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it's our business

newspad of the Employee Share Ownership Centre

Government probes EMI scheme

A major Treasury investigation is under way as to whether the government is getting value for money from the spectacularly successful Enterprise Management Incentives (EMI) scheme for smaller companies (SMEs).
The Treasury's Revenue & Customs arm (HMRC) has commissioned Ipsos-MORI to carry out comprehensive research into the "tax-advantaged" EMI scheme, introduced by Gordon Brown in 2000. This research is examining the experiences of employers and employees in offering or holding EMI share options and their perceptions of the effects on employee behaviour and company performance.
Using this research HMRC will assess whether EMI has met its policy objectives, namely: to recruit skilled staff to small, high-risk companies; to retain skilled staff in these companies; and to encourage growth of small companies.
The main fieldwork for the EMI Survey is already under way. Employers in companies offering EMI options have been randomly selected from HMRC databases. At least 1,000 employers are being contacted by phone and interviewed. In addition, 1000 employees who hold, or have held, EMI options have been randomly selected too and are being sent questionnaires to complete.
Yet in terms of take-up, the EMI scheme is a rip-roaring success, though one which, as Centre chairman Malcolm Hurlston has pointed out, the Treasury has been curiously reluctant to crow about. The most recent published official statistics show that as of June last year, no fewer than 7,250 SME companies were taking advantage of the EMI scheme, incentivising almost 100,000 key employees – a 45 percent increase in the number of participants in just two years. The value of the outstanding EMI share options they had received by mid 2006 was a staggering £1,850m.
So why this survey, which follows on from a similar preliminary study in 2003-4, many in the industry will ask?
The earlier EMI study, commissioned by the then Inland Revenue was carried out by consultants FDS International. It revealed, inter alia, that some companies had switched from using the Company Share Option Plan to EMI simply because the latter offered better tax advantages and easier administration. "Had EMI not been available, we can only infer that such companies would have left their previous arrangements running," said the prelim report. It concluded that EMI was being used to: "supplement and replace salary, motivate and retain key staff, to enable competitive recruitment, to prepare management succession, to give senior managers some insurance against the adverse effects of future takeover and as a means of sharing the fruits of success." The award of share options was regarded as 'normative' – an expected condition of employment in the IT, biotech, advertising and film industry sectors. Worryingly, some employers admitted to FDS International researchers that the tax incentives were the main or only thing which had attracted them to EMI and that they didn't see it as a way of attracting new employees.
The Treasury is monitoring the rising tax revenue loss implied by the generous EMI tax relief mechanisms. These allow executives and other key employees to exercise their EMI options after a few years with no income tax or NICs contributions to pay and only a ten percent Capital Gains Tax bill, because EMI taper relief starts from the moment their options are granted and not from the exercise date, as is the case in most other UK share option plans.
The amount of lost Treasury revenue is growing rapidly, as shown in the HMRC share scheme statistics, updated last month (source: Form 40 returns and EMI options notifications, which are three months out of date).
Continued overleaf

From the Chairman

The new Chancellor Alistair Darling is a supporter of employee ownership but he will want to see a bang for the taxpayer's buck.
Ten years ago when he arrived as financial secretary I wrote to him at the instigation of some members, pointing out the misuses of relief which were losing the country an estimated £1bn in nationally unproductive ways.
The loopholes closed.
This month's front page story in newspad reveals that a new review has already been launched.
We can expect no sympathy from the new Chancellor if we are not using what the taxpayer is giving us in the interests of productivity and national well-being. The employee ownership world needs to be more effectively self-policing if we are to hold and extend our gains.

Malcolm Hurlston

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No fewer than 2,570 more companies awarded 27,000 employees EMI options, worth £430m in the tax year 2005-6 alone. But in that year, 5,900 employees exercised their EMI options, which HMRC said would cost the Treasury an income tax and NICs relief loss of £170m, equating to *£28,000* per head. That level of tax & NICs relief loss was up more than 50 percent from £110m in the previous year, (when 4,500 employees exercised their EMI options). It looks likely that the tax relief loss to the Treasury during the fiscal year ended April 5 this year may have been in the region of £250m. During the same year (2005-6) 390,000 employees exercised their SAYE Sharesave options, but the total tax and NICS loss to the Treasury in their case was £420m – or *£1,000* per head. There will be a final report on the survey findings, which will be published on the HMRC website.

Treasury changes

Alistair Darling is the new Chancellor of the Exchequer. Second in line, as Chief Secretary, is Andy Burnham, MP for Leigh in Lancashire, who was formerly minister of state for "delivery and quality" at the Dept of Health. Financial Secretary to the Treasury is Jane Kennedy MP; Exchequer Secretary is Angela Eagle MP and Economic Secretary is Kitty Ussher MP.

Approved plans: market value determination

Clifford Chance informed clients that HMRC's *Share Focus Issue 5* sets out a change of practice (effective from last May) for determining market value (MV) when granting options/awarding shares under approved plans. Under previous guidance, HMRC generally required the MV of shares to be agreed in advance unless the company's shares were listed on the London or New York stock exchanges. The revised guidance applies to UK and US listed shares (but not to shares on AIM). Now the MV for such shares can be established on: the date of grant or invitation (the Valuation Date); or the day immediately preceding the VD; or an average during up to a maximum of five consecutive dealing days prior to the VD **without** having to seek specific HMRC agreement (although the method would need to be set out in the plan rules). MV can be defined by reference to (1) the middle market quotation or (2) the quarter up of the lower figure on the day. HMRC Shares and Assets Valuation dept. (SAV) recommends that the middle market quotation be used. If the company wishes to use an average over more than five consecutive days, this will need to be agreed in advance. However, HMRC said that it will normally accept such longer periods if this is a legal requirement in the relevant country. The guidance does **not** affect the procedure for determining MV in the context of (1) rollovers of options or (2) adjustments to options following a variation of share capital. In addition, in the context of a flotation or similar transaction, MV should be agreed in advance with HMRC. For private companies, HMRC recommends that MV should always be agreed in advance of any grant. SAV will agree MV on a particular date (date of grant/invitation), which will be valid for 30 days. If the company fails to grant options within that period, HMRC would require a further valuation.

The Share Incentive Plan legislation states that the MV of shares for various purposes must be established by reference to a fixed date. In the case of partnership shares, this must be on the 'acquisition date' (as defined in the legislation). However, this has caused problems for SIP trustees who may acquire the shares on several different days (in order, for example, to minimise share price volatility). HMRC acknowledged these problems and clarified its guidance on how MV is to be established where shares are acquired for the purposes of a SIP over several days. There will be greater flexibility for companies whose shares are quoted on a stock exchange and the SIP plan rules may now provide for MV to be determined (without seeking agreement from SAV) by different methods, as set out in *Share Focus Issue 5*. These methods include calculating MV based on the average purchase price of those shares, if all the shares to be awarded on a particular occasion are purchased in the market over five or fewer consecutive dealing days.

Reporting deadline reminder

Clifford Chance said that HMRC has been taking action before the Special Commissioners, trying to impose penalties where companies have failed to submit their share plan year-end returns, for either approved or unapproved plans. The deadline for submission of Form 42 for 2006/2007 is July 6 and July 9 for approved returns. HMRC wants to simplify and reduce the amount of information it requires under Form 34 (Sharesave) and Form 35 (discretionary share option plans) for 2008.

Rich pickings in £6bn merger

Saga, the services group for the over-50s and AA, the vehicle recovery and insurance company, agreed to a £6.15bn merger via a new holding company, but three private equity houses, who are part owners, are taking out more than £2bn in dividends as part of a complex refinancing deal. However, 80 percent of Saga staff will make £10,500 each from an investment of just £20 in an Eso scheme. Permira, CVC and Charterhouse Capital Partners will cash in less than three years after each bought into their respective investments. A new holding company is buying both companies. The new company contains £4.8bn of debt, which is being provided by a syndicate led by Barclays Capital and Japanese bank Mizuho, but the two original companies, Saga and the AA, only had £2.8bn of debt between them. The £2bn difference in debt reflects the cash the private equity firms are taking out of the business as part of the deal. CVC and Permira both placed £500m into the AA as part of their £1.75bn acquisition from Centrica. Charterhouse is thought to have put a similar amount into Saga in October 2004 at the time of its £1.35bn MBO from the founding de Haan family. The private equity owners of AA and Saga will be the main investors in the new business. Charterhouse Capital Partners will have a 37.5 percent holding in the new company, while Permira and CVC Capital Partners, joint owners of AA, which they bought for £1.75bn in 2004, will each own 21.5 percent of it. The remaining 20 percent of the equity will be held by management and staff of each company. The three private equity owners are putting in £1.4bn and Saga management and staff £86m, a Saga spokeswoman said. Earlier this year, Saga told the market that it had appointed UBS and Merrill Lynch to explore the potential for an initial public offering later this year. Andrew Goodsell, who will head up the new and as-yet-unnamed company, said a flotation remains on the cards, dangling the prospect of yet another shareholder bonanza down the line.

Lloyds TSB staff windfall

Thousands of Lloyds TSB staff are sharing a payout of £27m as Sharesave share options they accumulated reached maturity. On average, staff will receive £3,000, though those who chose to invest the maximum of £250 per month in the 2004 scheme now own options over shares worth more than £16,000. Angie Risley, Lloyds TSB Group HR director, said: "It's really important our staff feel part of our company success and the Sharesave scheme is a great way for us to reward employees for the part they play. The 2004 scheme has given staff an 87 percent interest return on their original investment." Lloyds TSB also runs a Share Incentive Plan, through which staff receive free company shares each year and invest a proportion of their pre-tax salary to buy its shares. Last April, employees were awarded three percent of their annual salary in shares up to a limit of £3,000 per person. £11m 'matching shares' are awarded to staff investing in the group's SIP. Through the scheme employees buy up to £125 worth of shares per month from gross salary. For every share purchased the company gives a free matching share up to the value of £30 per month. Over the course of the year, an individual investing £30 each month would now hold 126 shares in the plan worth £7,111. This compares to just £247 if they had simply taken the cash as part of their salary. Since the SIP was launched in 2003, the group has awarded employees shares worth a total of £279m. The £36m shares given to staff under the group's 2004 annual free share scheme will be released from their compulsory holding period this year.

Ogier wins gold

Centre member Ogier has been named 'Offshore Law Firm of the Year' by *The Lawyer* magazine at its annual awards ceremony in London. Ogier was chosen from five other short-listed firms. The completion of the merger with BVI-based WSmiths and the firm's growth into the Asian market were mentioned as key developments for the firm, which now employs more than 600 staff in nine locations. The "Offshore Law Firm of the Year" award was collected by Simon Schilder, an Ogier BVI partner. The judges looked for evidence of strategic clarity, technical legal excellence and quality control, growth in market share and each entrants' progression within the jurisdictions they operate.

CONFERENCES

Centre – IoD October 9: Speakers (and their topics) at the ever popular joint Centre – Institute of Directors annual share schemes conference for SMEs include: Justin Cooper of Capita Registrars, (why Eso in smaller companies and how to use an EBT); David Craddock of David Craddock Consultancy Services, (case studies about using Enterprise Management Incentive); Aidan Langley of PWC, (unapproved share plans, looking at separate classes and share loan plans); Robert Postlethwaite of Postlethwaite Solicitors (planning an exit); Michael Sterchi of KPMG (a case study of a dual listed SME company) and Sara Cohen of Lewis Silkin (EMI scheme overview). Hopes are high that a senior HMRC share schemes official will speak to delegates about the department's valuation work, with perhaps a general overview of the UK Eso world too. A few speaking opportunities remain for this event and if you or a colleague wish to speak, please contact jlewis@hurlstons.com asap if you have a preferred subject. The conference regularly attracts over 100 delegates, mainly from unlisted companies. Any presentations that incorporate a company case study will be particularly welcome. Feedback from last year's audience particularly valued plan case studies, detailed share plans and exits. Speakers gain free entry to the full event, usually costing £360 + VAT for Centre and IoD members and £460 + VAT for non-members**.** See the Centre website for registration details

Centre – STEP Guernsey November 9: William Franklin of Pinsent Masons, David Larsen of BMS Associates and David Craddock will be among the mainland speakers at the joint Society of Trusts & Estates Practitioners/Centre share schemes conference to be held at Old Government House Hotel in St Peter Port, Friday November 9. The focus will be on trustee issues, which have attracted mainstream media attention recently, as the winding up of Foster and Partners' former EBT has come under scrutiny. Admission prices will be £295 +VAT for STEP or Centre members (discount for 2nd and subsequent delegates) and £425 + VAT for non-members. If you would like to speak at this event please contact jlewis@hurlstons.com with your preferred topic. Speakers from the mainland can reclaim their economy airfares and will be accommodated in the OGH Hotel before the conf if needs must.

Davos 2008

The European Centre seeks speakers and presentation subjects for its ninth global equity forum at the five-star Steigenberger Belvedere Hotel, Davos, on **Thursday January 31 and Friday Feb 1.** Speakers are offered a £200 price discount. Please contact Fred Hackworth at fhackworth@hurlstons.com if you and/or a colleague would like to speak at this event. Delegates' pre-paid (by the Centre) bed nights in the Belvedere will be Jan 30 and Jan 31. You can either present solo, or together with a client. Member practitioner speakers will pay £575 for the all-in (except travel) package deal, while member practitioner delegates will pay £775. Non-member practitioners however will each pay £995. Exceptionally, Centre member plan issuer delegates will pay only £275 for their accommodation + conference package deal. If you book online now, you can get return tickets from London to Zurich for less than £100 (correct at the time of writing), using Centre member BA's website www. ba.com. You can return to Gatwick, Heathrow or London City airports, on Friday night. The discounted room rates are available to delegates who arrive in Davos early that week and/or depart later, up to Saturday morning. Further details will be added on the Centre website: www.hurlstons.com/esop.

Reward and performance

Three of the five companies singled out for criticism in a report by remuneration consultant Patterson Associates have leapt to the defence of their ceos. The report revealed that some of the best-paid bosses in the FTSE100 over the past five years delivered the least bang for their buck in terms of total shareholder returns (TSR). Patterson found that GlaxoSmithKline ceo Jean-Pierre Garnier destroyed value, in terms of shareholder return, with £100 being turned into £91 despite his £15.6m pay package. A GSK spokesman said: "Total shareholder return is one measure of many in the case of performance. It does not take into account market conditions or the well-being of the sector." Reckitt Benckiser shareholders paid £52.6m over five years to ceo Bart Becht to secure a £260 return on an initial £100 investment, said the report. At Land Securities, the same return was achieved at a cost of £5.8m, giving shareholders ten times more reward for their investment. Patterson compared the total pay of FTSE 100 chief executives over the past five years with the total return accruing to shareholders through share price movements and reinvested dividends. It found that ceos are in a win-win pay game where any shortfalls in long-term performance-related schemes are replaced by higher salaries and bonuses. BP declined to defend the performance of former boss Lord Browne, who received £20m, during which time £100 invested in BP grew modestly to £130. Sir Fred Goodwin, ceo of Royal Bank of Scotland, was paid £13.7m during a period when £100 invested was turned into £150. A RBS spokesman said: "He is paid what we believe is an attractive salary that is competitive against the peer group. Shareholders have enjoyed well above market average TSR in that five-year period." Amvescap, which has changed its name to Invesco and was allegedly the worst performer, refused to comment. Ceo Martin Flanagan took home £26.7m during a period when £100 invested was reduced to £69. The bonus culture is so ingrained in British boardrooms that incentives make up 80 percent of executive remuneration. **Deloitte** revealed that the average bonus of ceos in the top 350 companies had doubled in just three years when share prices, profits and dividends were growing at slower rate.

Vodafone has cut performance targets for directors' share options schemes again, despite the group's lacklustre performance. Next year directors must achieve only eight percent growth in earnings per share, half the rate needed in 2006, in order to fully vest their share options. They need hit only five percent growth in order to vest a quarter of their options. Vodafone claimed that the reduced levels were still "*some of the most stretching in the FTSE 100*". Ceo Arun Sarin received a package worth £3.25m, up 19 percent. He owns 6.2m shares worth more than £10m. Nissan President Carlos Ghosn told shareholders that the carmaker will not pay any bonuses to its board members for fiscal year 2006, so as to take responsibility for its poor performance, *Kyodo News* reported. This is the first time that Nissan has decided to skip the bonuses since Ghosn took the helm of Nissan in 2000. Mr Ghosn told the agm that he and other board members had no right to receive bonuses after Nissan saw the first annual fall in group net profit in seven years.

On the move

Carola Breusch *Director* left **Ansbacher Trustees (Jersey) Ltd** last month. The Centre's main point of contact in future at Ansbacher will be Elizabeth Dulake, MD, tel: 01534 504510 email: elizabeth.dulake@ansbacher.com

Responsibility for employee share schemes within **The Treasury** is on the move…to another part of the Horse Guards Rd HQ. We'll keep you posted.

A **Deloitte** Global Equity Update for the UK sets out changes to HMRC guidance on the taxation of options granted to internationally mobile employees. The change affects employees who are normally based in the UK but who are granted options while on foreign assignment, which they expect to exercise after returning to the UK. Whereas these options may not previously have been subject to UK income tax (provided that they were not granted in connection with UK employment), this may no longer be the case as the interpretation of "in connection with UK duties" has broadened, said William Cohen**,** employment and remuneration partner.

France: President Sarkozy followed up his pre-election threat to clampdown on 'golden parachute' payments sometimes given to departing mediocre senior executives. His proposed new law, before the new parliament, would force companies to obtain advance approval from shareholders for such payments, which would be only permissible if the departing executive has achieved fixed performance targets. This action was prompted by the revelation that former EADS ceo Noel Forgeard was given a golden goodbye worth €8m at the same time as its operating company Airbus was announcing a 10,000 reduction in the workforce - due to massive losses caused by severe delays on the A380 series. President Sarkozy demanded a clause in the legislation to prevent companies giving truckloads of stock options to a handful of key executives *unless* **all** salaried employees have the chance to take part in such stock option programmes. There was a the sting in the tail – a demand that the discount of up to 20 percent (from market value) on the award of stock options to employees should be withdrawn, to prevent option holders obtaining an immediate "free" gain.

COMPANIES

AIM listed **Eleco plc** announced it had issued 1m new ords of 10p to the trustees of the Eleco Esot to satisfy awards under the company's Long Term Incentive Plan. **Elementis plc** announced that the ESOT had had purchased 1m ords in the company for £908,256, which will be met from company funds, reported company secretary Kathryn Silverwood.

The Employee Share Ownership Centre is a members' organisation which lobbies, informs and researches on behalf of employee share ownership. It is operated by staff of Hurlstons Corporate Consultancy Ltd.