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it's our business

newspad of the Employee Share Ownership Centre

Davos tells European Commission to get a grip

Centre chairman **Malcolm Hurlston** and **Jens Lowitzsch** author of PEPPER IV told the Centre's 11th global employee equity forum in Davos that the European Commission's handling of employee share ownership issues would benefit from radical change. Eso was being looked after by the "wrong part" of the Commission, where it was given low priority and buried among a rag-bag of social issues, elite delegates from seven countries heard. Thus it was small wonder that the Commission was being pushed around by the Council of Ministers in Brussels in the battle to reform the Prospectus Directive. The rightful place of Eso, or 'employee financial participation' in EU parlance, was instead much closer to the Commission's enterprise and industry directorates, agreed Mr Hurlston and Professor Lowitzsch.

In his opening remarks, Mr Hurlston called on the EU institutions, including the Commission, to use arm-twisting to induce the southern European countries to introduce and stimulate broad-based Eso on a much large scale than was the case at present. In an age of salary sacrifice, employee share ownership plans were a beacon of hope. Sadly, European trade unions for the most part had failed the workforce in the aftermath of the credit crunch. As a result employees throughout Europe had shared the pain, but their unions had not troubled to gain for them an equity upside. Only pilots' unions were showing real enthusiasm for employee equity, he said.

Though recession and the credit crisis in the western world were still evident, the outlook for the Eso industry was more upbeat, he said in his opening address at the Steigenberger Belvedere Hotel. Many multinational companies would come to regret their failure to launch new broad-based employee share plans last March when stock markets were probably at rock bottom.

The chairman praised both Credit Suisse, which had chosen this Centre event at which to make its first major conference presentation and new member Collins Stewart, the independent finance broker, for both having put together very impressive papers for the Davos forum.

The growing practice of awarding large deferred bonuses to top executives was highlighted during the delegates' open debate session. This, it was feared, could lead to a string of 'golden hellos' (or golden goodbye) in which – like M & S for its new CEO, remuneration committees felt obliged to buy out the deferred options or shares forsaken by an incoming executive director when leaving his/her previous job.

Diageo's new executive long-term incentive plan was discussed by **Sue Mellors**, director of financial services at the drinks multinational. The plan gave staff more choice in how to be rewarded: the mix of share options and restricted stock units was more flexible than in the previous executive incentive scheme, she said. The impetus had come from the US, where employee choice is a key feature of executive reward, she said. Though Sue's team had only five months in which to put the plan together and launch it, they had managed to discuss it with 30 of its institutional shareholders and got 97 percent approval at the Diageo agm last October. The LTIP, which applies in 65 jurisdictions, is paperless, web driven and has no performance targets. The majority of executives said they preferred having their LTIPs in restricted stock units, rather than options. They could access a Diageo devised modelling tool, which enabled them to work out what mix of options and restricted stock they wanted, based on varied assumptions about Diageo's future share price movements. Thanks to Diageo's generosity, delegates washed down Sue's presentation with Johnny Walker and flavoured Bailey's miniatures.

From the Chairman

Why does John Lewis continue to misrepresent itself as employee-owned? And be supported in it by thinktanks and the media (even the FT) when it is widely known to be owned by a trust established to perpetuate the fine ideas of its founder, John Spedan Lewis? While its employees are termed 'partners' they own no equity in the business and the annual bonus is distributed in cash, not equity. I had to remonstrate with the FT on the matter last month. It does a disservice to the real message behind the company's success: that long term is better than short term and that employees are most effective when they have a stake in company (stake not being limited to shareholding). The true message of John Lewis has far wider resonance than the smokescreen of worker ownership. Indeed it is a message UK needs as it hauls out itself of the abyss.

Malcolm Hurlston

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Philip Halliday, global head of executive compensation at Credit Suisse and **Marcelo Victoria** head of product delivery in Zurich, delivered an inspired presentation about innovative in-house compensation solutions introduced at Credit Suisse to deal with the economic and financial crisis in the western world. Their solutions had to strike a balance between motivating and retaining existing talent and shareholder and regulatory approval. They wanted to make the individual feel able to influence the incentive outcomes.

Philip explained that Credit Suisse had raised the basic pay of its MDs considerably, partly to avoid excessive risk-taking, but their bonuses would decrease. Throughout its executive ranks, between 40 and 60 percent of variable compensation would be deferred. This included an adjustable performance plan, containing a bonus/malus cash based reward. Members of the executive board received only deferred awards, which may be reduced in the future based on the company's performance.

The CS partner asset facility was a pathfinder because it linked awards to MDs and directors with the market value of so-called 'poisoned debt' packages, which had originated in the bank's investment banking division. Another innovation was the cash retention award for 4,000 executives, which forced early leavers to repay a proportion of what they had been paid

These new executive reward structures were being administered by the Zurich based Credit Suisse employee share ownership service, said Marcelo.

Kevin Lim of RBC corporate employee and executive services delivered a case study about a post IPO share plan installed in the Geneva-based Addax Petroleum company, which was sold last year to the China Petroleum Corp. Addax had grown its workforce from 80 to 330 before the takeover, said Kevin. It had wanted to promote share retention and organise its plan in a tax efficient manner, but most of the drillers and engineers weren't too concerned about having shares; cash was king for them, so basic communications about Eso were necessary at all levels, he said. There was vesting at grant and first and second anniversaries but curiously, very few employees sold their shares, helped to hold on to them by RBC private banking share custody services. By 2009, when Addax was sold, its share price had more than doubled, so dozens in middle management made small fortunes. The share plan had help maintain key employees in post, attracted and retained skilled new employees, maintained employee alignment with company goals and culture and it had rewarded employees for company growth.

Jean-Nicolas Caprasse, of RiskMetrics Group, which advises institutional shareholders on risk management and how to cast their votes at company meetings, spoke about growing regulatory pressures and shareholder scrutiny of executive reward in Europe. He said the Centre conference was an extension of the World Economic Forum because the reward aspect of the latter now belonged to the media and to regulators. The average European CEO had increased reward by 74 percent between 2003-7, an annual rise of around 15 percent, compared to just 2.5 percent for average employees. CEO bonuses had leapt from 70 percent of base salary in 2003 to 151 percent by 2007. RiskMetrics research showed that while stock options were still the favourite form of share-based remuneration for top European executives in 2007, share incentive plans were increasing sharply in popularity, threatening to overhaul the use of share options. Deferred share plans were only used by 24 percent of top companies at that time, he added. Approval of executive remuneration was a shareholder prerogative in some parts of Europe, such as the Nordic countries, Netherlands and Italy. The UK sat in the middle, along with Spain, Portugal and Switzerland with its advisory shareholder vote on remcom reports, while France brought up the rear because only stock-based plans needed shareholder approval. Shareholders were now feistier than ever over share plans and executive remuneration, hitting big companies with between 30 and 50 percent dissent at some agms, said Mr Caprasse. Typical shareholder concerns over LTIPs were dilution, the vesting period and the performance triggers. Others included failure to show good stewardship of the company's assets and inadequate disclosure of remuneration policy. RiskMetrics was broadly supportive of broad-based Esops, provided participation was voluntary, similar terms for all and the minimum holding period was three years. Most clients liked to have RisMetric's independent opinion and advice to hand, but the final decision was always theirs, he added.

Paul Stoddart of Computershare Plan Managers compared and contrasted the administration of the two main UK tax approved all-employee share plans – the options based SAYE Sharesave and the Share Incentive Plan. They had happily co-existed for ten years, he said, but most companies viewed them as an either/or choice. SAYE was safe, low cost and encouraged saving via employees' savings accounts, but the approved monthly savings limit of £250 had not been changed for almost 20 years and would have been £400 per month had the limit been adjusted for inflation. Many companies lately had been refusing to grant the usual 20 percent discount to the initial options strike price because share prices were generally lower owing to the recession, said Mr Stoddart. The SIP offered a better tax deal than SAYE, which suffered from tough accounting charges and in about 75 percent of SIPs employees actually bought their partnership shares. The SIP was more flexible because participants could change their monthly contribution levels and accumulations kept rolling up, which wasn't the case with SAYE, where cliff edge vesting occurred when the savings contract matured. Only one third of top FTSE companies offered employees the chance to participate in both schemes, but the percentage doing that should be far higher in the interests of both, he added.

Michael Smith, **Glenn Coxon** and **Justin Jouan** of Collins Stewart delivered a presentation on trading employee shares: on how to get the best possible deal for the employee and the corporate plan sponsor. Together, they demonstrated that share trading is far more complicated than some issuers, employees or even market practitioners might think. Mike, who heads the corporate executive and employee trading services team, said it was easy for employees to lose significant amounts of money on share sales if they were not engaging with a broker who adopts a hands on approach where warranted. Too often orders were just sent to the market without a trading strategy in place, a particularly problematic issue for lower volume stocks. Furthermore he said that corporates should distinguish between whether orders are being executed on a 'principal' or 'agency' basis as this might impact the net price being achieved for the participant. Concern was also raised over foreign currency transactions and timing. In an era when share and currency prices are highly volatile, it wasn't surprising that senior executives could lose large sums when share sale proceeds weren't converted until the following working day, or in some cases not until the equity sale had been settled, some three days later His colleague Glenn Coxon, who heads Collins Stewart's wealth management business in Geneva, said that security surrounding share custody and cash management should not be taken for granted. With the collapse of Lehman, some EBTs have had to acquire more shares to satisfy share awards until the administrator releases the frozen shares. In addition many people became entangled in the collapse of AIG, when their offshore bond investments turned out not to be as liquid as cash as first thought. Glenn identified some key considerations to help minimise these risks, which included the effective ring-fencing of assets, exposure to the investment banking activities of the custodian, as well as their credit rating. Glenn advocated using an intermediary for cash management services to maximise flexibility, increase diversification and also ensure the very best cash rates are being delivered by using the aggregate buying power of an intermediary. Stockbroker Justin, based on the Jersey trading desk, took delegates through a live screen trading position (SETS), which looked at two different scenarios concerning a liquid security (FTSE100) and that of a less liquid company (small cap). He explained how a strategy might unfold depending on the client's objectives and the market conditions. This demonstration highlighted the role that a broker should be playing to add value to the client ensuring that the very best prices are achieved and that share trading was not just about 'clicking a button'. Lastly, Justin compared the use of call options and Contracts for Difference (CFDs), which may be of particular use to those companies that have a known stock liability in the future to meet share awards, but do not wish to commit working capital immediately to meet this liability. In these situations options and CFD based strategies can be particularly attractive, he added.

Alan Judes, of Strategic Remuneration, discussed the use of variable targets, which take account of *future* market conditions, in executive Long-term Incentive Plans (LTIPS). Remuneration reports nowadays looked three years into the future, thus shareholders were voting on policy, just as much as on history, said Alan. The disclosure environment was such that remcoms had to give detailed performance targets three years out for their top executives. Institutional shareholder guidelines spoke of the need for "demanding and stretching" performance in the context of the company's prospects and the prevailing economic climate. RiskMetrics said that targets had to be responsive to change market conditions and realistic so that executives viewed them as reasonably achievable. Alan's case history concerned Old Mutual's proposed performance targets for an LTIP last year. Base salary was set at or below the market median, but the annual incentive was up to 150 percent of salary, two thirds in cash and one third in restricted shares. If the annual incentive was used to buy shares then the bonus matching award would be in the ratio of 2:1 of performance shares and options. "Executives have to play – there is no free-standing LTI," said Alan. The company had suffered a significant fall in earnings per share from 2007-8, so the concern was whether or not the new targets were sufficiently stretching, as they started from a lower base. Vesting was on a three tier basis, determined by EPS = retail price inflation + 3/4/5 per cent for high performance, RPI + 1.5/2.5/3.5 per cent for medium performance etc.

Malcolm Martin of Remuneration Consulting (Australia) described how Eso had been downgraded by the socialist government elected in 2007. There was no longer any government commitment to lift average Eso participation at work from five to 11 percent. Silly changes had been made to Eso legislation. Tax relief cutbacks, such as in 83A, had been announced in the name of reducing tax evasion and then ditched in the ensuing outcry, led by trade unions. The government was on the back foot too for having tried to maintain that if an employee exercises share options and pays the exercise price (from after tax savings), then the exercise price received was deemed to be income which is to be included in the assessable income received by the employer. Why? - Because the funds have come from the employee in the relationship of employer/employee. Malcolm said that this interpretation was wrong in law because the money received for the exercise price was in fact capital and in no way was it a trading receipt.

Grant Barbour of Bedell Group said it was clear that EBTs would be affected by what George Soros had described as the worst economic crisis since the great depression. Faltering banks had caused unprecedented headaches for trustees. When share prices fell, EBT trustees worried whether they would be asked at some later date why they had not sold stock in the employees' interest. Some private clients had moved from cash to gold bullion holdings. Bedell's litigation department had almost tripled its budget; the firm was turning work away. Whenever there was a large class of beneficiaries in an EBT, legal threats – from divorcees, former employees etc – were never far away and had multiplied since the onset of the economic recession. EBTs were under attack too by HMRC, which was looking carefully at all such structures, including private wealth, as it was under severe pressure to maximise revenue. Most EBTs were governed by UK law, but those based in Jersey now came clearly under Jersey law, said Grant. But the tax havens of old had now gone – both Jersey and Guernsey were on the OECD's 'white list' – countries that had substantially implemented the agreed exchange of financial info criteria. The CI jurisdictions were safe, financially stable, well-regulated and reputable places in which to do business, added Grant.

Maoiliosa O'Culachain of Global Shares used the example of the web portal driven Willis Insurance brokers option exchange programme to demonstrate the evolution of equity plan administration. Willis HQ used the portal to get in anytime and it took Global Shares only four weeks in which to build it. Registrars had been paper based and everything was done manually when the share scheme industry began life, said Maoiliosa. The only regulations they had to deal with in the early days were tax treatment and insider trading, whereas now regulatory reports were coming from all directions. Share plan savings carriers had started to build administrative systems for payroll links and savings accounts. Then software companies developed early versions of plan administration systems. Brokers began to take interest, setting up specialised dealing desks and trustees became involved with LTIPS. Institutional investors entered the scene because they were concerned about dilution and performance. Modern web-based admin systems were accessible worldwide. "We can access accounts on a read-only basis and we can hide the names of participants," he said. Where might we be in five years time? – perhaps obtaining and using share scheme info on an iPod application, or even via Twitter.

David Pett of David Pett & Co. discussed ideas for attracting and retaining key men and women in companies. Approved share schemes were all very well but there was still an annual limit of £30K on gains before CGT kicked in. The Enterprise Management Incentive was a flexible approved share options based scheme and extremely successful among small companies, but the Gross Asset Value test maximum for qualification was only £30m and so many were excluded. "But we have seen an explosion of interest in other types of equity scheme," explained David. A Joint Share Ownership Plan was being taken up by 30 companies, including several FTSE100 companies. In JSOPs, employees and EBTs jointly acquire ords with a condition that when shares are sold three years later, the proceeds are split – with the EBT receiving the initial market value + interest and the employees receive the growth in market value less interest. The growth in value was taxed as a capital gain. Loan assisted market value purchases and Flowering Shares were other examples. Were we losing sight of the goals of Eso?, he asked delegates. "It is a human right to be able to share in the growth of value of the business, but all too often the structure of employee share plans is driven by the need the optimise its tax treatment," said David. Share ownership was the logical way of rewarding employees. He described in detail the operation of EBTs, which generally offered tax advantages.

Mike Landon of MM & K highlighted free shares – the 'forgotten part' of the UK Share Incentive Plan. He was "surprised" that more companies were not making use of free share awards in SIPs because awards of up to £3K tax free could be made to employees each year, even internationally, using this structure. The value to employees of free shares was much higher than growth in partnership shares, which had to be bought. Free shares could be used as: one-off awards, salary replacement, bonus or profit share and/or as a retention tool. They could be linked to performance plans, either on a group basis – on equal terms for all – or they could be discretionary in various business units, awarded only when unit performance targets were met. Extending free shares internationally was simpler to achieve than share purchase plans or SAYE type option schemes. The tax position was simpler and more favourable in some countries, such as France and Ireland. Their issue did not normally require a prospectus and they maximised employee participation, said Mike.

Dr Jens Lowitzsch of the Free University of Berlin presented the Pepper IV Report about varying levels of employee financial participation (FP) throughout the extended European Union. The report, which Jens had organised, concluded that while FP (Eso) had gained ground in Europe during the past decade, it had been extended to a *significant* proportion of the working population in only a handful of countries. Another conclusion, perhaps surprising to some, was that there was no pronounced West-East divide in Eso take-up. The concept was not just well-known, but well applied in former eastern bloc countries such as Bulgaria, Hungary and Poland, the research work revealed. Increasingly, said Jens, the main elements in Eso plans were the same or similar, wherever one tended to go within the EU. He supported Mr Hurlston's call for Eso to be moved out of the 'social corner' of the European Commission and to be seen instead as more of an entrepreneurial tool. The Internal Market and Enterprise directorates would be far more suitable homes for Eso promotional work, but it was currently mired in the economic and social development directorate, he added. Jens then briefly examined the Esop as a vehicle for business succession in SMEs. Up to three million European jobs were at risk every year as a result of retiring founder/owners being unable or unwilling to arrange either a family succession, or even a trade sale, which was hazardous anyway, because new owners sometimes had a 'slash and burn' approach to companies they had acquired. Many such family-owned businesses ended up in liquidation – with all the jobs lost – but there was growing interest among international investors in SMEs, particularly the German examples. Dr Lowitzsch's papers will be posted to the Centre's new web folder (see below).

An insurance levy on financial institutions to help bail out banks in any future financial crisis was backed at the World Economic Forum. Politicians and bankers have expressed support for the idea, while the International Monetary Fund (IMF) has described it as "practical". The levy would go into a fund, which could be used to bail out the banks instead of taxpayer money. Governments across the world have spent billions of dollars saving banks. The insurance levy is seen by many as a more realistic option than a tax on financial transactions, often referred to as a 'Tobin Tax', which has been discussed but has proved unpopular in some quarters. The tax has been proposed by the UK and France, but has gathered less support in the US. The insurance levy is seen as a more workable solution, not least because it has been backed by some leading bankers. Josef Ackermann, CEO of Deutsche Bank, has advocated what he called "a European rescue and resolution fund", while Barclays head Bob Diamond supported the idea of a global levy. The Tory leader David Cameron has backed the proposals.

New Centre web folder

Members have free access to a new Centre web folder, www.hurlstons.com/esoppapers, which will publish key Eso papers from time to time. The first posts feature David Pett's short guide to share schemes, Dr Lowitzsch's Davos presentation about the levels of employee financial participation in Europe and a national update from Australia.

Alliance Boots was the latest public company to announce that it will close its final salary pension scheme to existing members, thus potentially hitting the future pension prospects of 15,000 employees. Around 90 percent of Alliance Boots' current pensions spending goes to those on defined benefit schemes, who account for just 20 percent of the workforce. About 70 percent of the UK staff have not joined any of the company pension schemes. Alliance Unichem & Boots merged in 2006. The Alliance Unichem final salary pension scheme closed to new entrants in 2002, whilst Boots' was closed to new entrants in 2000. Newspad reported last December that chemical & metals company Johnson Matthey; computer services company CSC; media companies ITN and Trinity Mirror; struggling airline BMI, now owned by Lufthansa; Tate & Lyle; Telent (the remains of Marconi); Vodafone; Barclays; William Morrison and even the Institute of Chartered Accountants had announced similar plans.

Computershare takes over

The sale of HBOS Employee Equity Services to Computershare by Lloyds Banking Group has been completed, writes Paul Stoddart, new business director. "Computershare Plan Managers is now the UK's largest provider of employee equity plans, and will bring significant technology and operational benefits to issuing companies both during and after integration of the businesses. Unless you have been notified otherwise, your contact will remain the same for the time being," he said. The integration of HBOS EES with Computershare's business is being managed by Martyn Drake, MD of the UK employee share plan business, using a dedicated integration team, including senior staff from Computershare UK and HBOS EES, augmented by specialist Computershare staff brought in from around the globe.

On the move

Gabbi Stopp has left Pearson Group and has joined Barclays. She said: "I am looking forward to joining Barclays, they have a great team there and lots of interesting work to get my teeth into. I'll be working in at group centre."

The Financial Services Authority faced uncertainty as CEO **Hector Sants** announced his resignation just months before the general election, the result of which could lead to the disbandment of the City regulator. Sants, a former banker, is stepping down in summer. But FSA chairman Lord Turner will remain in post during the radical overhaul of financial regulation following the taxpayer bailout of the banking system.

Eso companies out-perform

Employee-owned companies regularly out-perform those in the FTSE All-Share Index. Over the last 17 years, employee-owned companies have outperformed FTSE All-Share companies each year by an average of ten percent. In the third quarter of 2009, employee-owned companies' share prices were up 27.6 percent compared to FTSE All-Share companies share prices, which were up 21.3 percent over the same quarter. (*Employee-owned here is defined as having at least ten percent of the equity in the hands of employees.)*

Jamaican Airlines Eso planned

The Jamaican Airline Pilots' Association (JALPA) said it will consider starting its own airline if it fails to acquire Air Jamaica. But that option would not be exercised until all avenues have been exhausted to take over the national airline, which Government said it would be taking off its books by the end of March. Among the plans put forward by JALPA is for an Esop and an Initial Public Offering to be put in place within a year or two of acquisition. Captain Maria Ziadie-Haddad, secretary of JALPA, said the association had already received thousands of signed applications from employees who are willing to participate in the Esop.

Vesting conditions probe
The interpretations committee of the International Accounting Standards Board has begun an urgent review of the distinction between performance conditions, service conditions and non-vesting conditions as they apply to accounting for equity incentives under Share Based Payments (IFRS2).

Acceleration of incentive awards
Centre member Clifford Chance reported that many listed companies are aware of the latest executive remuneration guidance from the Association of British Insurers as they consider accelerating the vesting of cash/share-based awards into the 2009/2010 tax year in order to crystallise an income tax charge at 40 percent – before the 50 percent top rate income tax charge begins in April. "We are currently advising many companies on acceleration," admitted Clifford Chance in the latest edition of *Employee Benefits News*. "Acceleration of existing awards is not necessarily straightforward and there are issues to consider, particularly any "claw-back"/forfeiture arrangements that will apply if any employee ceases employment before the original vesting date of his awards. Many companies are considering not only the position for existing awards but also what new arrangements can be put in place to maximise tax efficiency in future tax years. Of course, there has long been a range of incentive plans available which aim to minimise tax liabilities. However, many of these arrangements have not been adopted by listed companies because they tend to be more difficult to explain to shareholders (and to participants) or they may look too aggressive in tax terms. On the other hand, the introduction of the 50 percent tax rate has arguably now tipped the balance in favour of re-considering some of these plans," explained *EBN*. "The ABI's position paper reminds companies that *tax efficient schemes* may risk damaging the reputation of the company and its shareholders. Moreover, in the past HMRC has expressed concern about certain arrangements where it considers that the proper amounts of tax/NIC are not being paid. Nonetheless, it seems that companies are now looking at these plans, whereas they may not have bothered to do so when the maximum income tax rate was 40 percent. The ABI's position paper expresses a number of other views which will be of interest to companies operating executive incentive arrangements including the following: If share prices fall substantially, share/option grants should be scaled back in order to avoid future windfall gains. More generally, the level of grant should not always be the maximum available under the plan rules."
*Are you operating PAYE/NIC correctly on your share plans so as to reduce the risk of unexpected costs in the future? As from 6 April this year, HMRC is introducing a new **in-year** penalty regime for late payments of PAYE and NIC. The new penalties will apply to all employers regardless of size.

HMRC wins Grays Timber verdict
The Supreme Court has confirmed that HMRC was right to treat additional cash allocated to an executive during a company sale as income and not capital, despite the pre-agreement of other shareholders, David Pett, solicitor and founder of David Pett & Co. has informed the Centre. An MD's tax bill arising from such a transaction - in which he received a higher price for his shares than other shareholders - has been vastly increased as a result of the recent court decision in the Grays Timber test case. From April there will be an even greater gap between the new 50 percent top income tax rate and the unchanged CGT rate of 18 percent, which might have tempted others to follow a similar route, but for the court ruling. However, the rules governing such deals were described by the court as being complex and obscure.
Mr Pett said that the February ruling in the case of Grays Timber Products v HMRC, concerning the application of Chapter 3D of Part 7 ITEPA 2003 (charge to income tax on a sale of employee shares for an amount which exceeds their market value) is of interest because: **1** It is the first occasion on which the Supreme Court has handed down judgments about the 2003 rules governing the tax treatment of employee shares and securities. Lord Walker said the provisions were "complex and obscure" and expressed the hope that parliament would find time to review them. **2** The answers to FAQs first published on the HMRC website (but since withdrawn) about the interpretation of the term 'market value' in the context of Schedule 22 FA 2003, now Part 7 ITEPA 2003, were – on the basis of the arguments advanced by HMRC – incorrect. **3** The case turned on the meaning of market value in the context of a disposal by an employee of shares on a sale of the company where the aggregate proceeds were divided between the holders of a single class of ordinary shares on a basis that the MD would receive more per share (and the other shareholders receive correspondingly less) in line with a pre-existing agreement between a majority of the shareholders. The employee's right to receive a disproportionate share of the proceeds of sale of the entire share capital was held to be a personal right of no value to a hypothetical purchaser (in relation to whom the value of shares in an unlisted company must be determined under the general rules of share valuation). The valuation of the employee's shares at the time of the sale did not have to take into account the actual sale of those shares at a special price enhanced for reasons related to the employee's special position as MD. It is only the terms subject to which the purchaser will take and hold the shares that must be considered. The employee's special rights expired on settlement of the transaction .
4 Owing to the failure by counsel at the Court of Session to raise it at the earlier hearing, the Supreme Court declined to consider an argument in support of the taxpayer's case. In a similar situation the taxpayer might yet succeed on the basis of an alternative argument: that the employee's entitlement to share disproportionately in the proceeds of sale is itself an

'interest in the proceeds of sale of the shares' and is itself a security (per s 420 ITEPA 2003) – distinct from the shares themselves - which was sold for a sum not exceeding the market value of that security.

Tax exiles fear the worst after court ruling

Thousands of UK tax exiles could face large back tax bills from HMRC after the Court of Appeal dismissed Robert Gaines-Cooper's application for judicial review. He had claimed non-resident tax status, after leaving the UK for The Seychelles where he has lived since 1976, on the basis of the HMRC practice set out in the IR20 booklet.

The judges ruled that because Mr Gaines-Cooper had retained significant property assets and personal ties in the UK it remained "the centre of gravity of his life and interests" and HMRC was correct to deny him non-resident tax benefits.

Although Gaines-Cooper had never broken the 91-day rule in IR20, the judges ruled that he had not made a "clean break" from the UK, which was an implicit requirement of the guidance and necessary before the 91-day rule could be considered. Having fought HMRC over many years about his tax liability, he is thought likely to appeal against the ruling to the Supreme Court.

Special high net worth units within HMRC are now expected to go for thousands of wealthy ex-pat Brits, particularly if they have kept on 'homes' and other property in the UK and/or strong family ties, such as having children in UK boarding schools. Other aspects which will attract HMRC attention include: whether the expatriate's will was drawn up in the UK, whether he/she is still a member of London clubs, or even attends national events annually, such as Ascot or Wimbledon.

HMRC had already given notice that it intends to tighten the rules on non-resident status in order to recover hundreds of millions of lost tax revenue from very wealthy British ex-pats, and last year replaced the IR20 guidance on residency with a new booklet called HMRC6.

There is fear in Monaco where several hundred British expats, who live there for all or most of the year, claim non-UK resident tax status while in many cases keeping up family ties with dependants and other relatives still living in the UK. But John Carrell, head of tax at Farrer & Co, a law firm which specialises in private wealth, tried to reassure them: *"Despite the dramatic headlines the court did little more than confirm well established principles. If the so-called Monaco millionaires have been well advised they have nothing to fear! It is not enough for someone simply to buy a house abroad and arrange to spend less than 90 days a year in the UK. There has to be a distinct break in the pattern of his life and some (but not necessarily all) of his ties to the UK have to be severed. This has always been our understanding of the law and of HMRC's practice in IR20. However, it is surprising how often advisers – at any rate until some recent Court decisions on residence – ignored this and told their clients that they only needed to observe the day counting rules. In our view the taxpayer does not have to sever* ***all*** *his personal and social links with the UK. What he must do is make his main home abroad and transfer to that home his valuable furniture, personal effects, family photos and pets. If he has a spouse and/or minor children then they should accompany him. (Gaines-Cooper's wife – although a Seychelloise – stayed living year round in the UK and his children went to the local school in Henley.) Providing this is done he can keep a home here although it should be modest by comparison to his main home abroad, and he can visit relatives and friends here – keeping, of course, within the 90 days,"* he added.

Centre member **Deloitte** pointed out that the court ruling backs HMRC's distinction between someone leaving the UK permanently to live elsewhere and someone who has a full-time job abroad. Such long-distance commuters are ***not*** required to sever their UK family links in order to establish non-UK residency and the tax benefits. "Advisers complained that in recent years HMRC had re-interpreted IR20, so that it was more difficult for individuals going abroad to be treated as non-resident, but had not announced any change of practice. This had been described as a "betrayal of trust" making IR20 into a "trap". HMRC admitted that they had started to investigate non-residence claims more thoroughly, but stoutly denied any change of practice. On this issue the Court supported HMRC, noting that the evidence against HMRC was not conclusive. Professional advisers may find it difficult to reconcile this conclusion with their own experience of residence challenges in recent years," added Deloitte.

CONFERENCES

Jersey May 14: A top line-up of Centre speakers is in place for the Centre's next Share Schemes for Trustees conference, held in association with STEP Jersey, on Friday May 14. Former Tory Front-Bencher Howard Flight, who is a member of the Guernsey Financial Services Commission and Rosemary Marr, vice-president of STEP International and the Esop Institute's International Research Fellow, are among speaker confirmations for this event at the Royal Yacht (Hotel), St Helier. Other speakers include: Amanda Flint of BDO, David Craddock of David Craddock Consultancy Services; and William Franklin of David Pett & Co. Go to our website at: www.hurlstons.com/esop and click onto 'news' and 'events' to study the programme and speaker details. This extended half-day conference will allow delegates to learn and share knowledge about issues concerning the use of trusts in Eso plans. Centre members can attend for only £295; the non-members' delegate fee is £425. The admission fee includes a quality lunch in the Royal Yacht, served after the sessions end. To register please contact Anna Burgess at: (0) 20 7239 4971 and: aburgess@hurlstons.com

Cannes July 8 & 9: The Centre's 22nd annual conference is attracting an impressive array of speaker talent: Sarah Pickering - Alvarez & Marsal Taxand; Patrick Neave - Association of British Insurers; Amanda Flint - BDO Human Capital; Justin Cooper - Capita Registrars; Mick McAteer, panel adviser to the Committee of European Securities Regulators John Daughtrey—Equiniti; Leslie Moss - Hewitt Associates; Peter Leach - Killik Employee Services and Joe Saburn - Squire Sanders & Dempsey (US). Delegates from plan issuer companies are starting to register. Vacancies remain for additional speaker slots, so contact Fred Hackworth (eaddress: fhackworth@hurlstons.com) asap if you wish to speak and thereby obtain the hefty reduction in attendance price. You and/or a colleague can deliver either a solo or double-header presentation. We seek recent international employee share/stock plan case histories in which the presenters can be from the plan issuer company itself, with or without its Centre member adviser. We seek technical presentations too from member practitioners (service providers). These might cover: share/stock plan administration, multinational Eso tax issues, regulatory developments, trustee issues and executive compensation strategies In addition this year, we will require two/three presentations on aspects of wealth management. As this event takes place on **Thursday and Friday, July 8 & 9,** the package deal accommodation nights in the five star conference hotel, the Majestic, on the Cannes seafront, are July 7 & 8. Go to our website at: www.hurlstons.com/esop and click onto 'events' for more details. Co-sponsorship opportunities are available for the official brochure, the entire conference, or for individual elements within it, such as the cocktail party, or one of the conference lunches. Please contact Fred for further information.

New Centre member Mike Smith of Collins Stewart's Corporate Executive & Employee Trading Services desk is hosting an **employee remuneration seminar** at the broker's London HQ *88 Wood Street, EC2V 7QR* on either the evening of April 20 or at a repeat performance on the following morning April 21. Phone him on +44 (0) 20 7523 4553 if you'd like to attend and/ or receive an electronic invitation.

Pay rise for chairmen

UK chairmen and non-executive directors received pay rises at five times the level of inflation in 2009. Although many had their pay frozen, the average increase was around ten percent. In addition, new appointees are able to negotiate higher fees than their predecessors, according to the survey published by **MM&K,** the remuneration consultants, in conjunction with non-executive search firm Hanson Green and private equity recruitment specialist Directorbank. The survey was completed by 442 directors – 290 chairmen and 152 non-executive directors – who collectively provided data on 1,170 appointments on main market, AIM and private company boards, across all sectors. Median fees for chairmen of small cap and AIM-listed companies average £1,700 per day, and £2,750 per day for £1bn plus turnover companies, whilst median fees for non-exec directors of smaller listed companies average £1,500 per day, and £1,800 for £1bn plus turnover companies. When asked whether guaranteed bonuses for recruitment and retention were necessary, most survey respondents felt that they were not essential; with only 13 percent believing they were necessary as a recruitment tool and 15 percent for retention. "In our experience, most larger companies use guaranteed bonuses or will have used them over the last five years. This suggests that chairmen and non-exec directors need to make their views known to the executives and shape company remuneration policy in this area. An alternative view is that most of the respondents are wrong and the executives need to explain better and convince the non-executives of the need for guaranteed bonuses," said MM & K director Cliff Weight.

Rem com v shareholders:

The remuneration report of the UK's largest listed residential landlord, **Grainger**, was voted down by 53 percent of the 290m votes received at the AGM, while a further 6.5m votes were abstentions. Shareholders were angry about a £3m pay off given to former CEO Rupert Dickinson who quit last October for health reasons. Grainger's board said that half the payment was to offset potential litigation about the circs of his departure, while the other half was accrued and unpaid bonuses and salary in lieu of notice. As the vote was advisory, the payout will not be adjusted. **Royal Dutch Shell** said that it would freeze the salaries of its top directors and reform a generous bonus scheme to soothe shareholders' anger over excessive boardroom pay before its AGM. Hans Wijers, the new chairman of the Anglo-Dutch company's remuneration committee, said that the changes were being made after extensive talks with shareholders, 60 percent of whom voted down the executive pay plans at a stormy AGM last year. That revolt triggered the resignation of Sir Peter Job, Mr Wijers's predecessor. Wijers unveiled plans to link bonus payouts to Shell's performance on the Dow Jones sustainability index, which ranks corporate performance using various social and environmental indicators, including cuts to carbon emissions. As of this year, ten percent of the targets used to calculate payouts will be linked to the index, with the remaining 90 percent related to operational and financial performance, as well as the delivery of big projects on time and on budget. The key measure in Shell's bonus plan remains the group's performance against its peers — BP, Total, ExxonMobil and Chevron

Banking bonus news

Lord Myners renewed his attack on institutional investors, telling them that an excessive bonus culture in the financial services industry is hitting British pensions. The City Minister, who wrote to institutions

demanding to know what they planned to do to limit bankers' bonuses, used a speech to the National Association of Pension Funds (NAPF) to emphasise that the real losers in the failure of institutional pension funds to control bonuses are the funds' own clients. The NAPF and other industry bodies have fought back against Government criticisms that they helped to cause the banking crisis by being absentee landlords in the groups in which they hold shares. The association launched a governance code that will urge pension funds and other institutional investors to engage more actively with boards in order to promote better standards. Lord Myners told the NAPF that the reason financial services businesses had cut dividends in recent months is that they are spending too much on bonuses. The City Minister said that companies should be run for the benefit of their owners, not for their highly paid employees. High earners will cost the public purse hundreds of millions of pounds through tax dodges as they avoid the new 50p rate of income tax and the Treasury had significantly reduced its estimate of the revenue to be earned from the historic change, he said. Myners believed that the new top rate, due to come into force this April, would still generate extra income from the wealthiest two percent of the national workforce, but he cast doubt on whether the Treasury would pocket the £1bn+ it has earmarked for 2010, and the £2.5 bn it hopes to raise in 2011. Lord Myners told peers that "behavioural consequences of the new higher rate of taxation" — shorthand for tax avoidance - had forced the Treasury to lower its expectations. Accounting firms said that clients were pursuing four main ways to avoid paying half their salary in tax: bumping up this year's pay; storing up pay in their firm to be drawn down at a later date; leaving the country; or choosing to pay it to charity rather than the taxman. Myners justified the change, saying: "It is a matter of meeting the finance requirements at a time when the public sector has a very large deficit. The broadest shoulders must quite rightly bear the greatest burden." Despite stricter regulation forcing banks to defer bonuses to top earners, many City financiers, who have just learned the details of their 2009 pay packages, are enjoying more generous terms than politicians and regulators had hoped for.
On the other hand, Chancellor Darling's one-off banker bonus tax, which expires within weeks, looks like having earned the Treasury between three and four times the £500m first estimated.

German bank regulators can block or limit "inappropriately high" bonus payments under a draft law backed by Chancellor Angela Merkel's coalition that aligns Germany with guidelines agreed by the Group of 20 nations. The bill, which applies to insurance companies too, was approved by Merkel's Cabinet at a meeting in Berlin, a government spokesman said. Approval is still needed in parliament, where Merkel's government holds a majority. Germany's financial regulator can forbid variable pay or limit it "to a certain share annual net income" if a company no longer meets regulatory requirements, or is about to do so, according to the draft. The Finance Ministry will issue detailed rules on oversight and reporting requirements. The legislation builds on a plan outlined by Deutsche Bank CEO Josef Ackermann in which Germany's eight largest banks and three top insurers, including Deutsche Bank, agreed to restrain pay. The accord drew on recommendations by the Basel, Switzerland-based Financial Stability Board.

The **UBS** loss in 2009 will trigger the bank's bonus claw back mechanism for the first time, depriving senior bankers of CHF 300m ($282m) of deferred pay they were due to receive this year. Last year, the Swiss bank introduced a plan that would pay CHF 900m to MDs, executive directors and directors in equal parts in 2010, 2011 and 2012, but UBS posted a CHF 2.74 bn loss for 2009, compared with a loss of CHF 21 bn for the previous year. "The critical condition, a net profit for 2009 according to International Financial Reporting Standards, was not met," CEO Oswald Gruebel said in a memo to employees.

Citigroup puts its bonus scheme before investors at April's AGM. The US taxpayer still owns 27 percent of the bank despite Citi repaying $6bn (£3.75bn) of TARP money. Hoping to deflect public outrage, Citi *pledged to cap all cash bonuses at $100,000. However, more than 40 percent of bonuses are being packaged in shares that can be sold in April, converting them to cash almost immediately after staff are paid*. The bank took the decision on the share vesting date to protect top performers after losing several rainmakers. A City head-hunter said: "The top 10 guys were flat to ten percent down on 2007, while everyone else was up to 30 percent down. Directors took bonuses of $600,000 and $850,000, with MDs getting between $1.25m to $1.75m."

Goldman Sachs chairman and CEO Lloyd Blankfein will receive a $9m all-stock bonus for 2009, confounding expectations of a record-breaking payday. Mr Blankfein was awarded 58,381 shares at a price of $154 per share. He received a $600,000 salary last year. David Viniar, the bank's CFO, and Gary Cohn, the CEO, received the same stock bonus, which will vest over three years and cannot be sold for five years. The executives must hold 90 percent of all equity awards until Warren Buffett, the billionaire investor, exits his investment in the bank, and then retain 75 percent until they retire. At Goldmans dozens of divisional MDs have been awarded multi-million pound bonuses. The bank's 100 UK partners agreed to cap their pay at £1m each but there is no such ceiling for more junior staff, some of whom received record payouts. Head-hunters claim Goldman has paid staff an average of 20 percent more than rivals. However, its pay pool, at 36 percent, was smaller as a proportion of revenues than much of the past decade. Rival Morgan Stanley paid 62 percent of revenues in compensation. JP Morgan paid out 32 percent in reward.

Bank of America Merrill Lynch, which made losses of $2.2bn, is paying its senior UK staff 95 percent in stock. *However, staff will be able to cash out 35pc of their share-based pay in two tranches this August and next. The rest is deferred for three years*.

One of the Government's biggest problems is state owned **Royal Bank of Scotland**, which is discussing with the Treasury a bonus pot that could reach £1.3 bn. It agreed not to pay cash bonuses larger than £39,000, with the rest made up in shares. Half of those shares, though, will be available for staff to sell in the market in June. The rest will vest in equal portions across the following two years. RBS bankers below board level can cash in some of their shares from June, but that wasn't enough to stop two of their stars decamping – one to Nomura in Tokyo.

Three executives on the **Barclays** board, which includes FD Chris Lucas, are set to take all their 2009 bonus in shares spread over three years. Barclays did not take any direct state help during the financial crisis, but will seek to head off potential anger at big payouts so soon after western governments supported the banking industry. Barclays has said it will follow G20 guidelines on reforming pay structures. Barclays Capital, the investment bank headed by Diamond, told its senior staff that all their reward packages had to meet FSA rules, including the deferral of 60 percent of pay, despite pre-existing contracts which would have guaranteed some of them big bonuses in cash and shares. It is cutting the ratio it pays staff as a percentage of revenue to about 38 percent for 2009, from 44 percent in 2008.

Clawbacks?

US banks and securities firms are toughening rules that give them power to seize pay from employees whose bets or other actions blow up later. 'Claw-back' provisions used to cover just top executives or fraud. JP Morgan Stanley's board expanded the provisions to include any employee at the New York bank who gets company stock as compensation. In addition, J.P. Morgan can grab stock awards from employees found to have taken excessive risks or who didn't blow the whistle on bad risk-taking. Bank of America and Morgan Stanley also have recently sharpened their claw-backs as Wall Street responds to relentless outside pressure to overhaul its pay culture. Compensation experts, who got nowhere before the financial crisis when they pushed to make employees more financially responsible for their mistakes, say the toughened claw-backs are a step in the right direction. Morgan Stanley said that its revised claw-backs allow the firm to "reclaim compensation for up to three years after it is awarded" if the company "realises losses on certain trading positions, investments or holdings." Top executives, including new ceo James Gorman, could lose deferred cash compensation. MS didn't disclose how steep those losses would have to be to trigger the claw-back rules or which trades and assets are subject to the tighter provisions. But claw-backs could be difficult to enforce because the circumstances often are murky. For example, if a trading bet goes bad, should just the trader lose his compensation or also superiors who approved the bet? At JP Morgan the narrower claw-back rules usually were invoked when an employee was fired. Under the new policy, J.P. Morgan can revoke stock awards from employees without firing them. The company already had rules that allow it to go after compensation previously paid to top executives for almost any reason. Most of the sharper claw-backs are aimed at stock that is awarded as compensation and vests over several years. The rules are likely to affect a growing percentage of overall compensation, since firms are distributing more deferred shares in response to public anger over their reward practices. Some companies are considering provisions that would allow them to retrieve cash or vested stock in certain situations. "Boards are struggling with it," said one executive at a Wall Street firm. "The issue is how to strike the balance between providing incentives to attract the best people and retain them without giving people an opportunity to play the system."

UK wealth inequalities widen

The richest ten percent of the population are more than 100 times more wealthy than the poorest ten percent, said the government-appointed National Equality Panel. An anatomy of economic inequality in the UK analyses the degree to which the country has become more unequal over the past 30 years. Labour can take no comfort from the report. On one measure, by 2007-08 Britain had reached the highest level of income inequality since shortly after WW II. The top ten percent, led by higher professionals, amass wealth of £2.2 m, including property and pension assets, by the time they come close to retirement, while the bottom ten percent of households, led by manual workers, have assets of less than £8,000, the report says. When the highest-paid workers, such as bankers and CEOs, are added to the equation, the division in wealth is even more stark, with individuals in the top one percent of the population each possessing total household wealth of £2.6m or more. For more details visit:www.equalities.gov.uk/pdf/Findings%20final.pdf

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