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it's our business

newspad of the Employee Share Ownership Centre

More consultation on proposed unapproved share scheme changes

A major new consultation exercise was launched by HMRC in response to the Office of Tax Simplification's review of unapproved employee share schemes.

HMRC has given the share schemes industry until **August 16** to comment on its responses to five of the recommendations made by the OTS in its report on unapproved schemes, published last January.

The main OTS proposals concerned: the point at which income tax becomes due on employee share or share option awards; the tax treatment of employment-related securities awarded to internationally mobile employees; the rules that apply for certain share exchange arrangements; corporation tax relief for employee share acquisitions; the valuation of shares; and employers' information and PAYE obligations.

However, several other OTS recommendations have been either rejected outright, or subject to further discussion, behind closed doors, either with senior OTS officials, or with ministers.

One of these is the controversial OTS plan to side-step EBTs by introducing a new 'employee shareholding vehicle,' to make it easier and possibly cheaper for SMEs to warehouse employee shares. Though this remains on the table, HMRC said there would be further internal discussion as ministers are not sure whether such a vehicle could be designed in a way that does not create potential for abuse, or significant additional Exchequer costs.

The Centre is supportive of the view of trustee members who argue that EBTs are effective, reliable and well understood and, as such, should not be undermined by the creation of an unproven new vehicle for registering, warehousing and supervising employee shares.

Centre chairman Malcolm Hurlston CBE said: "We are providing an effective channel for the views of trustee members. It is time the UK government took a more British Isles view."

The OTS' call for a new definition of readily convertible assets (combined with a retrospective test of whether a market for the securities exists or not) was kicked into touch by HMRC on the ground that, if enacted, this would be open to abuse and would create extra costs for taxpayers.

Exchequer Secretary David Gauke MP wrote in the foreword of the HMRC response: "As a first step the Government is consulting on five of the OTS's proposals, either as recommended or in slightly modified form. This will enable us to obtain further evidence on potential impacts from businesses and other interested parties before deciding how to proceed. We will announce the outcome of this consultation in autumn this year and, where appropriate, will publish draft legislation for Finance Bill 2014."

Meanwhile, the Government said it was seeking further views and evidence on five of the OTS' recommendations, namely:

1. An extension to the existing rollover provisions
2. Allowing corporation tax relief where a company is taken over by an unlisted company
3. Aligning the tax treatment of internationally mobile

From the Chairman

The travails at Co-op Bank provide a dire warning to co-op enthusiasts in government and opposition alike. It was easily forgotten that the vast majority of the 1000 co-ops in existence postwar went bust thanks to bad or corrupt management inadequately reined in. Many traded while insolvent paying dividends out of property sales. The co-operative structure is still a possible modern answer but too easily dominated by management. No doubt many of the current bright new initiatives will also end in tears. Lewis Lee and Sir Arthur Sugden, who created the bank out of the Co-op's Loan and Deposit department and kept the lid on policy wonks would not be happy.

Malcolm Hurlston CBE

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employees with that for general earnings and making consequential corporation tax changes

4. Replacing 'quarter up' valuation for listed company shares with a closing price valuation
5. A modification of the alternative OTS recommendation in relation to section 222 of the Income Tax (Earnings and Pensions) Act 2003. This would change the current 90-day deadline for an employee to make good the relevant tax amount to July 6 following the end of the tax year, but would not alter the class of NICs currently applied. "The Government believes this modification will better control the Exchequer cost of any change," said the minister.

*The exchange and rollover provisions (1) can prevent an income tax charge arising in certain circumstances where share options held by an employee are exchanged for new share options, to restricted and nil or partly paid shares. However, these provisions do not apply where the shares are restricted by certain conditions attached to them, or to shares issued for free or for an initial payment of less than their value. The potential change would establish consistency in tax treatment of all employee equity awards in these situations, HMRC was told.

*Corporation Tax relief (2) is available for employee share acquisitions, subject to conditions. In its report, the OTS said that in certain circumstances, where the business had been taken over by an unlisted company, relief that might otherwise have been available to the company may not be. The proposals would permit relief for all employee share acquisitions for 90 days following the takeover, providing that the other relevant conditions had been met.

HMRC's responses to these two recommendations were broadly supportive, but it seeks evidence from businesses and their advisers of the impact that such changes would have.

*On internationally mobile employees (3), the OTS had recommended that their tax treatment should be aligned with the general earnings charge and that Corporation Tax deduction should be extended to employees seconded to work for UK companies. The big problem here is that some UK employees of multinationals might escape taxation on their equity awards, whereas

UK tax might be charged on similar awards for work carried out abroad (e.g. secondments) by the same employees. In addition, the tax rules concerning employee equity awards earned by internationally mobile employees were not the same as those used for other sources of their income. OTS called for a "certain and consistent treatment of each type of award made to inbound and outbound employees, but this is not currently the case for restricted stock units."

OTS wants all share plans to be treated consistently from a residence perspective. Its preference is/was to change the residency rules regarding employee equity awards so that they would be applied on an earnings basis.

OTS said that this approach would be more consistent with that adopted by the Organisation for Economic Co-operation and Development (OECD) concerning the treatment of employee stock options, under which the 'employment benefit' arising is treated as earned during the period from the date the relevant option is granted up to the point at which the employee has an irrevocable right to exercise the option. The OTS suggested that this would simplify the position for international companies seeking to operate the same arrangements in all locations.

In reply, HMRC said: "In broad terms, we believe that implementation of this recommendation would involve the establishment of earnings periods for each category of employment related securities (ERS) covered by Part 7 of ITEPA. An illustration of the type of approach that might be applied for ERS can be found at section 41B of ITEPA (concerning the remittance basis of taxation). A simple calculation could be used to establish what proportion of the Part 7 income should be treated as earned in the UK. As with section 41B of ITEPA, a 'just and reasonable' rule could be applied to override the basic rules, where these would give an inappropriate outcome in relation to non-standard awards. Associated rules similar to those in sections 15, 22, 26 and 27 of ITEPA could then be applied to the relevant income."

Furthermore, the OTS had pointed out that in some cases it could be difficult for companies to determine whether NICs were due under the current rules, as this may depend upon the specifics of the award made to the internationally mobile employee and the particular circumstances of that person (including which country they have moved to from the UK and at what point a tax point arises). HMRC itself, after working with various 'stakeholders,' had accepted the desirability of moving to apportionment of NICs to align as closely as possible with the tax rules, or the OECD model recognising when the shares were earned between grant and vesting, OTS had claimed.

On the internationally mobile employee recommendations, HMRC concluded: "We recognise that the approach recommended by the OTS has significant simplification potential. In order to inform its consideration of these recommendations, the Government would welcome views and evidence on the impact of these proposed changes for businesses and individuals, in terms of one-off or ongoing tax or administrative costs or savings and how the proposed change would affect the number of internationally mobile employees subject to UK income tax on employee equity awards?

*On valuation (4), HMRC said that the OTS had made proposals concerning possible changes to HMRC valuation of employee share and share option awards. “As well as consulting on the OTS recommendation on the ‘quarter up’ valuation method, HMRC will explore the points made by the OTS about its guidance as part of ongoing work to improve this guidance,” said the government’s response. However, the OTS suggestion that the last trading day’s share price should be used as the base could produce a higher share price for tax purposes than the current system, HMRC warned. It added: “The recommendation that pre-transaction share valuations from HMRC should be available in additional circumstances will be considered once we can better assess the impact on HMRC’s valuation resources of the Government’s introduction of the new employee shareholder status.”

The OTS had recommended that ‘non-recognised stock exchange’ valuations should be automatically accepted for tax purposes, but this was rejected. “Such valuations are nearly always acceptable for tax purposes, but the Government believes that it is beneficial for both businesses and HMRC to have flexibility to be able to adopt a different valuation approach where appropriate. The Government will **not** therefore proceed with this recommendation,” said HMRC.

*On Section 222 of ITEPA, the OTS had explained that: “Where PAYE is due on notional (non-cash) payments such as ERS (employee equity awards), employers are usually unable to deduct the relevant amount in the same way as they would for cash payments, such as salary. In such cases, the employer must seek to deduct the full amount of tax due in respect of the notional payment from other PAYE income paid to the employee. Where this is not possible, the employer must pay to HMRC the balance of the PAYE amount due on the notional payment. This balance is treated as earnings of the employee from the employment, and is subject to an income tax charge under section 222 of ITEPA, but only if the employee does not make good the relevant amount to the employer within 90 days. This is an anti-abuse provision, designed to put the employee in the same position as if they had received a cash payment equivalent to the balance of the PAYE amount paid by their employer.”

HMRC replied: “The OTS’s main recommendation in this area is that section 222 of ITEPA should not apply to employee equity awards, and that amounts not made good by the employee should be treated as an employment-related loan where appropriate. The Government has carefully considered this recommendation. While it acknowledges the points made by the OTS, it does not propose to consult on this proposal at this time, given the potential for adding complexity to the current rules on employment-related loans.”

However, HMRC basically accepted a secondary OTS recommendation on this point - which would change the deadline - for an employee to make good any outstanding amounts before a Section 222 ITEPA charge was applied - to July 6 following the end of the relevant tax year.

Nevertheless, HMRC wants the industry to consult with it about the impact of the latter proposal in terms of one-off or ongoing tax or administrative costs/savings.

Industry sources suggested that in light of the technical complexities there was scope for industry and advisers alike to push for some practical simplification. While the use of equity plans in the UK by international companies was widespread, there were some who found them too difficult to implement. Companies should take this opportunity to make their voices heard on this issue. Responses to the HMRC consultation exercise on unapproved employee share schemes should be sent by August 16 to:

Savings & Share Schemes Team, Room G53, 100 Parliament Street, SW1A 2BQ or by email to: shareschemes@hmrc.gsi.gov.uk The lead HMRC official is Colin Strudwick.

Royal Mail: decision on IPO nears

The £2bn plus proposed privatisation of Royal Mail will take another step forward when it hands over responsibility to Centre member **Equiniti** for creating one of Britain’s biggest-ever employee share ownership schemes.

For Equiniti, one of the UK’s largest administrators of employee share schemes and provider of corporate back office services, has won the contract to create the scheme, which will involve offering free or discounted shares to about 130,000 postal employees.

The appointment comes weeks after Michael Fallon, the Business Minister overseeing the sell-off plans, launched the process that is likely to result in a stock market listing for Royal Mail.

Equiniti’s role will involve acting as registrar and administrator of the share scheme, though ministers appear to be still undecided about the precise form that it will take.

The Government has pledged that at least ten percent of Royal Mail’s shares will be handed to staff, potentially involving a windfall of between £1000 and £1500 for every employee of the state-owned postal services company. *Sky News* revealed that Whitehall officials were debating whether employees of Royal Mail subsidiaries in France and Germany would be included in the employee share scheme. Postal workers may be required to hold onto their shares for some time in the event of a stock market listing. A period in which selling would be restricted – in order to prevent ‘stagging’- would, ministers hope, prevent disorderly trading in Royal Mail’s shares.

Awards dinner
The Centre's ever-popular annual black-tie Awards Dinner will take place on **Wednesday November 13** at the Oriental Club in London's West End. A champagne reception will be followed by the dinner, during which the winners of the three award categories will be announced and their framed certificates presented by the guest of honour.

Trades union bank launches Esop
ESOP Centre member, **Unity Trust Bank***, is launching an employee share ownership plan, which it says will ensure that employees share in the bank's success now and in the future.
Unity Trust has provided a £50,000 gift to the trust to set up the scheme and acquire shares from the current shareholders, who include trade unions and the Co-operative Bank.
All staff members who have worked at Unity Trust Bank for at least one year will receive an initial gift of 100 shares, but those with ten years' service or more will receive a further 100 shares.
A total of 11,000 shares worth c.£2.80 each have been gifted to staff at a total value of £30,800. The remaining shares will be holding stock and will be used if staff elect to take shares rather than cash as part of profit sharing.
An employee benefit trust will be set up to acquire and distribute shares to staff. Trustees of the EBT will include staff representatives and an independent trustee.
Andrew Jesson, head of structured lending at Unity Trust Bank, said: "I have worked at Unity Trust Bank for 25 years and saw the Bank introduce the first Esop into the UK in 1989. Employee share ownership is a force for good, allowing employees to participate actively in the organisations for whom they work. This is the essence of what we do as a socially responsible business, helping to build sustainable organisations that in turn grow local economies and deliver social change. We are certain that increased employee participation will help boost productivity at Unity, providing real benefits to our customers and greater satisfaction for our staff. Giving staff a chance to have a stake in the bank and to be rewarded for success and growth is a really positive development. Employee participation in the scheme is very strong and I'm sure all stakeholders will reap the rewards of such a committed workforce."
**Unity Trust Ltd opened its doors for trading on May Day 1984 - an appropriate launch date for Britain's first trade union bank. The Co-operative Bank agreed to match the trades unions' investment and supply management expertise for the initial launch period.On January 2 1986, Unity Trust's status changed from private company to public limited company. Following a rights issue in 1986, which enabled more trades unions to become founder members, fourteen more unions joined, plus three federations, including the TUC. Fifty-eight trades unions, representing 80 percent of all trade union members, were now shareholders. Unity Trust plc acquired full status as a bank in 1987 under the terms of the Banking Act of that year. Unity was devised in 1982 by Centre chairman Malcolm Hurlston CBE and following his visit to the US with ceo Lord Thomas of Macclesfield brought the esop to Europe. Welcoming the move, Mr Hurlston said: I am the Bank's largest personal shareholder and I welcome being joined by the staff (but not to the extent of losing my top spot.)*

Self-certification: what's required
Legislation implementing changes, notably self-certification, to tax approved employee share schemes, is progressing through Parliament, reported Centre member **Linklaters**. Details about how self-certification will replace the current cumbersome pre-approval process for broad-based Eso plans were published by HMRC.
Self-certification will apply from April next year. This is being introduced as part of a move to a complete online system for registration of plans and submission of annual returns. HMRC said that it was still working on some of the finer details - such as what issuers and advisers need to certify regarding new plans - with stakeholders. However, it has provided an outline of the system.
From April 2014, employers must register all new and existing share plans – tax approved and unapproved. They will need to provide details such as corporation tax reference, company registration number and plan type.
Registration will be through the existing PAYE online service. Once registered, the employer will be given a unique scheme reference number, which will be displayed on the share scheme screen for future filing purposes.
Companies will need to certify that SIP/SAYE/CSOP plans meet the tax-approval requirements. For *existing* plans this will mean simply stating that the plans have previously been approved by HMRC. There are no details yet on what conditions will need to be met for self-certification of *new* plans. Self-certification must take place by July 6 after the end of the tax year in which first grants are made under a new plan.
Where a company changes some features of tax-approved plans, these will not require pre-approval by HMRC. Instead, companies must report the changes in the relevant annual returns and confirm that certain conditions are met when changes are made to key features.
'Intelligent forms' will be downloadable so employers

can complete them during the tax year in real time, though they only need to be submitted after the end of the tax year. The first returns to be submitted online will be for the year ending April 5 2015, so first filing will be due by July 6 2015.

More details of the new system are still needed, said Linklaters, such as: what conditions will be necessary for self-certification? What will be HMRC's review process for certified new plans? What happens if HMRC decides that the conditions have not met but grants have already been made under the plan? In addition, more information is needed on the online interactive system, which HMRC is proposing to introduce. However, these major changes to the way plans are to be monitored by HMRC and administered are to be welcomed, said Linklaters. They should result in less red tape and simpler procedures and hopefully create cost savings for companies operating share incentive plans. For queries please contact Gillian Chapman or Graham Rowlands-Hempel at Linklaters.

Share plan returns reminder

Where UK resident or ordinarily resident employees or directors have been granted options or share awards, then corresponding UK annual share plan returns for the 2012/2013 tax year must be filed with HMRC **before July 7** this year. Significant penalties can apply if the returns are not filed in time, warned Centre member **Bird & Bird** employee incentives and benefits team. HMRC requires companies to report the grant and exercise of unapproved securities options and the acquisition and disposal of other employment related securities and other reportable events on Form 42. Each Revenue approved plan has a specific return form. *Enterprise Management Incentive Options (Form 40)* There is no requirement to report the grant of EMI options on Form 40 but even if only grants have taken place a form needs to be returned showing no activity for the year. *Company Share Option Plans (Form 35), Save as You Earn Plans (Form 34) and Share Incentive Plan (Form 39).* It is important that companies start collecting the information required now in order to complete the relevant returns so that they are filed with HMRC in a timely and accurate way, added Bird & Bird.

On the move

Uncertainty hangs over the future of service provider **Accurate Equity UK,** only nine months after it announced the opening of London offices at 35 New Broad Street and the appointment of new UK staff. As this issue went to press, Centre member Accurate Equity UK stood on the brink of liquidation after the proposed injection of private investor finance, to safeguard its push for business in the UK, was postponed. Davos speaker **Arne Peder Blix** is no longer ceo of Accurate Equity AS, in which he remains one of the largest shareholders, but he remains a board member and has been retained as strategic advisor to the company. Arne has been replaced as ceo by **Finn Dahl**, previously the company's chief operating officer.

The UK staff, who have been warned that their office may close, could soon become creditors if the London operation is wound up. UK md **Stuart Bailey;** director of UK business development **Mike Baker**; senior manager of global marketing **Sophie Altaf** and director of client implementation **David Lee** are all working from home. They have been told that they have performed very well indeed in acquiring new clients and building up a pipeline of potential new business since their recent appointments. The Scandinavian HQ and all other parts of Accurate Equity continue to trade normally.

Bedell Cristin has been named '*International Law Firm of the Year'* in the Citywealth Magic Circle Awards 2013. Anthony Dessain, senior partner at Bedell Cristin, was presented with the Award by broadcaster Andrew Neil at a black tie event in London on May 16, attended by almost 400 leading lawyers, wealth managers and private client advisers.

Bedell Trust announced the appointment of **William McGilivray** as a director in its London office.

EU flexes its muscles on executive pay

Golden parachute payments to departing senior executives may face greater scrutiny from shareholders as part of EU proposal to stem 'excessive' awards, reported *Bloomberg.* Michel Barnier, the EU's financial services chief, said he wants to give shareholders more power to veto compensation packages to exiting executives, by means of a draft law later this year. "Lucrative severance packages for executives who have under-performed are the subject of increasing criticism. Shareholders now care about the relationship between executive compensation and the performance of the company," he said.

The European Commission's push for more shareholder power over pay adds to binding curbs on banker bonuses that were agreed on by the EU this year. Barnier said that his plans were inspired in part by a referendum in Switzerland about limiting bonuses.

"First of all, we need more transparency on remuneration, and secondly, shareholders should be given a binding 'say on pay.' Our revision of the *Shareholder Rights Directive* will address these issues. I intend to present the legislative proposal after the summer," Barnier said, adding that the proposals would apply only to *listed* companies. Payments to

top managers in the EU are under increased scrutiny amid the bloc’s recession and austerity measures from Ireland and Spain to Cyprus.
A wave of compensation measures and reward restrictions is now under way. These range from a cap on financial institution bonuses in the EU, binding say-on-pay votes in several European jurisdictions and even criminal sanctions for violating compensation restrictions and corporate governance requirements in Switzerland, said *Simon Witty, partner at Davis Polk & Wardwell (DPW).*
Under CRD IV, which is scheduled to be implemented for credit institutions (including banks) and investment firms (such as broker-dealer or wealth management firms) next January, the basic rule is that bonus payments will be capped at 100 percent of total fixed pay or, with shareholder approval, 200 percent of total fixed pay. Shareholder approval means approval by either 66 percent of shareholders owning at least half the shares issued or, failing that, 75 percent of all shares. The effective bonus cap can go up by up to 25 percent, if the pay is in the form of long-term (at least five years) deferred instruments
There is a lot more to the banker bonus cap than just the cap. There are rules on how much of the bonus must comprise equity compensation or certain capital instruments, how much must be deferred and for how long, claw backs, mandatory deferrals or holdbacks for discretionary pension benefits and the collection of information on individuals who are paid €1m or more in any given fiscal year. The cap will apply to all credit institutions and investment firms in the EU. If a financial institution’s HQ is in London, all of its relevant employees (including those located in New York or Hong Kong) will be affected, and even if a financial institution’s HQ is in New York or Hong Kong, its relevant employees working for an EU subsidiary will be affected. The cap will affect only those employees whose professional activities have an impact on the risk profile of the relevant financial institution. Examples include senior management; risk-takers; employees engaged in control functions; and employees whose total pay takes them into the same bracket as senior risk management and risk-takers.
The EU has announced a proposed mandatory EU-wide *say-on-pay* initiative. The UK has been asked to implement a binding say-on-pay vote by October 2013, plus other related requirements. Switzerland has a *Minder Initiative*, which introduces a binding say-on-pay vote, together with other executive compensation measures, which will come into force by March 2014. Germany and Spain too have announced say-on-pay initiatives, which are expected to be binding. In contrast to the CRD IV compensation restrictions, which will apply to non-EU financial institutions (at least partially), there is no reason to think that the say-on-pay initiatives will apply to, for example, US or Hong Kong companies for the time being.
In the UK a binding shareholder vote will be held at least every three years on a company’s remuneration *policy report*, which is *prospective* in that it will set out the company’s future policy regarding the compensation (including loss of office payments) of all directors. A company will continue to have an advisory shareholder vote each year on its remuneration *implementation report*, which is *retrospective* in that it will set out how the company’s compensation policy was implemented during the past fiscal year.
A pension group recommended that members vote against **AstraZeneca**’s remuneration policy at the company’s agm to protest against a golden hello payment and planned incentives for ceo Pascal Soriot. **Novartis** met similar pressure earlier this year over plans to award outgoing chairman Daniel Vasella $77m as part of a non-competition agreement. When his golden parachute arrangements were leaked to the media, there was an outcry in Switzerland, prompting him to abandon the deal.

RIP Eircom Esop

The Eircom Esop has been wound up after 14 years of distributing tax-free returns to 14,000 current and past employees of the ex state-owned Irish telecoms company. The final dividend of almost €13m was distributed last April and those with the full allocation of shares got €1300 each. It was the 17th pay out since May 2002, bringing the total distribution by trustees to €940m – representing an average pay out of € *67,142* per participant. The Eircom Esop has been like an ATM for participants since it was created in parallel with the privatisation of Eircom in 1999, said *The Irish Times.* Some of the employees’ 15 percent original stake in the company was paid for, but some not. The trustees obtained a deal from the Irish Revenue Commissioners which allowed tax-free staggered pay-outs to members. The Esop rolled over its interest every time the company changed hands and finally owned one third of the company when it was put into examinership last year, enabling its lenders to take control.

CONFERENCES

Barcelona: June 6 & 7

It’s your very last chance to register for the Centre’s 25th annual conference, which takes place in **Le Meridien Hotel, Barcelona** on **Thursday June 6 and Friday June 7.** You have the option of registering as a day delegate, with lunches and cocktail party invitation included, or buying the Centre’s attractive accommodation and conference package deal offer. New delegates are being accommodated by the Centre in the **Montecarlo** and **Bagues** hotels, both on La Rambla and within easy

walking distance of Le Meridien. Centre chairman Malcolm Hurlston CBE will announce the names of the **Centre 2013 Awards** finalists in the three categories during the conference party. To see the full programme, admission prices and registration form, visit the Centre website at:
www.esopcentre.com/event/barcelona-2013
Late registrants should contact Juliet Wigzell at the Centre immediately at jwigzell@esopcentre.com to arrange advance payment. More than 40 people are registered for this event, which boasts 17 speaker presentations. Plan issuer companies have registered in respectable numbers. A big 'Thank you' from the Centre to all our Barcelona conference co-sponsors this year – all Centre members, namely: Channel Islands based trustees **Appleby Global & Bedell Group** (conference brochure); **Computershare** (delegate handbook) and **GlobalSharePlans** and **Solium** (pre-conference jazz session).

National Employee Ownership Day: Thursday July 4

The Centre is playing an active role in the UK's first National Employee Ownership Day. The main London celebratory event will be hosted by Centre member **Linklaters** and attended by at least two government Ministers. For more info, please contact UK director David Poole.

Guernsey: Friday, October 11

The Centre is accepting proposals from speakers for its next joint share schemes conference, to be held in association with the Guernsey branch of the Society of Trust & Estate Practitioners, at the St Pierre Park Hotel, on Friday October 11. This half-day event, which often attracts delegate audiences of more than 50 EBT practitioners, will focus on the latest developments in employee share plans of relevance to trustees. Attendance prices are £295 for Centre members and £425 for non-members. Members interested in speaking should send your proposed title, along with two or three bullet points outlining the content of your presentation to dpoole@esopcentre.com and he will contact you to discuss in more detail.

Loan Funded Share Plans in Australia

In an interesting variation on employee stock purchase plans - loan funded share plans (LFSPs) in Australia allow an employer to make an interest-free loan to employees to buy shares. The shares are held in trust by the employer until the loan is repaid. The right to take possession of the shares is subject to vesting. Any dividends paid on the shares are used to repay the loan. The structure of a LFSP is relatively simple. The employer makes an interest-free limited recourse loan to enable the employee to acquire shares in the employer for market value. The employee is protected from downside risk if the value of the shares falls below the outstanding loan balance. We thank the California based National Center for Employee Ownership for the above information

Protection reduced for trustees' redress

A Supreme Court ruling on the circumstances in which courts can set aside erroneous decisions made by trustees is "likely to create uncertainty" due to the subjective nature of the test, an expert has said. Tax expert Chris Thomas of Centre member law firm **Pinsent Masons** was commenting as the UK's highest court ruled that it could overturn mistakes of '***sufficient gravity***' in cases where trustees held an incorrect belief or made an incorrect assumption about the tax implications of their decision. Courts could do so in these circumstances even where the trustees were following professional advice, the Supreme Court said.
In a related case, the Supreme Court said that trustees could not generally rely on the *Hastings-Bass* principle to have a decision set aside where that decision had been based on professional advice - even if that advice later turned out to have been wrong. The Hastings-Bass principle allows a court to set aside decisions taken by trustees who have not properly considered all the relevant matters which they should have taken into account, putting them in breach of their fiduciary duties.
Mr Thomas said that the court's decision on the general application of the Hastings-Bass principle was not a surprise given the earlier conclusions of the Court of Appeal, which had refused both applications. In cases where trustees had taken a decision based on incorrect professional advice, the correct remedy would be a negligence claim against those advisers.
"Many advisers had always viewed the Hastings-Bass principle as something of an anomaly and felt that it was difficult to justify why trustees should effectively have a 'get out of jail free' card which is denied to other taxpayers in similar circumstances," he added.
"What is more surprising is the wide interpretation of the 'mistake' doctrine. The test of 'sufficient gravity' applied by the court, and the reference to whether it is 'unconscionable or unjust' to leave a mistake uncorrected looks like a case of the court deciding what it thinks seems fair and then working backwards to achieve that." He said that although the verdict could seem equitable and would likely be welcomed by trustees, it was "very subjective" and "likely to create a lot of uncertainty as to when relief might actually apply".
The Hastings-Bass rule, named after a 1974 case, is based on the idea that trustees are constrained in their decisions by their duties to the people they are holding funds, pensions or other assets on behalf of. This principle overlaps slightly with the general rule

that a voluntary disposition, such as a gift or settlement, can be set aside on the ground of mistake. In his leading judgment, Lord Walker said that since about the year 2000, the principle had increasingly been relied upon to set aside the decisions of trustees in cases where tax planning arrangements involving trusts had gone wrong.

The Supreme Court's decision covered two cases: one, Futter, was concerned with incorrect advice given by solicitors on the effect of capital gains rules where the gains were realised by non-resident trustees while the other, Pitt, involved the inheritance tax treatment of a damages settlement received by a man who had suffered serious head injuries in a road traffic accent and who later died.

In his ruling, Lord Walker said that there should be a high degree of flexibility in how courts treated Hastings-Bass claims, particularly given the many different uses for trusts. Laying down a rigid rule would "inhibit the court in seeking the best practical solution in the application of the Hastings-Bass rule in a variety of different factual situations", he said. However, in neither case had trustees "personally failed in the exercise of [their] fiduciary duties" by following incorrect advice, he said. The test for whether a decision could be set aside on the grounds of mistake was more ambiguous, he said; although the requirements were particularly strict. The only true requirement was that there was a "causative mistake of sufficient gravity. "The test will normally be satisfied only when there is a mistake either as to the legal character or nature of a transaction, or as to some matter of fact or law which is basic to the transaction. Forgetfulness, inadvertence or ignorance is not, as such, a mistake, but it can lead to a false belief or assumption which the law will recognise as a mistake," he added.

Herbert Smith Freehills said that the key points to take away from the judgment were:

- Trustees may not be able to rely on the *Hastings Bass* principle where they have acted within their powers and have taken professional advice, even if that advice later turns out to be incorrect.
- Where trustees have acted based upon incorrect professional advice they (and/or the beneficiaries) may be limited to bringing a negligence claim against their professional advisors.
- Where the *Hastings Bass* route is not available trustees should consider avoiding the erroneous transaction by relying on (unilateral) mistake.
- Trustees who rely on their own breach of fiduciary duty to avoid a transaction will not necessarily be able to recover their costs from the trust funds.

The Supreme Court's decision will have implications for private, commercial and charitable trusts. Pension trusts may be affected too.

Bank share dilution to fund Esos

ING announced that it would start issuing depositary receipts for new ING Group NV ords, in order to fund obligations arising from share-based employee incentive programmes. Less than 11m shares (0.3 percent of the 3,831m shares currently outstanding) are likely to be issued for this purpose this year. Previously, ING funded the programmes from a hedge portfolio, which was rebalanced periodically. In December 2010 ING announced that it would cease to rebalance the portfolio in order to simplify the management and administration of the programmes. Since then, all the shares in the delta hedge portfolio have been used to fund the obligations arising from its employee equity programmes. While ING cannot buy shares in the market until all core Tier 1 securities have been repaid to the Dutch state, ING will fund these obligations by issuing new shares.

Brass plates polished

The Cayman Islands will join the automatic information exchange of tax information pilot agreement, announced by the G5 group of leading European economies. Cayman's Minister for Financial Services held discussions with the Treasury and HMRC, centring on implementation of the G5 pilot and the Foreign Account Tax Compliance Act (FATCA), the US law which forms the basis of the automatic information exchange. The country has also pledged to review its financial services legal and regulatory framework, including its money laundering and financial crime laws. Finance ministers for the G5 indicated that it would provide a template for a wider multilateral agreement. The pilot is based on their model agreement to implement FATCA with the US, which was published in July 2012. The UK, France, Germany, Italy and Spain are participating in the scheme – *see previous issue*.

Juliana O'Connor-Connolly, Premier of Cayman, said that the agreement would continue the country's 'global commitment' to the exchange of information for tax purposes. Cayman has exchanged taxpayer information with EU member states under the EU Savings Directive since 2005. She said: "We would call on other jurisdictions to commit to this initiative, which will take us to a new level of tax transparency and remove hiding places for those who would seek to evade tax and dodge their responsibilities."

FATCA introduces reporting requirements for foreign financial institutions (FFIs) with respect to accounts held by US residents, irrespective of national privacy laws. Institutions which do not collect and report this information can be subject to a 30 percent withholding tax on US source income and proceeds from the sale of US securities.

British Virgin Islands (BVI) was expected to agree to similar disclosure obligations, with other jurisdictions expected to follow. Criminal investigation, or significant civil penalties of up to 200 percent of unreported tax liabilities, will continue to be a risk for taxpayers who hope to evade surveillance by HMRC.

Good & bad news on pay

More than half of employers (53 percent) expect their pay budgets will have increased by the end of the year and many would like to see variable pay (eg bonuses linked to individual or company performance) play a greater role in reward packages. This was the major finding from a survey of senior reward and benefits professionals, launched at the annual Chartered Institute for Professional Development (CIPD) reward conference. The CIPD's *Reward Management Survey 2013,* reported that the top two drivers for increased pay budgets were pay rises (84 percent) and rise in staff numbers (51 percent), suggesting that respondents are confident about increasing wages and taking on more staff this year. At present, 26 percent of organisations report that variable pay represents between 20 and 30 percent of total reward, whereas in an ideal world, 38 percent would like such a split. Among private sector service firms 45 percent would like to see this ratio in future (compared to just 30 percent at present). Total spend on benefits budgets looks likely to rise in 2013, with 34 percent of private sector employers forecasting an increase but only 15 percent in the public sector. Instead, public sector employers (29 percent) are more likely to report a reduction in spend on benefits.

*Pay awards concluded in April this year were lower than those in the first three months of the year, according to the latest provisional data from pay specialists XpertHR. In the three months to the end of April, the median (mid-point in the range) basic pay award was worth two percent, half a percentage point below the two and a half percent median recorded in the first three months of the year. The sample of 131 basic pay awards includes the first of this year's deals from within the public sector - where pay awards are subject to the Government's policy of restricting increases to an average of one percent. However, this was only part of the picture, with the median pay award in the private sector falling to two percent, from 2.5 percent in the previous three-month period. Pay awards in manufacturing companies (at a median 2.1 percent) remained slightly above those in the service sector (at 1.9 percent). Within the private sector, there were clear winners and losers in the pay stakes. Overall, one pay award in ten resulted in a pay freeze, but more than half of these have been recorded in organisations in the not-for-profit sector. In contrast, the pay awards worth three percent or more were concentrated in the electricity, gas and water, and engineering and metals sectors.

Bonus Corner

Almost one third of FTSE100 companies have not increased the basic salaries of their directors this year, a survey by FIT Remuneration Consultants revealed. Those directors who have been given a pay rise received an average 2.5 percent, in line with inflation, the survey said. Senior executives' bonuses are lower than last year, falling to 69 percent of their maximum possible award on average, down from 77 percent a year ago. Long-term incentive awards have remained largely unchanged from a year ago. "Our survey shows that remuneration committees are taking notice of the ever-increasing focus on executive pay, as manifested in last year's Shareholder Spring," said Rob Burdett, partner at FIT.

Supermarket group **Morrisons** refused to award its top executives any bonuses after they failed to meet its under-lying pre-tax profit growth target, the annual report revealed. **Aviva, Lloyds Bank** and **Tesco** (*see story below)* have either reduced or scrapped bonus payouts this year after reviewing last year's performance.

However, sports marketing and advertising group **Chime** pushed through bonuses and a controversial 'no limit' performance share scheme for top executives, despite more than 50 percent of shareholders failing to vote them through at its agm. Chime, which owns businesses including Lord Coe's management consultancy and Comparethemarket.com ad agency VCCP, counts Sir Martin Sorrell's WPP as its largest shareholder with a 21 percent stake. The company broke its own corporate rules to award its ceo Chris Satterthwaite and fd Mark Smith bumper remuneration of almost £2m for 2012 at its agm. Chime's policy is to cap bonuses at 50 percent of base salary, but the pair were awarded bonuses at 75 percent after what was deemed an 'extraordinary' year. Yet the company had agreed with shareholders beforehand that there would be no bonus awards under Chime's deferred share policy while it ran another scheme, a co-investment plan. Satterthwaite received total remuneration of £1m, including a £393,570 bonus - a 63 percent year-on-year increase partially skewed by no bonus payout in 2011. Half the bonus was awarded in deferred shares, despite Satterthwaite still being a member of the co-investment plan. Satterthwaite and the fd will not have a review of their base salaries until January 2016. Another agm resolution, to approve the establishment and rules of a controversial new performance share plan for directors, saw a majority of investors fail to support it. There were 34.4m votes in favour and 35.3m either witheld or against the resolution. Amost 18m votes were cast against the resolution. While directors are expected to achieve share awards worth 200 percent of salary – which is the case with the first award of shares worth just over £1m to Satterthwaite at 204 percent of his base salary – there has been no maximum award ceiling put on the scheme. This theoretically means that in 'exceptional' circumstances Chime's remuneration committee could award whatever level of performance share award to directors it likes. In addition Manifest, which provides research into proxy voting issues, believes that overall the new scheme is too generous, calculating that the expected remuneration will effectively give Satterthwaite a 54.6 percent boost in his overall package.

The **Co-op Group's** new ceo Euan Sutherland is looking at the possibility of reclaiming performance bonuses awarded to former executives in the banking division, which faces a large capital shortfall. Ex ceo Peter Marks received a £103,000 long-term performance bonus in 2012 and a £490,000 annual bonus for 2011. Barry Tootell, who quit as the Co-opBank's ceo last month, made £595,000 last year and £263,000 in various bonuses in 2011 when he took over from Neville Richardson, former ceo of Britannia Building Society. Sutherland would like to clawback some of the bonuses awarded to other executives too who have left the Co-op Group recently. Ex HSBC director Niall Booker will be the bank's new ceo.

Almost a quarter of online grocery retailer **Ocado**'s shareholders failed to back the company's remuneration plans at the company's agm. One institutional investor said it was unhappy about ceo Tim Steiner's 29 percent pay rise to £450,000, while others criticised the £400,000 shares award to Sir Stuart Rose, as part of a share-matching plan, when he became Ocado's new chairman in January. The **Association of British Insurers (ABI)** issued a 'red top' alert over Ocado's incentive plans, including its Long-Term Incentive Plans, which the ABI said were "opaque."

Moya Greene, ceo of **Royal Mail** is in sight of an annual bonus worth almost £500,000, months before the company presses the button on the UK's biggest privatisation for a generation. Ms Green, who took over as boss of the state-owned postal operator in 2010, is expected to receive the payout after nearly trebling Royal Mail 's operating profit to £403m last year. Royal Mail's remuneration committee has yet to formally agree the pay proposals for the 2012-13 financial year. It is expected that the imminent annual report will show that Ms Greene's base salary had been frozen at £498,000 for the third consecutive year, reflecting the company's present state ownership. Under the terms of her contract, she is eligible for an annual bonus equivalent to a year's salary. Ms Greene and her executive colleagues are incentivised according to strict operational and financial targets. A dozen key metrics include Royal Mail's group operating profit as well as customer satisfaction and employee safety. Last year, Ms Greene received a cash bonus of £371,000, or almost 75 percent of her base salary. She can expect a long-term bonus award vesting in three years' time that could be worth around £500,000, although she is unlikely to earn any additional payment for helping to steer the company through a stock market listing or sale *(see story on postmen's employee shares earlier in this issue).*

Around 40 Sony senior management gave up bonuses worth between 30 and 50 percent of their annual pay for the year ended March, because its key electronics unit remained mired in losses.

Tesco executives will not receive a bonus in the current financial year unless they can reverse a decline in profits, the company said in its annual report. It was a torrid year for the company, which announced a withdrawal from the US and wrote down the value of its global operations by £2.3 bn, recording its first profit fall in two decades. "The (2013-14) annual bonus will be less heavily weighted towards short-term profits but linked to a more balanced scorecard of financial, strategic and operational measures. However, bonuses will only be paid if profits have grown," Stuart Chambers, chairman of the remuneration committee said. Having reported an underlying pre-tax profit of £3.55 bn for the 2012-13 year, down 14.5 percent on 2011-12, Tesco said it expects to deliver mid single-digit trading profit growth. Tesco, which employs 416,000 full-time employees, has been losing market share to discounters and high-end operators. No bonuses were paid to executive directors in 2012-2013 because the firm's profit targets were not met. Instead, ceo Philip Clarke and cfo Laurie McIlwee received base salaries of £1.12m and £869,000 respectively. In 2012 Clarke turned down an annual bonus of £372,000, due to the retailer's poor performance, while executive directors received just 13.5 percent of the maximum potential bonus.

The Employee Share Ownership Centre Ltd is a members' organisation which lobbies, informs and researches on behalf of employee share ownership