INCENTIVES BULLETIN

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In this Bulletin, we have brought together and summarised the key trends and developments in share plans and executive remuneration over the last few months, including the new deadlines for PDMR transaction reporting, the increase in the use of Environmental, Social and Governance (ESG) metrics in senior management's variable pay, Government statistics demonstrating the increasing popularity of tax-advantaged share schemes and a caselaw update. We await with interest announcements relating to share plans in the UK Budget on 27 October, on which will be issuing a separate HR Budget Briefing on the evening of 27 October.

NEW DEADLINES FOR PDMR TRANSACTION REPORTING

In a move which affects all UK-listed companies, new section 30 of the Financial Services Act 2021 has amended the timetable for the disclosure of share dealings by persons discharging managerial responsibilities (PDMRs).

Previously, PDMRs were required to disclose their dealings to their employing company "promptly", and no later than three business days after the date of the transaction. The company had to announce the dealing within three working days of the transaction. This led to the unsatisfactory result that companies would have no or very limited time to make the required disclosures where PDMRs used the three-day period available to them under the Market Abuse Regulation (MAR). Consequently, it has become common practice for listed companies' internal dealing codes to require PDMRs to make the notification within a shorter timeframe.

Under the new rules, companies will have to disclose transactions within two working days of the transaction *being notified to them* by the PDMR. While this removes the awkwardness of the previous notification deadlines, we expect companies will continue to ask PDMRs to notify companies of dealings within a shorter timeframe than the three days permitted, and that grants will be disclosed to the market by the end of the dealing day following grant, if not on the day of grant itself.

HMRC PUBLISHES SHARE PLAN STATISTICS FOR 2019-20: EMI WINS THE POPULARITY CONTEST

HMRC has published statistics on the use by companies of tax-advantaged schemes (i.e. SIP, SAYE, EMI and CSOP) during the 2019-2020 tax year. The report states that employees received an estimated £530 million in income tax relief and £340 million in national insurance contributions relief over the tax year, demonstrating the value which these tax reliefs generate for UK employees.

The Enterprise Management Incentives (EMI) regime was the largest contributor to the total cost of tax relief, as well as the most popular scheme with companies: 15,340 companies operated tax-advantaged schemes (an increase of 6% on the previous tax year), of which more than 13,000 operated an EMI scheme. 99% of companies operating EMI did not operate any other tax advantaged schemes. EMI schemes are subject to strict employee and employer eligibility requirements. However, where available to companies, EMI offers the most significant tax reliefs, and allows the grant of options over shares worth up to £250,000 per employee.

We await the outcome of HM Treasury's March 2021 call for evidence on the use of EMI schemes. The government announced in the 2020 Budget that it would review EMI rules to ensure EMI provides support for high-growth companies to recruit and retain the best talent, and the call for evidence's aim was to understand whether the EMI scheme should be extended to include more companies. We look forward to seeing whether any such changes will be announced in the Autumn 2021 Budget later this week.

RECORD LEVELS OF SAYE AND SIP INVESTMENT

Beyond the growing popularity of EMI, 2020 was also a bumper year for employee investment in SIPs and Save As You Earn (SAYE) plans. The weighted average monthly savings for new SAYE grants in 2020 was just over £146 increasing to a record high from £138 in 2019. It is particularly interesting that savings levels do not seem to have been negatively affected by Covid-19. In addition, take up for 5 year options was at the highest rate (15.14%) since 2014. SIP investments saw even greater improvement with record high participation levels – 40.64% of employees now participate, up from 33% in 2019.

Despite the overall increased level of investing, there remains a pronounced gender imbalance. Around two thirds of participants saving £500 a month through SAYE contracts were men. Lower average savings by gender are also evident across SIPs, with an average difference of approximately £1,000 saved between men and women.

VERMILION - COURT OF SESSION BY MAJORITY DECIDES MR NOBLE'S OPTION IS NOT AN EMPLOYMENT-RELATED SECURITIES OPTION FOR S471 ITEPA

Mr Noble owned and was director of a consultant company, Quest Advantage Ltd, which provided corporate advisory services to Vermilion in 2006. In lieu of charging fees, Quest was granted a share option (the 2006 Option) with rights to acquire 2.5% of Vermillion's ordinary share capital. Later in 2006, Vermilion ran into severe financial difficulty and appointed Mr Noble as a director to oversee performance and report to investors during a rescue funding exercise. As part of the refinancing, Mr Noble agreed to the replacement of the 2006 Option with a new option (the 2007 Option) on amended terms – including that Mr Noble would be the option holder, rather than Quest Advantage Ltd.

At first instance the FTT considered the interpretation of section 471(3) ITEPA which deems a securities option made available by the employer to have been made available by reason of employment (and therefore be an employment-related securities option subject to income tax) unless certain limited circumstances apply. HMRC argued for a literal interpretation of s471(3) but the FTT held that the factual circumstances were at variance with the assumption of the deeming provision. In the alternative, the FTT held that the 2007 Option was not made available by reason of Mr Noble's 'employment' (directorship) in Vermilion but because it was granted only on surrender of the 2006 Option. On appeal, the Upper Tribunal disagreed and decided that it was an employment-related securities option falling within s471(1) and so chargeable to income tax and subject to NICs.

The case advanced to the Court of Session which held, in August 2021, that the earlier FTT decision should be restored. The majority ruling held that the 2007 Option did not result in Mr Noble acquiring something which he did not already have so s471(1) did not apply. Alternatively, it was held that the employment was not an operative cause of the grant of the 2007 Option as it was part of the refinance package granted when Mr Nobel became a director and agreed to the replacement option. Lord Carloway dissented, arguing that "by reason of employment" in s471(1) did not require employment to be the *sole* reason for the option and it was sufficient that employment (i.e. directorship) was a condition of the 2007 Option being granted.

Given the dissenting judgment by the Lord President of the Court of Session, we expect HMRC to appeal the decision to the Supreme Court and we strongly advise caution on relying on this case as precedent pending that appeal.

MARLBOROUGH DP LIMITED V HMRC – FTT CONCLUDES LOANS FROM REMUNERATION TRUST WERE NOT EARNINGS NOR DISGUISED REMUNERATION

The *Marlborough* case concerned a company (Marlborough) which entered into a remuneration trust arrangement with its sole shareholder and director (Dr T). It established a separate Belize-based company ((MB) also with Dr T as sole shareholder and director) and a discretionary trust between Marlborough and a Belize trustee for the purpose of providing benefits to certain persons and related persons that have or will provide services or products to Marlborough. By virtue of delegation by the trustee and a fiduciary agreement with MB, MB essentially acted as the trustee's nominee. In his capacity as director of Marlborough, Dr T made several contributions to the trust in line with Marlborough's profit levels and then requested that the trustee advance the same amount to Dr T. This was arranged through a notional loan agreement between Dr T and MB (as nominee for the trustee), although it was acknowledged that Dr T would not necessarily need to repay the loans. Dr T therefore paid no employment income tax or dividend tax on these contributions, and Marlborough sought a corporation tax deduction for the contributions to the trust as business expenses.

HMRC contended that the corporation tax deduction was not available as the contributions to the trust were not "wholly and exclusively incurred" for the purposes of Marlborough's trade. Also, HMRC argued that contributions to and loans from the remuneration trust arrangement were earnings on general principles or taxable under disguised remuneration rules and made PAYE determinations on Marlborough.

Marlborough accepted that a main purpose of the arrangement was to reduce Dr T's tax liabilities, however it argued that the contributions to the trust represented Marlborough's profits and were not connected to or a reward for Dr T's services. If the trust arrangement had not been used, the contributions would have been distributed to Dr T as dividends.

The FTT concluded that the contributions loaned to Dr T were not earnings. Considering various points of fact - including the lack of any contractual obligation to pay the sums as directors' fees and the timing of the contributions being irregular and only paid as and when the company had any profits - the FTT determined that the loans were not paid as a reward for Dr T's services, but more as a return on his shareholding in Marlborough. The FTT further held that the disguised remuneration rules in Part 7A of ITEPA 2003 did not apply as the loans were not provided "in connection with" Dr T's employment.

This is a rare example of an appellant's tax planning arrangements succeeding before the tribunal. However, the conclusion reached in this case is highly fact-specific, and given the broad sweep of the disguised remuneration legislation we would still advise companies to exercise extreme caution when operating arrangements of this type.

INCREASING USE OF ESG METRICS IN FTSE 100 BONUS PLANS AND LTIPS

New research suggests that around two thirds of FTSE 100 bonus plans now incorporate some form of ESG (Environmental, Social and Governance) requirements. Whilst less common than in bonus plans, the proportion of FTSE 100 LTIPs incorporating ESG metrics has reportedly doubled in the last year to approximately 30% this year.

ESG metrics are currently one of the most commonly discussed topics in Remuneration Committees as companies seek to support their strategic objectives regarding ESG with executive remuneration. The publicly available data, as well as our experience with clients, demonstrates that these metrics are more common higher up the FTSE index. ESG metrics are also more common in annual bonuses compared to long term incentive arrangements, and the overall proportion of the award that is subject to ESG metrics remains a relatively minor proportion of the overall value (c. 20% of awards, although this represents a slight increase on last year).

HMRC PUBLISHES TRUST REGISTRATION SERVICE MANUAL

HMRC has published its new Trust Registration Service Manual, which sets outs which trusts need to be registered, notification deadlines for notification, and data retention obligations for the trustee.

This will be relevant to the trustees of any employee benefit trusts set up by UK companies. These are usually set up offshore, and the guidance confirms that, in general, non-UK resident trusts (i.e. where the trustee is not resident in the UK for tax purposes) do not have to register on the Trust Registration Service. However, they do have to register if they acquire UK land or, in some circumstances, enter into a business relationship with a UK business.

The trusts may also have to register for UK tax purposes if they have a UK tax liability. In most circumstances, employee benefit trusts will not have to pay UK tax in relation to the trust's assets or income, because they will have a dividend waiver in respect of any unallocated shares held by the trust.

LOOKING AHEAD

We will shortly be publishing our 'HR Budget Briefing' to coincide with the delivery of the Autumn 2021 Budget by the UK Government on 27 October.

In anticipation of the 2022 AGM season we will also be publishing an update on the new Investment Association, ISS and Glass Lewis guidelines once they are released later this year.

If you would like to discuss any of the issues referred to in this briefing please contact one of the individuals listed below or your usual Slaughter and May contact.

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