

Incentives & Rewards I-Brief

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The Employee Incentives & Rewards Team is delighted to issue its first Incentives & Rewards Information Brief or "I-Brief". The I-Brief provides a short update of any new legislation, case law or HMRC practices/policy-making affecting incentives and rewards generally, with a particular emphasis on share and share option schemes. We will also focus on particular points to watch out for when implementing or dealing with incentives of this nature.

We are pleased to feature a guest writer in this edition - Robert Leggett, Director and Head of Corporate & Business Tax at Ensors Chartered Accountants.

But first, let's start with an ageing difficulty plaguing share schemes generally.....

"Old" news? The effect of the Age Regulations on share schemes

It will come as no surprise to most companies that Regulations were introduced in October 2006 to prohibit discrimination on the grounds of age in the workplace. Whilst many employers have got to grips with the impact this has on their workplace practices and policies generally, for many, the effect these have on company share schemes may not yet have hit home.

Many share schemes contain features which could now be deemed to be discriminatory on the grounds of age. For example it is quite common to see a scheme which requires an employee to complete a period of service before they become eligible to participate in it. Similarly, awards of shares or options are often made on the basis of length of service or an employee's seniority. It has also been traditionally acceptable to give preferential treatment to retiring employees to enable them to retain their options or shares once their employment has ended. All of these features are now at risk of being discriminatory as a result of the Employment Equality (Age) Regulations 2006.

At first sight you might wonder why this could be so. Surely it is acceptable to stipulate that an employee must complete a requisite period of service before being entitled to participate in the share scheme? Answer: possibly not. Features such as this could now be found to be indirectly discriminatory against younger workers who are less likely to have the period of service required under the scheme. Take the example of a share scheme which requires an employee to have a period of seven years' service in order to participate in it. An employee who is 21 years of age is unable to meet that requirement. Alternatively, a scheme may require an employee to complete a number of years' service after being granted an award of shares or a share option before those shares can be unconditionally acquired or the option exercised. This might discriminate against

retiring employees who are unable to complete that period of service before their retirement date. Schemes containing rules which favour retiring employees are treating younger workers less favourably on the grounds of their age because that preferential treatment arises directly as a result of the employee obtaining the specified retirement age. An employee who is, for example, 20 years younger than the retiring employee, but who on leaving has acquired the same length of service, is treated less favourably simply because of their age.

Whilst the above share scheme features may appear discriminatory on the face of it, there are a number of exceptions contained in the Regulations which could be relied upon.

The first of those states that employers will not be guilty of age discrimination if they provide benefits on the basis of an employee's length of service, provided that they do not disadvantage workers with more than five years' service. If there is a condition relating to five years' or more service then that condition must be justified on business grounds, for example on the grounds of rewarding loyalty, motivating employees or aiding retention. In the context of employee share schemes this means that an employer can decide who is eligible for awards and/or determine the value of those awards based on a length of service requirement of five years or less without any justification. If the requirement relates to more than five years' service, careful thought should be given as to why this requirement is necessary.

Secondly, it will not be discriminatory under the Age Regulations if a share scheme contains a feature or rule which is permitted by legislation governing the terms of HMRC approved share schemes. For example, the Save As You Earn ("SAYE") legislation requires an employee participating in a SAYE scheme to be able to exercise his option either when he retires at the age specified in the share plan (which cannot be lower than 60 or higher than 75) or at any other age at which he is bound to retire in accordance with the terms of his employment. The Share Incentive Plan ("SIP") legislation provides that any free or matching shares must be delivered to retiring employees when they retire on or after reaching the retirement age specified in the plan which cannot be lower than 50. Inserting retirement provisions such as this which comply with the statutory requirements will not be discriminatory.

Note however that employers remain at risk of a discrimination claim if the retirement age specified under the scheme is more than the lowest age permitted by legislation. Therefore, taking the above SIP example, if a company were to set a retirement age in a share incentive plan scheme at 60, arguably this discriminates against employees between the ages of 50 and 60. The Company

could have chosen to set the retirement age for the purposes of the share scheme at 50 and thereby enable the employee to retain the full benefit of his share award. This exception only applies to HMRC approved schemes and not unapproved or Enterprise Management Incentive ("EMI") schemes. Therefore, if you are considering giving preferential treatment to retiring employees in an unapproved or EMI Scheme, you will need to justify the discrimination (which is likely to be very difficult), remove or amend the discriminatory terms of the scheme or run the risk of a discrimination claim if they continue to favour retiring employees. The safest solution is to remove the retirement provisions altogether but failing that, consider whether retirement can be defined without reference to age.

In summary, any companies operating employee share schemes who have not reviewed these since October 2006, should seriously consider the terms of the scheme and assess the risk of discrimination claims.

Are EMI share options still a worthwhile incentive for employees?



6 April saw the introduction of the new Capital Gains Tax rules, abolishing CGT taper relief and introducing a rate of 18% on all capital gains. Does this mean an end to Enterprise Management Incentive (EMI) share option schemes?

In the past, one of the main attractions of EMI schemes from a tax perspective has been that business asset taper relief is normally available. This meant that an employee was able to benefit from a maximum capital gains tax rate of 10% if the options were exercised and the shares immediately sold two years or more after grant. For shares sold after 5 April 2008, this rate will increase to 18%.

So should companies continue to implement EMI share option plans?

The answer is yes – if the company has good commercial reasons for issuing share options, the EMI Scheme is still likely to be the most effective.

There are no income tax charges when EMI options are granted or exercised (provided the grant was not at a discount), so a capital gains tax liability only arises at the time the shares are sold. Companies should also be entitled to corporation tax relief on the amount of any gains made by employees on exercise of the option.

Conversely, unapproved options when exercised are subject to income tax, and potentially National Insurance Contributions on the difference between the grant and the exercise value of the shares. In addition, CGT will then be due on any subsequent gain when the shares are sold.

EMI options are flexible, with few restrictions on the type of shares which can be used. Each employee can be granted options over shares worth up to £120,000, and the scheme can be restricted to key personnel if desired. However, the employer must:

- be a UK trading company;
- have fewer than 250 employees (after the Finance Bill receives Royal Assent expected July 2008);

- have an asset base below £30m when the options are granted; and
- only grant EMI options over shares with a total value of up to £3m.

Consequently, EMI options should continue to be a favourable method of attracting and retaining key employees of trading companies after 5 April 2008, particularly where a trade sale or flotation is anticipated after a period of growth.

This information is based on information currently available, and is given by way of general guidance only, and no action should be taken solely on the basis of the information contained herein. No liability is accepted by Ensors for any actions taken without seeking appropriate professional advice.

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Quick Fire!

- From 6 April 2008, the limit on the maximum value of shares (as at the date of grant of each option) that can be put under EMI options granted to any one employee in a three year period increased to £120,000, from the £100,000 limit previously in place. However, if anyone wishes to grant EMI options over this limit, all is not lost because there is a loophole in the current EMI legislation which allows for more EMI options to be granted. Get in touch to know more!
- The SAYE option scheme bonus rates have now been reduced with effect from 4 April 2008. This will not effect SAYE savings arrangements currently in place whereby the SAYE bonus rate is fixed at the start of the saving period.