A New Focus on UK Tax-Advantaged Share Schemes

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09 / 28 / 20

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Employee share schemes are widely used by UK companies as a key tool in the recruitment, retention and incentivisation of the workforce. By allowing employees to acquire a stake in the business in which they are employed, employers engender loyalty to and engagement with the business, and align the employee and owner interest in driving performance and the value of the business. Employees across all types of companies and sectors commonly expect the overall remuneration package to include participation in an employee share scheme. For UK listed companies, the operation of share schemes is necessary for compliance with governance requirements and institutional investor expectations.[1] For banks, building societies and investment firms, they are a required mechanism for compliance with regulatory remuneration rules.[2] Use of employee share schemes plays a key part in enabling businesses and employers to demonstrate environmental, social and governance (ESG) credentials, to which investor and public attention continues unabated. Broad-based (and not solely senior level) employee share ownership strongly supports a culture focused on employee welfare and a fair remuneration structure, and where performance conditions are used to drive specific behaviours, there is increasing focus on the use of ESG-based metrics.

The UK government has long encouraged employee share ownership via the use of Tax-Advantaged Share Schemes (TASS). There are four different types of UK TASS: the Company Share Option Plan (CSOP), the Save-As-You-Earn (SAYE) or Sharesave Plan, the Share Incentive Plan (SIP) and the Enterprise Management Incentive Plan (EMI Plan). TASS facilitate providing shares to employees and (subject to meeting UK tax legislation requirements) benefit from relief from UK income tax and National Insurance contributions (NICs), thereby creating a tax-efficient form of remuneration for employees and employers alike.

The oldest form of TASS — the SAYE/Sharesave Plan — turned 40 this year, and there is an increasing focus on the use of TASS and the extent to which they remain effective and relevant for today's workforce. Earlier this month, the UK tax authority HM Revenue and Customs (HMRC) published research, undertaken to explore the motivations for, and barriers to uptake, in TASS.[3] The report highlighted many of the issues of which employers, employees, industry groups, advisers and administrators have become aware in recent years.

How Do TASS Operate?

All TASS must comply with statutory requirements relating to the company, the employee, the shares used and on quantum, with the applicable rules differing between the schemes. Subject to the requirements of the tax legislation, companies may (and commonly do) use more than one TASS alongside share incentive arrangements that are not tax-advantaged.

The CSOP, SAYE Plan and EMI Plan are all share option plans, under which employees are granted a right to acquire shares at a future date. CSOP options must be granted with an exercise price equal to the market value of the underlying share at the time of grant.

[1] The UK Corporate Governance Code; The Investment Association Principles of Remuneration.

[2] Financial Conduct Authority and Prudential Regulation Authority Remuneration Codes.

[3] HMRC Report 594.

SAYE Plan options may be granted with an exercise price at up to a 20% discount to market value. Subject to certain exceptions for good leaver or takeover events, CSOP and SAYE Plan options must be held for at least three years before exercise to qualify for the tax advantages.

EMI options are more flexible: They may be granted with an exercise price less than market value (but there will be an income tax and NICs charge on the discount), and they may be exercised at any time until 10 years from the date of grant (provided there has not been a disqualifying event). The EMI legislation is more permissive as to other terms than the more restrictive CSOP and SAYE legislation. However, EMI Plans are restricted as to their availability for use, being aimed at smaller companies. There are limits on gross assets, the number of employees in the business and the type of business.

Under an SAYE Plan, employees agree to a three- or five-year savings contract under which they make contributions from their monthly salary to fund the exercise price of their options at exercise. Options need not be exercised — participants are always entitled to request the return of their savings as an alternative to exercise. Under a SIP, employees are awarded shares that are held by a trustee on their behalf. The company may award "free shares", "partnership shares" (acquisitions funded by monthly contributions from pretax salary), "matching shares" (awarded by the company where a participant acquires partnership shares up to a 2-1 ratio) and "dividend shares" (paid on existing SIP shares). Broadly, SIP shares must be held for a period of at least three or five years in order to fully benefit from the tax advantages.

SAYE Plans and SIPs are "all employee" arrangements, meaning they must be operated on an equivalent basis for all employees. CSOP and EMI Plans are discretionary, with companies being able to choose who participates and at what level (within the permitted limits). SAYE Plans and SIPs all require the use of a third-party administrator for the setup and operation of the arrangements (to act as the savings carrier/administrator in the case of SAYE Plans and as the trustee/administrator in the case of SIPs).

TASS in 2020 and Beyond

The composition of the UK workforce and attitudes towards work and reward have changed significantly since the various TASS arrangements were designed and the rules written. The structure and rules for TASS mean they tend to suit well-established companies, are arguably easier to operate in listed companies than in private companies, are more attractive to older, wealthier employees and by their nature envisage a stable workforce.

TASS remain popular with employees and employers, with employers perceiving a positive impact from TASS participation on employee engagement, and on recruitment, retention and incentivisation, and employees feeling invested in the success of the business and motivated to perform well.[4]

However, it is clear there are elements of TASS as currently structured that discourage or prevent wider participation. The cost of establishing and operating TASS is often a first barrier for employers, in particular for SAYE Plans and SIPs, which may be prohibitive for smaller and early-stage businesses. Employee (and employer) understanding of the arrangements can be an issue, along with employee attitudes towards savings and investment (which tend to vary by life stage). Employee communications are frequently regarded as overly complicated and too dense, and could benefit from being simplified (though there is a need to accurately convey the contractual terms of the arrangements to participants). The timeline for realising value from participation in TASS (with three years long accepted as a sensible span of time for retention purposes, and over which to rely on an increase in share price) is too long for some participants, particularly in sectors of the workforce where generational makeup and/or the nature of the industry mean more frequent job changes are common (and where there is less commitment to savings and investment for the longer term). This is most notable for smaller companies, to which the EMI Plan (which has a more flexible setup, operation and required terms than the other plans) was specifically targeted, but the lack of liquidity in private companies remains a barrier. EMI options are often granted as "exit only" options for this reason (*i.e.*, only exercisable on a liquidity event) and work well on that basis at a senior level, but since an employee's time horizon may differ substantially from that of the owners, to what extent these provide a genuine and valued incentive to the wider workforce remains questionable.

Recommendations across published research and industry group surveys[5] are united in calling for better information and education for employers and employees (especially younger and nonmanagerial staff) about TASS. The recommendations aim to shift perceptions about participation, and about savings and investments more generally, and call for increased flexibility in the permitted terms of TASS so that they are accessible to a wider range of companies, industry sectors and participants. The HMRC research interestingly notes tax incentives would assist employers with the TASS setup costs.

[4] See HMRC Report 594 and HMRC Employee Share Schemes Statistics 2018-2019; Quoted Companies Alliance: Employee Share Schemes Survey 2020; ProShare: Attitudes to Employee Share Ownership.

[5] See footnote 4.

The Future of TASS

Employee share schemes are key to driving performance, employee engagement and to culture and behaviours throughout the workforce, and the availability of tax-advantaged forms of such schemes are fundamental in encouraging their use by employers and employees.

The last major review and overhaul of TASS was in 2013 and 2014, when significant changes were introduced to remove the HMRC "approval" process and move to a self-certification regime, and to simplify the applicable legislation (though in many cases, the legislation did not become clearer and the changes raised several new questions). In light of the current focus on TASS, the time may be ripe for further review, to address the various issues and concerns that have been raised and to consider the recommendations already on the table for the improvement and revitalisation of TASS. HMRC's commitment to the continuation and increase in the use of TASS is clear from the fact that it commissioned the research. HMRC, employers, advisers, administrators and industry groups alike can play a role in improving awareness and understanding of these arrangements, and in ensuring they remain available, and fit for purpose, for UK businesses of the future.