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## newspad of the Employee Share Ownership Centre

### Centre challenges Chancellor over scrapping CGT taper relief band

The Centre is seeking a meeting with Treasury officials in an attempt to dissuade Chancellor Alistair Darling from scrapping the ten percent capital gains tax taper relief band. Centre chairman Malcolm Hurlston wrote to the Chancellor, requesting the meeting, after reviewing the latter's pre-budget report, in which Mr Darling announced the imposition of a new flat rate 18 percent CGT rate and the abolition of indexation and taper relief from next April.

Senior practitioner Centre members are warning that the Chancellor's CGT proposals should be amended before his first Budget, in order to stave off damaging consequences in the employee share ownership world. They have identified four areas of major concern arising from the Chancellor's plan to unify CGT at 18 percent:

\*Longer term employee share saving will be discouraged once the taper relief band goes, as the tax incentive to hang onto shares after plan maturities will disappear. This is at odds with Gordon Brown's stated intention of using broad-based employee share schemes as a means of improving the savings habit in the general population.

\*In SAYE Sharesave schemes the level of CGT paid by lower employee participants earning less than £33,000 will skyrocket once a flat rate of 18 percent is levied on all gains above the £9,200 annual allowance. This is because currently employee basic rate taxpayers effectively pay CGT at only five percent once they've held onto their shares for two years after maturity.

\*In Enterprise Management Incentive stock option schemes for SMEs, it will become harder for young, 'gazelle' companies to hang onto key staff after their options mature, once CGT taper relief has been axed. When their EMI options mature, they may choose to cash them in immediately and migrate to a larger company.

\*The level of non-salary incentive available to both founding directors and key staff in SMEs will be badly dented by the 80 percent jump in the level of CGT levied on their gains - from ten percent (after taper relief) to 18 per cent.

Most practitioners think that Treasury officials overlooked the potential impact of the CGT changes on employee share ownership (Eso) when the plans were being drawn up.

Mr Hurlston accused the Chancellor of having inflicted

*From the Chairman*

*We are coming up to critical days for employee ownership in the UK. The old certainties of the Brown era - in particular the acceptance of the value of employee ownership - have been swept aside. Instead we have the double whammy of collateral damage from the single rate of cgt and the upcoming HMRC studies of share scheme effectiveness. There is no doubt that saving money is high on the list of the Chancellor's priorities and the £1.1 billion cost of employee share ownership is a tempting target. Now is the time to be confident about the benefits to the UK economy of the work we do and to tell every MP about case histories you know. There will need to be a human counterpoint to the arid studies of HMRC and the attractions of certain saving as opposed to possible productivity gain.*

*Malcolm Hurlston*

"collateral damage" on Eso and on the EMI in particular. The chairman's comments were reported by the FT and The Daily Telegraph: "By accident or design, Chancellor Darling has severely wounded the EMI - Gordon Brown's major achievement for enterprise. Mr Brown introduced EMI to encourage productivity and to help the entrepreneurial company. Its attraction depended heavily on taper relief (another Brown invention). All the signs are that EMI has been outstandingly successful in helping small companies develop. Now that has gone.

"We urge the Chancellor to delay action affecting employee shareholding until he has received the HMRC report into the efficacy of EMI and discussed it with stakeholders. In future, the move to a single rate of CGT could reduce costs of creation for approved schemes and the main beneficiary, paradoxically, could be the Company Share Option Plan. The impact will also be disproportionately felt. Private equity high-rollers at whom his change was aimed will have the CGT rate they pay raised by only eight percentage points.

"By comparison, a basic rate shop-floor worker who scrimps to pay into a SAYE scheme will be bitten by a rise of 13 percentage points in the rate he/she incurs, more than tripling the tax hit! Darling may have intended to 'shock and awe' the private equity big boys, but unless significant protective steps are taken the collateral

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damage from his scattergun approach will hit the lowest paid the hardest, undoing much of the groundwork done by his predecessor.”

Centre practitioners reacted strongly to the Chancellor’s CGT changes.

William Franklin of Pinsent Masons: “A decade ago Gordon Brown introduced taper relief because he wanted to encourage longer term investment with a lower rate of CGT. The new Chancellor has swept aside all that by the single rate which taxes short term gains no differently from long term gains. The Treasury says that we live in different times: ten years ago the economy was more volatile and the need was to encourage longer-term thinking. That may sound like dangerous self-deception – the belief that the economic cycle has been tamed. However Darling has shown he is no poodle of his predecessor.”

“Now is surely the time for the share plan industry to point out that the five year holding period for SIPs is an anachronism which has held back the take up of SIPs. However we also need to be ready to make the case again for tax-favoured share plans. While not an enemy of share based incentives, Darling has never shown great enthusiasm for giving tax breaks to encourage particular business activities and it would not be surprising if the current package of tax-favoured share plans did not come under scrutiny.”

Paul Davies of Ernst & Young said: “We are extremely disappointed with these proposals as they threaten to undermine the entrepreneur culture that has blossomed over the last decade. Abolition of the taper removes a large incentive for entrepreneurs and challenges the success of the UK.”

Kevin Thompson of Clifford Chance: “Although we will need to see the detailed legislation, it looks as if EMI will lose its competitive advantage whereby taper relief currently runs from grant rather than exercise. So this is bad for EMI, not so much in the increase in the rate from ten percent to 18 percent but in terms of the abolition of taper relief. The abolition of taper relief is, however, possibly good for CSOP and SAYE since employees will no longer have to hold shares for two years or more after exercise in order to optimise their CGT position.

“The new 18 percent flat rate of CGT will apply even if they sell shares immediately after exercise. One significant drawback of the abolition of taper relief is that the annual CGT exemption, currently £9,200, applies to the gain after applying taper relief. In other words, after two years the annual exempt amount is in effect £36,800, since only 25 percent of the gain is taxed and that reduced gain is then covered by the annual exemption. The abolition of taper relief will mean that the annual exemption reverts to being what it is stated to be, currently £9,200. This looks like very bad news.

“The 18 percent CGT rate will not go down well with lower-paid employees (eg store staff participating in share plans). If they are basic rate taxpayers, their current rate of CGT once they have held shares for at least two years

is only five percent, which is going to be increased to 18 percent!! In many cases the gains will be covered by the annual CGT exemption, although many employees have made gains from SAYE options that far exceed the exemption. To increase their CGT rate so dramatically looks bad. This goes beyond tax-approved plans and also affects unapproved share purchase arrangements, which some private equity-owned companies have put in place on an all-employee basis.”

Neil Sharpe of New Bridge Street Consultants said: “The Government appears to have overlooked the impact of its CGT reforms on employee shareholders. Without the attraction of holding shares to accrue taper relief, employees are more likely to sell the shares they acquire through share plans and diversify into other assets. It’s a mixed result for Sharesave and CSOP participants – if they sell shares immediately after exercise, they will be taxed at a lower CGT rate than they would be now, but if they hold onto their shares they will not get down to the current rates. It’s very unfortunate that one of the major attractions of EMI schemes, taper relief from grant rather than exercise, will be lost, particularly as EMI schemes have proved so popular.”

Mike Landon of Mercer doubted whether many of the UK’s 1.7m Sharesave participants would be subject to the planned 18 percent CGT bill after next April whenever their schemes mature. “The reality is that most employee shareholders will not be affected by the proposed changes, and some will actually be better off. In some cases, there will be a large increase in the CGT bill, but most employee shareholders do not pay any CGT when they sell their shares. The capital gain they make will usually be covered by the CGT exemption, worth £9,200 in the 07-8 tax year.

“Even those employees who do make bigger capital gains from SAYE plans frequently sell the shares as soon as they have acquired them. So they do not qualify for taper relief in any case. From next April, these employees will be paying CGT at 18 percent, instead of the 40 percent currently paid by a higher rate taxpayer, and the 20 percent paid by a basic rate taxpayer. They will be better off under the new rules.” He added: “The tax-advantaged Eso plans - such as SAYE plans, SIPs, CSOPs and EMI - will continue to be more attractive than unapproved share plans. Participants will benefit from owning shares in their companies either completely free of tax or paying a CGT rate of 18 percent, rather than having to pay income tax and NICs on the value of their shares.”

Robert Postlethwaite of Postlethwaite Solicitors said: “EMI remains an attractive and highly flexible incentive plan and I suspect it won’t change its popularity much, if at all, though these are early days. The CSOP may become a little more attractive, particularly for exit-focussed private companies, which don’t qualify for EMI, as it will be possible to secure an 18 percent CGT rate without having to retain shares after exercise.”

#### **PRIVATE EQUITY AND ESO LOBBY**

Staff share schemes at ex-LloydsTSB Registrars are set to

close within six months, newspad has learned. This follows the purchase of one of the UK's biggest employee share scheme registries – now renamed Equiniti - by private equity house Advent International, a non-listed company. Former Lloyds-TSB staff must exercise their SAYE-Sharesave options within six months using money saved to date but monthly contributions can still be made until the deadline. Advent thought hard about setting up new approved Eso schemes, but found HMRC rules loaded heavily against them (particularly over the share control issue). "Instead, Advent is introducing a co-investment plan for staff that uses units, rather than shares, which are matched on a 1:1 basis up to a maximum of £5000.

Malcolm Lynch of Wrigleys supports the Centre's campaign to get the Treasury change the rules in order to make share schemes easier to install in companies controlled by another company. "This is a problem which faced UBH International for several years since Baxi Partnership Ltd was the ultimate parent company," he wrote.

"But the campaign for private equity to gain the same access to tax-efficient Eso schemes as other companies has seemingly left the Chancellor unmoved. Instead, Darling has made schemes less attractive for many by raising the base rate of capital gains tax on them from five (for base rate income tax payers) or ten percent (for the higher 40 percent band) to a flat 18 percent. Private equity firms now realise that if they allocate more shares in their buy-outs to all staff, as well as to senior management, they could benefit both by improving performance and answering their trade union critics. But many buy-out firms are being prevented or discouraged from launching such schemes at the companies they own by outdated approved scheme rules."

Clifford Chance briefed the Centre, which submitted a paper to the Treasury, making the case for improving private equity's access to staff share schemes. Kevin Thompson, partner at CC and co-author of the briefing note, said: "For some years back, doing tax-approved share ownership plans has been a non-starter for private equity."

Some private equity companies distribute 'sweet equity' throughout companies they acquire, such as Saga, the travel and insurance group bought by Charterhouse in 2004 and this year merged with the AA. But many buy-out firms restrict sweet equity to senior managers, their own partners and investors. Tax-approved schemes are deductible against corporation tax and exempt from income tax and NICs.

#### **CENTRE IOD EVENT**

Centre chairman Malcolm Hurlston opened the sell-out joint Centre-Institute of Directors share schemes conference for SMEs with a call for more Enterprise Management Incentives, as it was the most popular and effective share scheme to date for growing companies. Sara Cohen of Lewis Silkin told delegates why EMI was probably the best share plan in the world, but warned

about the need to watch that EMI & CSOP options combined do not exceed the £100,000 limit, otherwise the EMI options could be disqualified.

John Meehan of Capita gave a whistle-stop tour of the different schemes on offer, urging delegates to consider their own reasons for introducing a plan before they get too far into the process, as this would influence plan design. There had been a shift from options to restricted share plans, due to the increased burden of IFRS2/FRS20 regulations. He gave two examples: Logica where employees at the start of the plan secured options at 14p, which were worth £14 at maturity – and £20 just six months later. Although Northern Rock was a sorry saga, at least Sharesavers needn't worry about getting their savings out.

Juliet Halfhead of Deloitte tackled ShareSave vs. SIP and explained why SIP is gaining in popularity. She emphasised the need to examine the employee profile in a company – e.g. were they mostly higher rate tax-payers, or basic? She noted that the popularity of SIP might increase as IFRS2/FRS20 extended to AIM and private companies. However, the key to establishing a successful Eso plan was ultimately about getting maximum value for spend – so even if there was an accounting cost to bear, they might find it was the best solution.

Aidan Langley of PwC said that on October 1 a clause in the Companies Act 2006 had been activated whereby loans to company directors were now permitted – a boon to those companies that had outgrown EMI or did not qualify for it. He asked whether some EBTs ended up as a form of pyramid scheme, as departing employees selling years worth of accumulated shares to the EBT would stoke up the EBT faster than it was able to distribute them, unless the company maintained exponential growth. The company ended up with huge sums of money tied up in the EBT and the value could not be released without securing a third party buyer – possibly earlier than would have been desired.

David Craddock presented four live plan case studies. He said the secret of successful ESO plans was that you become richer by helping other people become richer and correspondingly, as they became richer, they helped you to become wealthy.

Michael Sterchi of KPMG illustrated the advantages that could be obtained by staff with options in a company moving between the UK and Switzerland, owing to the way that differences between the taxable event are resolved. With proper planning, much of the gain in price could be realised tax-free.

Alan Page of Killik ESS demonstrated how an SAYE which vested in March with a £65K gain could incur either £22K tax, or, if in an ISA, where personal allowances and pension contributions are utilised effectively – no tax at all. He emphasised how this showed the importance of giving employees more assistance than telling them how to deal with the mechanics of vesting.

Robert Postlethwaite of Postlethwaites explained how

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selling shares to a SIP could be a practical and tax-efficient way to arrange an exit and demonstrated how the cost to the company of providing £100 reward to an employee through cash could be almost double the cost of providing the same reward through free shares via SIP.

Colin Gibson of HMRC disclosed that local tax offices would be increasing compliance activity and that they aim to open specialist local centres nationwide. He noted that e-filing would almost certainly become mandatory in the near future and that the results of the EMI and SIP surveys were likely to be made available this Autumn. Later, during the speakers' Q & A, he said that one of the findings was that many people who were given options were unaware of it and that this raised the question of what benefit HMRC could be getting for the tax relief that they were giving to such people.

Since much of the conference material was affected by the pre-budget statement, the Centre has sent an update from Deloitte to all who attended. Deloitte point out that where both are permissible, it will still be more beneficial to use EMI rather than CSOP because of the higher limits (£100k v £30k). However the relative advantage will be less and where the underlying shares are sold immediately after exercising the options both EMI and CSOP will face the same 18 percent tax as opposed to the previous 10 percent and 40 percent. IoD delegates learned that shares could potentially be sold and repurchased to crystallise the ten percent but the repurchase would have to wait 30 days to meet the matching rules. Alternatively and requiring individual examination it may be possible to effect a disposal for CGT purposes to lock in the gain while deferring access to the benefit until the vesting or forfeiture rules had lifted. Of course, from a commercial point of view an employee's exposure to share price movement during the remainder of the vesting period might need to be replicated.

### ON THE MOVE

Gabbi Hatton has left Tesco, to take up the post of share plans manager at Pearson. She now works for Stephen Jones, deputy co secretary. Teresa James has stepped into her role at Tesco. She has worked in share plans for seven years. Her e-address is [teresa.james@uk.tesco.com](mailto:teresa.james@uk.tesco.com) and phone is 01992 646610.

BDO Stoy Hayward has acquired Chiltern, the UK's leading independent tax boutique. Chiltern staff will continue to trade under the Chiltern brand for the time being, but they are expected to relocate to BDO's new offices early next year. One of the many benefits is the marriage of the BDO share schemes team with Chiltern's reward consulting group. David Ellis, partner at BDO Stoy Hayward said: "The combined team will be one of the biggest in the industry capable of offering a very comprehensive service to companies." The new group will offer wide-ranging advice to employers looking to

use shares as an incentive for executives and employees. Amanda Flint at Chiltern is enthusiastic: "We will be able to accommodate a wide range of projects in both the national and international arena. The experience of the new team makes us a force to be reckoned with."

### CONFERENCES

More than 40 people have registered for the Centre-STEP Guernsey 'Eso schemes for trustees' conference on Friday November 9 at Old Government House Hotel in St Peter Port. The speakers are: Gareth Rowlands of Towers Perrin, Amanda Flint of Chiltern Reward, Catherine Gannon of Gannons (employment lawyers), STEP Guernsey chairman Alison MacKrill of Turcan Connell, Charles Cooper of BWCI Trust Co, William Franklin of Pinsent Masons and David Craddock of David Craddock Consulting. Centre director Steve Round will be in the chair. The agenda includes presentations on internal share markets for SMEs, share trusts and deferred share schemes, employee share plan administration and accounting for Esos and EBTs. Admission prices are £295 for STEP or Centre members (discount for 2nd and subsequent delegates) and £425 for non-members. Register now.

### Davos Jan 31 & Feb 1, 2008, Newsflash:

Eugene Weultjes from the Amsterdam office of US lawyers Greenburg Traurig LLP will give a presentation at the European Centre's ninth employee equity forum in Davos on Stock options from a Dutch and European perspective. Among the issues he will cover are: the Dutch share scheme governance code (which covers the overpayment of senior executives) and the contrast with the US, which lacks such procedures. See the full agenda on the Centre website at [www.hurlstons.com/esop](http://www.hurlstons.com/esop) and click onto the 'events' tab. Please email Fred Hackworth at [fhackworth@hurlstons.com](mailto:fhackworth@hurlstons.com) to register, or if you have any queries.

### FORUMS

Watch this space for new forums coming to the Esop Centre's website: [www.hurlstons.com/esop](http://www.hurlstons.com/esop).

A Davos forum is opening this week on the Centre's website. Anybody registered, intending to participate or attending vicariously can swap notes among themselves on agenda issues, travel arrangements and get-togethers. In particular, speakers and delegates may want to suggest, or comment on, issues which they would like to see raised during the feedback sessions at two-day forum in the five-star Steigenberger Belvedere Hotel. Meanwhile the Centre team will keep you posted on changes, travel and entertainment. You can access the Davos forum now through the members' area of the website at: [www.hurlstons.com/esop](http://www.hurlstons.com/esop).

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