acquired on exercise of options, or the proceeds of the sale of those shares, may be returned to the company. This has not until now been possible for approved schemes. Under the new rules we would expect that companies would look to impose these provisions on their approved CSOP options, as well as unapproved share awards.

Another consequence of the change is that it should make it easier for companies to align tax recovery provisions in relation to any PAYE and NICs which may arise on the exercise of CSOP options with those for unapproved options. HMRC currently takes the view that a straightforward provision giving the company the right to sell some of the shares acquired on exercise on behalf of the participant to meet the tax liabilities (in the form often used for unapproved options) is not allowed because of this provision.

For private companies, it should be easier to impose leaver provisions on the shares acquired (for example, if an employee shareholder ceases to be an employee, he is obliged to offer his shares to the other shareholders). However, HMRC has declined to simplify the rules relating to approved schemes where the relevant company has different classes of shares, with the consequence that care will generally need to be taken to ensure that the imposition of the restrictions does not create a separate class of share.

Material interest

The approved schemes currently prohibit the grant of awards to employees who have a "material interest" in the company. These provisions are now being removed as unnecessary for the all-employee schemes (SIP and

SAYE), and for CSOP they are being aligned with the provision for EMI options (so, broadly, the material interest definition will be changed from a 25% shareholding to a 30% shareholding).

Other provisions relating to SIPs

Two further changes apply just to SIPs: the annual limit on the value of dividend shares that can be acquired by a participant (currently £1,500) is being removed, and where a company is offering "partnership shares" (shares purchased by the participants out of pre-tax earnings), the participant is to be given more choice on the method of determining the number of shares where the company operates an accumulation period for contributions from the participants.

EMI options

The period for exercise of an EMI option following a disqualifying event, so that the tax benefits are fully retained, is to be extended from 40 to 90 days.

Amendment to share plans

The proposed legislation provides that existing approved schemes will be automatically amended with any modifications needed to reflect the majority of the changes made by the legislation. However, this could give rise to confusion if companies do not also amend the text of their approved scheme rules to reflect these automatic changes. Furthermore, there will be some additional flexibility to make discretionary changes to scheme rules to reflect some of the amendments (such as the proposal to allow restrictions on scheme shares). We would recommend that companies give serious consideration to amending their approved schemes when this legislation comes into force (expected to be July 2013).

HMRC has confirmed that its approval will not be required for any amendments to approved schemes solely to reflect the new legislation (by which we assume they mean the changes applied to schemes automatically by the legislation). In addition, as such amendments will not in practice change the effect of the rules (as this will already have been done by the legislation), it is unlikely that any shareholder or participant consents for the amendments will be required under the scheme rules.

Adoption of new plans

HMRC will now review and comment on draft schemes based on the draft legislation, although such schemes will not be approved until after the legislation is in force.

Future changes

Some proposed changes are to be subject to further consultation, with a view to being introduced in 2014, in particular a move from the current system, where HMRC approves schemes before they can be used, to a self-certification process by the establishing company.

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