SLAUGHTER AND MAY

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Pensions and Employment: Employment/Employee Benefits Bulletin

Legal and regulatory developments in Employment/Employee Benefits

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Find out more about our pensions and employment practice by clicking here.

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For more information, or if you have a query in relation to any of the above items, please contact the person with whom you normally deal at Slaughter and May or Clare Fletcher.

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Stop press

Autumn Statement 2015: Employment aspects

The Chancellor of the Exchequer George Osborne delivered his Autumn Statement yesterday. The key points of interest from an employment and employee benefits perspective are:

- **Disguised remuneration** – The government intends to take action against those who have used or continue to use disguised remuneration schemes and who have not yet paid their fair share of tax. The government will also consider legislating in a future Finance Bill to close down any further new schemes intended to avoid tax on earned income, where necessary, with effect from 25th November 2015.

- **Employment intermediaries** – As confirmed at Summer Budget 2015, the government will legislate to restrict tax relief for travel and subsistence expenses for workers engaged through an employment intermediary, such as an umbrella company or a personal service company. Following consultation, relief will be restricted for individuals working through personal service companies where the intermediaries legislation applies. This change will take effect from 6th April 2016.

- **Employee share schemes: simplification of the rules** – The government will introduce a number of technical changes to streamline and simplify aspects of the tax rules for tax-advantaged and non-tax-advantaged employee share schemes. These changes will provide more consistency, including putting beyond doubt the tax treatment for internationally mobile employees of certain employment-related securities (ERS) and ERS options. Any charge to tax will arise under the rules that deal with ERS options, rather than earnings.

- **Salary sacrifice** – The government remains concerned about the growth of salary sacrifice arrangements and is considering what action, if any, is necessary. The government will gather further evidence, including from employers, on salary sacrifice arrangements to inform its approach.

- **Office of Tax Simplification (OTS) review of employment status** – The government has responded to the final report of the OTS review of employment status and is taking forward the majority of recommendations.

- **Apprenticeship levy** – The government will introduce the apprenticeship levy (as announced in the Summer Budget) in April 2017. It will be set at a rate of 0.5% of an employer's paybill and will be paid through PAYE. Each employer will receive an allowance of £15,000 to offset against their levy payment. This means that the levy will only be paid on any paybill in excess of £3 million. The aim is to deliver 3 million apprenticeship starts by 2020 (Finance Bill 2016).

- **Disabled employees** – The government will publish a White Paper in 2016 that will set out reforms to improve support for people with health conditions and disabilities, including exploring the roles of employers, to further reduce the disability employment gap and promote integration across health and employment.

New publication

New rules on non-compete clauses in Sweden

We attach a bulletin which has been prepared by Mannheimer Swartling, our Swedish best friend firm, which considers new rules on non-compete clauses which will enter into effect in Sweden on 1st December 2015. These rules will be particularly relevant for businesses employing staff in Sweden.

If you would like further information, please speak to one of the contacts listed in the bulletin.

Cases round-up

Collective redundancies: constructive dismissal by pay cut is covered

The ECJ has confirmed that where an employee instigates the termination of their employment contract in response to unilateral and significant changes to essential elements of that contract made by the employer (in this case, a 25% pay cut), for economic reasons unrelated to the individual employee, that termination falls within the definition of "redundancy" under Article 1(1)(a) of the Collective Redundancies Directive (the Directive). This means that the employer may need to collectively consult with employees before implementing such contractual changes (*Pujante Rivera v Gestora Clubs Dir, SL*).

Dismissals and pay cut: R, along with nine other employees of G, was dismissed 'for economic and production reasons'. Around the same time G terminated a number of other contracts, including a number of voluntary redundancies. In addition, another employee (X) received a 25% pay cut for the same economic and production reasons as R's dismissal. X instigated the termination of her contract on that basis, as the pay cut was found to exceed the significant changes to working conditions permitted under Spanish law.

Redundancy? R brought proceedings claiming that G should have applied the collective redundancy procedure under Spanish law implementing the Directive. A preliminary issue arose as to which contract terminations should count towards the threshold for these purposes. The Spanish court referred a number of questions to the ECJ, in particular as regards the termination of X's contract, and whether this should be treated as "a dismissal effected by the employer for one or more reasons not related to the individual worker concerned" under Article 1(1)(a) of the Directive.

Employee termination following contractual changes is covered: The ECJ held that where an employer, unilaterally and to the detriment of the employee, makes significant changes to essential elements of his employment contract for reasons not related to the individual employee concerned, this falls within the definition of 'redundancy' for the purpose of Article 1(1)(a) of the Directive. The ECJ was clear that "redundancy" must have an EU definition for these purposes, as one where the termination is not sought by the worker, and is therefore without his consent. Although in this case X sought the termination of her contract, it was in response to the unilateral contractual change made by G for reasons not related to X herself. Having regard to the purpose of the Directive, the ECJ concluded that "redundancy" should not be given a narrow definition, and should encompass circumstances such as X's.

Relevance for the UK: It has been clear under UK law for some time that termination and re-engagement to effect a change of terms may be a "redundancy" for collective consultation purposes (*GMB v Man Truck and Bus UK Ltd*). This decision confirms that the definition also covers constructive dismissal, where the employee treats himself as dismissed in response to a unilateral change of terms by the employer, if that change amounts to a fundamental breach of contract by the employer.

Benefit change exercises: Employers who are proposing to make significant contractual changes to the terms and conditions of 20 or more employees at one establishment within a period of 90 days or less must be aware of the requirement to collectively consult with those employees before implementing the changes, under section 188 TULR(C)A 1992, which implements the Directive in the UK. The requirement may be triggered not only if the employer expressly terminates and re-engages employees to implement the change of terms, but where the employer unilaterally implements the change in terms in such a way that amounts to constructive dismissal of the employees.

Different definitions of "redundancy": It is worth remembering that the definition of redundancy under TULR(C)A 1992 and the Directive is much wider than that which applies for unfair dismissal and redundancy pay purposes. Therefore whilst the above situations may count as "redundancy" for collective consultation

purposes, it is quite unlikely that they would amount to "redundancy" for those other purposes (which would require broadly either a workplace closure or a diminished need for employees to carry out work of a particular kind).

Collective redundancies: City Link directors acquitted of failing to notify BIS

The Insolvency Service has failed in its first attempt to prosecute directors for breaching the requirement to notify BIS of proposed collective redundancies via form HR1, under section 193 TULR(C)A 1992 (*BIS v Smith, Peto and Wright*).

Administration of City Link: Between October and December 2014, City Link explored sale and restructuring options with its principal shareholder, Better Capital. However, on 22nd December Better Capital informed City Link that it would not make the required funding available. City Link's directors then realised that the business would become insolvent by mid-January, called an urgent board meeting, and decided that same day that the only option was for the company to enter administration.

Redundancies and BIS notification: Ernst & Young were appointed administrators on 24th December, and decided to make 2,700 staff redundant with immediate effect. It gave notification to BIS under section 193 on 26th December.

Prosecution: The Insolvency service instigated a prosecution against three of the City Link directors (together D), alleging that the need to notify BIS under section 193 arose on 22nd December, when the decision was taken to place the company into administration. D maintained that they formed no proposal to make the workforce redundant at that stage, and believed that their jobs could be saved in administration.

Administration did not make redundancies inevitable: D were found not guilty. The court applied the test of whether there was a "clear, albeit provisional intention" to implement a plan where dismissals will inevitably, or almost inevitably, result. On the facts, there was a clear intention to put City Link into administration. However, the court did not accept that this made redundancies inevitable or almost inevitable.

Genuine belief that jobs could be saved: The court was persuaded by D's evidence that as at 22nd December they all genuinely believed there was a real prospect of the business being bought while in administration and the jobs saved, that a sale was not only possible but quite probable, and therefore that redundancies were not the only foreseeable consequence of the administration, nor even the most likely one. This was corroborated by the administrator's evidence that he found a potential buyer who made a firm offer for the business, albeit not at a level which the administrator was able to accept, but which would have meant that no redundancies would have been needed at all.

No 'crystal ball': The court rejected the suggestion by the Insolvency Service that a director could be expected to "*put a crystal ball on his or her desk, at a time of huge shock and turmoil, and predict the likely consequences of an action, unless a consequence is either the only foreseeable one, or is the only consequence that can reasonably be envisaged in the circumstances*".

No 'proposal' for redundancies before administration: The court therefore found that no proposal was formed by City Link on 22nd December 2014 (or at all) to make the workforce redundant. There was neither an overt proposal to that effect, nor (on the evidence before the court) an inevitability or near-inevitability that redundancies must flow from the plan to go into administration. The proposal to make the workforce redundant was made by the administrator, and communicated to BIS at the earliest opportunity, namely 26th December 2014. The prosecution therefore failed.

No precedent for all administrations: The court did however made it clear that no employer should take its findings to set a precedent that an employer can avoid its responsibility under section 193 simply by going into administration. It stressed that its finding

that no proposal had been made was based on the evidence in this case, not on a general principle in relation to administration.

Murray Group case: Payments into EBTs were taxable as earnings

The Scottish Court of Session has allowed an appeal by HMRC and held that sums paid into employee benefit trusts (EBTs) set up by the former Rangers Football Club were earnings subject to income tax (*The Advocate General for Scotland v Murray Group Holdings*).

EBT payments: Murray Group Holdings (M), which at the time owned Rangers Football Club, started to pay bonuses and other reward payments for footballers and other employees via an EBT, rather than directly to the individuals. Because the payments from the EBT to the employees were structured as loans, the intention was that they should not attract a charge to income tax or NICs as earnings.

Initial HMRC challenge failed: M successfully argued before the First and Upper-tier Tax Tribunals that the payments were loans and not earnings, and were not subject to tax. This meant that the demands of HMRC in the club's administration should be substantially reduced.

Payments were redirected earnings: The Court of Session has now allowed HMRC's appeal, finding that the cash payments made by M to the EBT were in consideration of services by the employees, were part of their remuneration packages, and thus had been "earned" by the employees. It found that this analysis is unchanged even if the employee requests or agrees that the payments be redirected to a third party (such as an EBT). Therefore, the scheme amounted to "a mere redirection of earnings" which did not remove the liability to income tax. The Court therefore concluded that the obligation to deduct tax under the PAYE system fell on the employer when it made payments into the EBTs.

Wider implications? Although the disguised remuneration rules have altered the tax position on payments into EBTs since the facts of this case arose, the Court's comments are nonetheless useful from a general perspective when assessing whether sums amount to "earnings" for tax purposes. In particular, it remains to be seen whether HMRC will seek to extend the redirection of earnings argument to other situations such as salary sacrifice and/or deferred bonus arrangements, in order to claim an up-front tax charge.

Points in practice

Latest IA Principles of Remuneration (November 2015)

The Investment Association (IA) has published a new version of its Principles of Remuneration (November 2015). These replace the IMA Principles of Remuneration published in October 2014, which in turn replaced previous versions published by the ABI.

The Principles are predominantly intended for companies with a main market listing, and set out IA members' views on the responsibilities of investors and remuneration committees, as well as guidance on executive salaries, bonuses, pensions, contracts, severance and share-based incentive schemes.

The 2015 Principles only include one significant change to the previous version. They now provide that **LTIPs should have a performance and holding period of at least five years in total**.

The IA has also published a supplementary letter to remuneration committee chairmen, which gives an overview of current issues of concern to shareholders. These are:

- **Salary increases**: all salary increases should be justified with a clear and explicit rationale, particularly increases in excess of inflation or

increases for the general workforce (which would not be supported in normal circumstances). A growing number of investors consider that executive directors should not receive regular salary increases, given the overall structure of their remuneration packages.

- **Bonus target disclosure**: Bonus targets should either be disclosed retrospectively in full at the year end, or a commitment should be given to disclose such targets in full at a specified time in the future. Where companies do not disclose any targets or do not commit to full future disclosure, IA members have asked IVIS to Red Top those companies as they believe that there is insufficient information to make an informed voting decision. Where relative achievement is disclosed with no commitment to disclose the actual target ranges, an Amber Top will be given. This policy will take effect for companies with year-ends on or after 1st December 2015.

- **Notice and PILON**: the majority of IA members are still in favour of notice periods of up to a year. New contracts should have equal notice periods for both the company and the director. New contracts should also introduce clauses to allow for the withholding of pay in lieu of notice (PILON) where there is any ongoing regulatory or internal disciplinary or misconduct investigation.

- **Pensions**: Members expect executive pension arrangements to be in line with those for the rest of the company, and are concerned over the large increase in pension amounts as well as complex pension arrangements with executive directors, which differ from arrangements in place for other employees.

- **Recruitment arrangements**: Investors will continue to scrutinise recruitment arrangements and buyout awards. In particular any attempts to re-award or re-issue recruitment awards in the circumstances of a fall in company value is a concern for IA members, who believe that it is inappropriate for the executive to be shielded from such risks.

- **Leaving arrangements**: Remuneration committees should take a firm approach when determining leaving arrangements and assessing whether an individual is a good or bad leaver. Members expect full justification of the treatment of leavers, particularly where a leaver is deemed to be a good leaver.

The letter also provides details on the IA's Executive Remuneration Working Group, created in September 2015 to consider a radical simplification of executive pay. The letter confirms that the working group is due to publish its proposals in the spring of 2016.

Collective redundancies: Insolvency Service publishes responses to call for evidence

The Insolvency Service has published a summary of the responses it received to its March 2015 call for evidence on collective redundancy for employers facing insolvency (see our Employment Bulletin dated 2nd April 2015, available here).

The publication reveals that the main issues that emerged from the consultation responses to the call for evidence were:

- Almost all respondents believed meaningful consultation with a view to reaching an agreement, particularly on ways to avoid or reduce dismissals, could often not happen in an insolvency situation.

- Some concerns were raised that disclosure about a company's financial difficulties could undermine rescue and survival of the business.

- Respondents believed tensions between employment law and insolvency law inhibit consultation when a company is in formal insolvency. A lack of time and money was seen as a major inhibitor to beginning consultation by trade unions, employment and insolvency lawyers and insolvency practitioners.

- There is uncertainty about when the requirement to consult and to notify begins, and how long consultation should last (with a number of respondents believing there to be a fixed statutory period).
- For insolvency practitioners in particular, where there is no recognised trade union or employee representative in place, the process for electing employee representatives at a point when a company has entered into an insolvency process was perceived to be onerous and prohibitive to rescuing and preserving the value of the business.
- Several respondents expressed the view that, in insolvency situations, the effectiveness of protective awards was undermined because the burden for failing to consult falls on creditors and taxpayers.

The government's position remains that there is no conflict between insolvency law and employment law. However, the publication states that the government will carry out further work to see how best to address the points raised in the responses, and in particular will look further at options that will clarify what is required from employers and their representatives in an insolvency situation and at the same time increase the effectiveness of sanctions for non-compliance.

EBA report on use of role-based allowances

The European Banking Authority (EBA) has published a follow-up report on actions taken by competent authorities following the publication of its opinion on the application of the CRD IV Directive and the use of role-based allowances (RBA) (see our Employment Bulletin dated 23rd October 2014, available here).

The EBA's opinion was that RBA that are not predetermined, are not transparent to staff, are not permanent, that provide incentives to take risks or, without prejudice to national law, are revocable, should be classified as variable remuneration and fall within the bonus cap under CRD IV. Competent authorities were asked to ensure that institutions' remuneration policies complied with the EBA opinion by 31st December 2014.

The report reveals that:

- The most frequent use of RBA was observed in the UK.
- None of the competent authorities (including the PRA in the UK) have yet adopted specific legal/regulatory instruments following the publication of the EBA opinion. This was mainly explained by the fact that the EBA's final guidelines on remuneration are still awaited.
- However, in all member states the competent authorities include RBA as part of their supervisory review and evaluation of institutions' remuneration policies.
- The PRA is said to have committed to change its supervisory instruments for the performance year 2015 and onwards to verify that institutions apply the criteria set out in the EBA opinion and will take appropriate measures, where necessary, to change their remuneration policies and practices.

The report confirms that the EBA is currently finalising its guidelines on sound remuneration policies which will contain further criteria to classify remuneration components between fixed and variable ones. The final guidelines should be available by the end of 2015.

EBA report on allowing 200% bonuses under CRD IV

The European Banking Authority (EBA) has published a report, Benchmarking of approved higher ratios, which summarises the data provided by EU member states which allow shareholders to approve bonuses of up to 200% of salary under the CRDIV bonus rules.

The report reveals that, as at December 2014:

- All member states, except Belgium, Slovenia, Sweden and Romania, have implemented the possibility for shareholders to approve a higher maximum ratio of up to 200%. Norway, Poland and Iceland have not yet implemented CRD IV and were therefore excluded.
- The Netherlands allowed for higher ratios in 2014 but, since February 2015, a new law has been in

force that (after a transitional period) only allows a higher ratio than 100% for staff located in countries that are not member states.

- The share of institutions with an approved higher ratio against the total number of institutions in each member state ranges from 0.3% (Austria) to 12.2% (France). One quarter of the institutions with an approved higher ratio are listed institutions. The UK is at 5.5%, but those institutions represent 77.2% of the balance sheet total of the whole UK banking system.
- In the UK, around half of the identified staff in scope of the 200% ratio work in investment banking.
- The main reasons presented by institutions to justify the 200% ratio were:

  i. to remain competitive with EU and international peers;

  ii. to maintain the ability to attract and retain highly qualified staff (in particular, for senior positions);

  iii. to recognise a clear link between pay and performance and to use variable remuneration not only to reward exceptional performance but also as a motivating factor for staff;

  iv. to keep cost flexibility by being able to reduce costs in response to weaker performance; and

  v. to minimise the increase in fixed compensation costs, which is important for certain investment firms in light of the prudential funds requirements.

The EBA will use the data provided to further analyse the effect of the bonus cap on the cost flexibility of institutions. It will also (alongside the competent authorities) continue to monitor developments with regard to the approval of higher ratios for variable remuneration, and will take into account its findings in the review of the remuneration provisions mandated under Article 161 of CRD IV.

Webinar

Global Benefits and Compensation Roundtable webinar

Charles Cameron, a partner in our Pensions and Employment Group, is a guest speaker at a webinar on 3rd December, 2015 on Global Workforce Classification: Benefits & Compensation considerations. The roundtable will look at cross-border liability benefits and compensation considerations arising from the increasing reliance by multinationals on a workforce consisting of diverse classifications such as outsourcing, consultancy agreements and zero hours contracts. The webinar takes place from 4.00pm to 5:15pm GMT. Further details are on the Conference Board website.

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