

## **Non-Tax-Advantaged Schemes (Lectures B1364/1365 – 17.55/11.08 minutes)**

This article explains some of the tax issues and attractions of non-tax advantaged share schemes.

Where does the term come from? Originally HMRC would approve all schemes under the tax approved regime including CSOP (Company Share Option Plan), SAYE (Save As You Earn Plan) and SIP (Share Incentive Plan) and EMI (Enterprise Management Incentive Scheme). However, some years ago HMRC changed their process so that all one needed to do was register those plans and therefore the name changed to tax advantaged plans. Plans which fell outside these special schemes then became known as Non-Tax-Advantaged Plans.

*Why do companies adopt Non-Tax-Advantaged Plans?*

Non-Tax-Advantaged Plans do not have to comply with the HMRC requirements and therefore can be more flexible. Multi-National Enterprises often adopt Non-Tax-Advantaged plans so that they have similar or the same plans in all the countries in which they operate.

Many companies set up Non-Tax-Advantaged Plans to link employee remuneration to company performance. They are looking to align the company's objectives with the employees' objectives. This may be reinforced by having conditions under which the vesting of options or the release of shares is affected.

Because the share schemes are linked to a person's status as an employee, they are normally considered as Employment Related Securities. The gains are treated as remuneration and normally subjected to Income Tax and National Insurance in the same way as other remuneration.

*What are the formats for Non-Tax-Advantaged Share Plans?*

Typically, they take the form of either a share purchase plan or a share option plan. A common feature of these plans is that there are conditions to be fulfilled for the employee to benefit from the plan. These conditions often include maintaining employment and the company meeting revenue or profits thresholds.

Under a share option Plan, an employee is granted an option to buy a share at a pre-determined price; normally the market value at the time of the grant of the option. For example, an option may be granted at £1 meaning that the employee is able to buy the share at the fixed price of £1 in say 3 years' time.

The period between the grant of the option and when the option can be exercised is known as the vesting period. When that vesting period has finished, the employee can exercise his/her option to buy the share at the price that has been fixed. This means that if the share is now worth £3, the individual will have now made a paper gain of £2. When and if he sells the share, this gain will then be turned into cash. If the price has risen from the time of exercise at £3 to a sale price of £4, then there would be a capital gain of £1.

*As the Schemes are called Non-Tax-Advantaged does that mean that there are no tax advantages?*

In theory the answer to this is yes, as the default position would be that the gain on exercise is subject to full tax and NI in the same way as cash. So, in the previous example where the individual paid £1 for an option and at the time of exercising the options, the shares were worth £3, the gain of £2 is subject to tax and NI. This is the case even if the shares are not sold and that would create a

“dry tax charge” where tax would be due without providing the funds to pay it. Quite often this tax would be provided by the individual selling enough shares to cover the tax bill. Or if the employee wishes to keep all the shares, he/she would fund the tax bill from other resources.

*Are there any differences between the treatment of Non-Tax-Advantaged Share Plans and cash?*

There can be significant differences. For example, if shares are given to an employee which are a minority interest in an unquoted company, this would be discounted for the lack of voting control and liquidity of the shares. This could amount to a discount of up to 80% on the value which means that a share which based on the total value of the company is worth £10, has a taxable value of say £2 because of the discounts available for unquoted trading shares.

*National Insurance*

National Insurance is not due on shares which are not readily convertible assets, i.e., not easily tradeable for cash. Quoted shares on a recognised stock exchange would be considered as readily convertible assets and therefore subject to NIC and PAYE. Unquoted shares may escape the NIC liability and any tax might only be due when the individual is required to file a self-assessment tax return. One needs to be careful that if any shares are subject to trading arrangements, they can be classified as Readily Convertible Assets.

*What other planning is often used for Non-Tax-Advantaged Plans?*

An election is often made under S.431 ITEPA 2003 by which the individual and the company pay the relevant tax and NI upfront on the value of the share at the start of the plan. If this is done then, any subsequent growth is only subject to capital gains tax (CGT). The top rate of CGT is 20% as opposed to income tax and NI for an employee of 47% and employer NIC of 13.8%. One major consideration is that if the shares fall in value, the tax paid upfront is not refunded.

*What are the consequences for Internationally Mobile Employees?*

The UK will look to tax the gain on a time apportioned basis. The gain relating to the individual's period of residence in the UK and, when non-resident, the time spent performing employment duties in the UK, is what would be taxed. For example, an individual has a 3-year share option plan and spent one year in the UK, one year in France and one year in Singapore. On the exercise of the options after 3 years the individual makes a gain of £30k. £10k i.e., one third, would be subject to UK tax.

*Conclusion*

Large numbers of companies use Non-Tax-Advantaged Plans for their employees. The tax treatment is not as straight forward as cash but there are some potential tax advantages for the well-advised company.

*Contributed by Jeremy Mindell*