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it's our business

newspad of the Employee Share Ownership Centre

Employee share ownership works wonders, says new index

A new version of the UK Employee Ownership Index (EOI)*, published for the first time today (Oct 1), continues to show consistent share price out-performance this year by companies with substantial employee ownership, compared to the FTSE All-Share index.

The UK EOI, calculated by index specialist FTSE International, a subsidiary of the London Stock Exchange Group (LSE), revealed spectacular advances in share prices of companies with at least ten percent employee ownership, both during the last quarter ended September 30 and over the year since January 1. By comparison, rises in the share prices of quoted companies generally were far more modest.

In the quarter ended September 30, the new ten percent employee ownership index was 23.9 percent higher, as against a rise of only 5.6 percent in the FTSE All-Share index during the same period. Over the year to date, the new ten percent index was up by 44.2 percent, compared to a rise of 14.6 percent in the FTSE All-Share.

Like the original index, which has been continuously published since 1995, the new index tracks the share prices of companies listed on the main market of the LSE and on AIM which have more than ten percent of their issued share capital held by employees.

However, in a major innovation, the new UK EOI boasts an additional index, which tracks companies with more than *three* percent employee ownership, which includes many Centre member companies. The three percent version includes more companies (69 versus 19) as reference points, so is less susceptible to sector bias. *It is important to understand that this latter index includes companies with between three and 51 percent + employee ownership.*

These, the very first published statistics for the new three percent plus UK employee ownership index, show average share prices 18.0 percent higher over the last quarter and 36.2 percent higher than on January 1 respectively – way ahead of their FTSE All-Share equivalent prices.

This means that £100 invested in the three percent index on January 1 2003 would now be worth £635 compared to £264 if invested in the FTSE All-Share. The three percent index is more telling for investors than the ten percent index because it includes a broader spread of companies.

The impressive set of quarterly results of the new UK EOI will give plenty of ammunition to share scheme advisers who need to convince more companies to adopt all-employee share schemes at a time when budgets are tighter than ever.

Clients can be shown strong evidence that broad-based employee share ownership really does make a difference, both in smaller employee owned companies (with perhaps 25 percent employee ownership) *and* in quoted companies with less than ten percent employee ownership too.

The new indices are further bolstered by the fact that they now show total returns, including the effect of reinvested dividends, whereas the original ten percent index was based on capital only.

Like the original index, the new indices are equally weighted but are re-weighted every quarter according

From the Chairman

For all the focus on worthy long shots at BIS and the Cabinet Office the major impact of employee share ownership will come from the commitment of major companies. The new Employee Ownership Index provides proof positive that plans are working. This should further encourage major companies to sing loudly in their annual reports about what they have done for all employees, mainly with taxpayer blessing. It is an honour for the Centre to publish the threepercentplus Index. It is the start of an important démarche.

Malcolm Hurlston CBE

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to FTSE's methodology to maintain parity. Equal weighting ensures the performance of big companies doesn't swamp the performance of small companies, as they do in most published indices.

Nigel Mason of Capital Strategies, which developed the original index in 1995 and now works with FTSE to maintain the new indices, said: "We welcome the involvement of FTSE International. It brings independence and impartiality to the process. We hope this will encourage investors to begin to look at companies with significant employee share ownership as an asset class worthy of consideration."

FTSE's involvement follows a commitment made last year by Xavier Rolet, ceo of London Stock Exchange Group plc, who said: "A new FTSE Employee Share Ownership Index will highlight some of the key benefits of encouraging employees to take an active interest in the future success of the companies in which they work. This new FTSE index will help raise awareness of how significant employee equity ownership can be advantageous for both companies and employees."

Centre chairman Malcolm Hurlston CBE welcomed publication of the new UK EOI index. He said: "Despite valiant former efforts we have been lacking an independent and reliable index which can play a credible role in proving what we all know about the overperformance of companies whose employees own significant amounts of stock. The '3%+' index is especially welcome because it is far more relevant to the reality of employee share ownership in the UK and for the first time includes enough companies to be continuously credible. I congratulate Nigel Mason on his hard work and Xavier Rolat for coming good on his commitment."

Changes to the constituents of the new indices are made quarterly only on official FTSE review dates. The benchmark index is now the total return version of the FTSE All-Share excluding investment trusts. The old benchmark was the capital only version including investment trusts.

*The UK Employee Ownership Index is a trademark of Capital Strategies Ltd. For info about the UK Employee Ownership Index go to: www.employeeownershipindex.co.uk
For additional information, please contact nigel.mason@capitalstrategies.co.uk

Royal Mail's giant Eso launched

Royal Mail will list on the London Stock Exchange this month, probably on October 11, valued at around £3.3bn, after the astonishing success of the pre-floatation offer.

Investors, especially City institutions, piled into the restricted 'book-building' share offer and over-subscribed it within hours of the prospectus being issued.

This created the intriguing prospect of up to 100,000 postal workers defying union opposition and accepting their free shares – already worth at least £2000 per head.

In addition, those postal workers who want to *buy* additional shares for themselves are being given priority in the queue, provided they stump up a minimum £500.

Centre chairman Malcolm Hurlston CBE and leader of the trade union bank project urged them to do exactly that. He said: "Irrespective of the merits of privatisation and the well grounded views of their union, I encourage postal workers to accept the free shares and to buy whatever they can afford of the concessionary shares, then make the company a principled success.

"When they've got the shares it will make sense to pool the voting rights through CWU or through a trust, which the Centre is planning for the purpose. That way they can benefit from the wages of capital and have a clear voice in the future."

Members of the public, on the other hand, face the risk of not getting all the shares for which they bid.

BBC business editor Robert Peston said that the privatisation should be completed by October 15, before a possible strike by postal employees, who have begun voting on whether to take industrial action to oppose the plan.

The government reiterated that ten percent of the shares, which will be priced between 260p and 330p, were being offered free of charge to around 150,000 eligible UK-based Royal Mail employees. Thus postal workers collectively were being offered up to £330m worth of free shares.

Between 40.1 and 52.2 percent of the Royal Mail equity will be sold under its privatisation proposal (excluding over-allotment provisions, which depend upon demand for the shares), the Department for Business, Innovation & Skills (BIS) announced.

Members of the public can apply for Royal Mail shares online at www.gov.uk/royalmailshares until October 8, unless the government closes the offer before then. The minimum application for the public wishing to purchase shares is £750, and £500 for eligible Royal Mail employees.

Book building of the stock, organised by Goldman Sachs and UBS, was expected to close on the 8th too, if not before. Up to 70 percent of the Royal Mail equity on offer was expected to be gobbled up by institutional investors.

Mr Peston said that this was a "very big moment" in the history of the 500-year-old postal service, describing the government's programme as ambitious. "Remember that industrial relations are pretty terrible at the moment, and the government's timetable for this means it is now impossible for there to be a strike before the privatisation is done. It will be in the private sector before there can be a strike." Business minister Michael Fallon told the BBC that the six-days-a-week universal service was "completely protected," but private investment would help the Royal Mail improve that service.

Centre member **Equiniti** is setting up the £300m postal workers' share scheme, which will take the form of a Share Incentive Plan.

The company will pay a dividend of £133m next year to cover the rest of the current 2013-4 financial year. This would be worth £200m in a full year and is intended to further incentivise investors. The impressive income yield therefore is likely to be in the range of 6.1 to 7.7 percent.

However, the Communication Workers Union (CWU) is balloting 100,000 of its members on a nationwide strike over the privatisation, as well as on changes to salary and pensions. The CWU sent a statement to its members: "Those who want to sell off the Royal Mail Group are motivated purely by short-term gain and vested interests." Voting in the strike ballot will close on October 16.

In addition, the threat of a late November High Court case against Royal Mail emerged after TNT Post UK claimed that RM's 20 percent VAT exemption on all bulk mail contracts would be unfair and illegal, post privatisation. TNT Post UK believes that the VAT exemption should be removed for all Royal Mail activities except stamp and letter services, which are part of the six-days-a-week universal service obligation.

Business minister Michael Fallon said that strike action would be "completely unnecessary" and that the government was going ahead with the privatisation anyway.

Record bookings for Centre Awards dinner.

A record attendance at the Esop Awards reception and dinner is now guaranteed – 125 tickets have been sold to date and only 15 remain, so book now to avoid disappointment.

The Centre thanks member **Ogier Corporate Services**, which is a supporting sponsor of this prestigious event. *Ogier's corporate services division, headed by Philip Norman, provides onshore and offshore director, corporate administration, secretarial, bookkeeping and accounting services to diverse corporate and institutionally owned multi-jurisdictional structures consisting of companies, limited partnerships, unit trusts and other vehicles.*

Centre chairman **Malcolm Hurlston CBE** will address the diners and then international director **Fred Hackworth** will announce the names of the winners and runners-up for the main categories of awards this year, namely:

Best International Share Ownership Plan (more than 1,500 employees)

The finalists for this year's main award are: **ARM Holdings**, nominated by **YBS Share Plans**; **Edwards Group**, nominated by **Equiniti**, and **Rio Tinto**, nominated by **Computershare**.

Best Employee Share Ownership Plan (fewer than 1,500 employees)

This year two entries have been selected as finalists in this category: **ASOS**, nominated by **Capita,** and **IGas**, nominated by **Equiniti**.

Best all-employee share plan communications:

There are three finalists: **Morrisons**, nominated by **YBS Share Plans**; self nominated **Pearson**, and **Telefonica**, nominated by **Global Shares**.

The judges, Francis O'Mahoney of BT and Kevin Lim of Solium, have already met. The panel was chaired by the Centre chairman (who opines only on communications). As a result there are three winner and two high commendations.

In addition this year there will be two individual awards: **Esop Institute student of the year award**: chosen by the Registrar and the Chief Examiner after the July 31 exams and **Share plan personality of the year award.** Newcastle United FC owner **Mike Ashley,** majority shareholder in **Sports Direct** (*see news story further down*) is a nominee for this award, as are **John Whiting,** former tax director at the Office of Tax Simplification and now tax guru (non-executive director) at HMRC and Business Secretary **Vince Cable MP** for overseeing the Royal Mail employee share scheme

Ticket prices for members at this key event in the Centre's calendar are: £160 per seat and £1,500 + VAT for tables of ten. Please contact Juliet Wigzell jwigzell@esopcentre.com Tel: + 44 20 7239 4971 if you are thinking of booking either a convivial table or individual seats.

Despite the near sell-out there are still some sponsorship opportunities *for this year's dinner: download the sponsorship brochure from http://tinyurl.com/lzh6xnj*

New bank attracts Eso service providers

The enforced impending hive-off of 314 RBS bank branches to form a new bank, based in Manchester, is set to attract major interest from employee share scheme providers. The new bank, to be floated on the stock market in 2015, will fly the flag of the old Williams & Glyn brand, not seen for 30 years.

RBS will create the new bank after accepting an £800m investment bid from a consortium, led by private equity firm Corsair Capital, which includes the Church Commissioners and Lord Jacob Rothschild's RIT Capital Partners. The new bank will serve initially 1.7m customers and will hold five percent of the SME business lending market, especially in the north west of England. Its ceo will be John Maltby, former Lloyds commercial banking

chief and chairman Philip Green, ex ceo of United Utilities.
The disposal of so many branches was forced on RBS by the European Commission as a key condition of the bank's £45bn bailout by UK taxpayers in October 2008. Williams & Glyn was the first UK bank to introduce, back in 1974, the free bank account for those customers who remained in credit.

Treasury challenges new EU bonuses rules

The government lodged a legal challenge with the European Court of Justice (ECJ) over new EU rules on reward in the banking sector, which the UK fears will undermine responsibility in the banking system, rather than promote it. These new rules – most notably bonus caps - are contained within the EU's latest legislation governing the amount and types of capital that banks must hold - the Capital Requirements Directive IV (CRD4).
The Treasury said "In the government's view, the EU's latest legislation in this area should be about building on all this work to make banks safer and their pay policies more acceptable. However, the provision for a 'bonus cap' under CRD4 - which was introduced without any assessment of its impact or supporting evidence - will undermine the significant progress that has been made to implement pay practices that support financial stability. Britain is therefore launching a legal challenge as we think that the legislation, as currently drafted, is not fit for purpose - to improve stability across the banking system. The proposals will lead to an increase in fixed salaries, which would do the opposite."
The UK has been at the forefront of global efforts to tackle unacceptable pay practices in the banking sector, leading efforts to make banking more responsible and installing some of the toughest remuneration rules of any major financial centre, it claimed. "Tough and rapid action has seen real improvements in the alignment of bankers' pay with risk and performance, and a significant shift in the way bankers are paid. This has lead to a substantial reduction in upfront cash bonuses, which can encourage short-term risk taking," said the Treasury. "The Centre for Economic and Business Research estimated that City bonuses in 2012/13 were more than 60 percent lower than 2011/12, at £1.6bn - and 85 percent lower than the £11.5bn estimated to have been paid in 2007/08."
The government's challenge covers legal issues regarding the compatibility of the bonus cap provisions with the EU Treaty and the powers delegated to the European Banking Authority which HMG believes go well beyond its remit of setting technical standards. The Treasury will seek clarity from the ECJ on these points. However, given its obligations under European law, Britain will still be implementing the remuneration provisions in CRD4 pro tem.
A Treasury spokesman said: "The UK has been at the forefront of global reforms to make banking more responsible, including big reductions in upfront cash bonuses and linking rewards to long-term success. These latest EU rules on bonuses, rushed through without any assessment of their impact, will undermine all of this by pushing bankers' fixed pay up rather than down, which will make banks themselves riskier rather than safer."
This is already happening, according to the **British Bankers' Association (BBA)** response to the European Banking Authority's (EBA) draft regulatory standards on the indentification of material risk takers: "The EBA's proposals further exacerbate the move to fixed pay and will have a global effect. A behavioural response of banks to the EBA proposal will be for institutions to increase the level of an individual's fixed pay. This has already happened. The more widely the net is drawn the greater the number of people likely to benefit from an increase in base pay and consequently the greater will be the incremental fixed cost of the institution. We fear that this will have wider salary inflationary impacts, not just in the EU, because of the extra-territorial nature of the CRDIV remuneration requirements. As EU banks pay a higher proportion of total compensation by way of fixed remuneration so their competitor banks in third countries will be forced to do the same in order to attract world- class talent that is highly mobile. This would be a poor outcome," added the BBA.

Centre to urge top companies to report their all-employee share schemes

The Centre has prepared a report urging the UK's top public companies to take employee share ownership far more seriously than they normally do in their annual reports to shareholders. For only 18 among the FTSE 100 index of top companies bother to report up front on progress achieved in their broad-based Eso schemes – unless as an after-thought in the annual accounts.
Although at least 80 of the current FTSE 100 companies have an all-employee share scheme of one kind or another, they are poorly reported and are usually ignored in corporate responsibility reports, said former UK Centre director David Poole, now a research fellow of the Esop Institute.
David researched: what type of all-employee schemes each FTSE 100 company reports and how they report it; whether they use equity remuneration for execs, and whether they report the use of their all-employee Eso schemes in their corporate responsibility reports.
The preliminary findings, currently subject to peer

review, are that 80 FTSE 100 companies have all-employee schemes but they are inadequately reported. Only few report it as a source of pride in chairman's introduction or in the narrative of the reporting section. Either share scheme people have been modest or the CR experts have been asleep on the job.
Mr Poole said: "The vast majority of Eso schemes are reported only in the remuneration report, where it is tainted by association, or in the accounts. Ninety-one of the 100 use some form of equity reward for executives but only 18 companies included sections about employee share ownership in their corporate responsibility reports."
The Centre will be discussing the findings with the government, the CBI and reporting bodies to encourage quoted companies to include clear information each year about their all-employee schemes each year in ethical/CR audits. Centre chairman Malcolm Hurlston said: "Employee share ownership is an important factor in employer-employee relations. Responsible corporations surely want to parade their Eso involvement before shareholders and other stakeholders. We will press for an annual 'Eso audit' to become obligatory in the main narrative of annual reports and CR reports. Eso needs a higher profile within FTSE 100 companies."

BIS publishes employee ownership templates
Senior Centre member David Pett's Employee Share Trust (EST) template has been published by the Government's Business, Innovation & Skills department. The EST includes a model trust deed and other documents, and can be found at:
http://tinyurl.com/ozf7gfp This is part of the government's drive to improve and simplify access to broad-based employee share ownership for smaller companies.
An introduction to the main tax issues connected with the EST is at:
www.hmrc.gov.uk/shareschemes/est-intro.pdf
HMRC's gloss on this is at:
www.hmrc.gov.uk/shareschemes/ee-ownership.htm

Worldwide ESPP participation in recent decline
In a survey of 350 multinational companies in a variety of countries (the 2012 Global Equity Incentives Survey), Centre member **PricewaterhouseCoopers** and the National Association of Stock Plan Professionals (NASPP) found that in Employee Stock Purchase Plans (ESPP), there has been "A steady decline in global participation from 2007-2012. In particular, the majority of companies that previously reported employee participation rates of 26-50 percent now have 0-25 percent of eligible employees participating in their ESPPs. Of those companies that have historically offered an ESPP, in the past year a large majority - 82 percent - continued to offer the plan. However, nine percent of companies chose to eliminate it in the past year, while 38 percent have eliminated their ESPP in the past 2-3 years."

Pay rises stay low
The going rate for pay awards continues to be just two percent, despite better news on the economy, according to research from XpertHR based on pay deals covering almost one in four of the UK workforce (7.3m employees). This is 1.3 percentage points below inflation as measured by the Retail Price Index (RPI) in August. XpertHR looked at pay awards over the 12 months to the end of August 2013, finding that the median pay increase over that period was just two percent, compared to 2.3 percent during the previous 12-month period. Key findings - based on 945 basic pay awards from a total sample of 1,231 deals - include the following:

- Private sector pay awards were worth a median two percent compared to one percent in the public sector. Over the same period a year ago, private sector deals were worth 2.5 percent while the median pay award in the public sector was a pay freeze.
- Wage freezes are finally playing a lesser role. So far in 2013, zero awards have made up 11 percent of all pay awards, compared with 18 percent in 2012 and 38 percent back in 2009.
- Manufacturing deals have been consistently higher than those in the services sector over the year, worth 2.3 percent over the 12 months to August 2013 compared to two percent in services.

Real Time Information (RTI)
The number of PAYE schemes registered for RTI has reached 1.6 million, 200,000 of which are using HMRC's free basic PAYE Tools to make their submissions. More than 10m RTI submissions have been made to date. This month, the Department of Work and Pensions will start the national roll-out of Universal Credit, which depends on the monthly RTI information for its success. Electronic notifications will be sent out to employers to warn them about possible late filings and late payments. HMRC will be launching PAYE Online in April 2014, to enable employees to update a range of benefit information online, and to keep tax codes correct and up-to-date

MyCSP
The Government's first mutual joint venture MyCSP, which administers pensions for 1.5m civil service employees, has the potential to be good value for money with a projected saving of 25 per cent on costs after seven years, said a report published by the National Audit Office (NAO). However, the complexity of the deal combined with poor quality of

data, initial planning, and infrastructure meant that it took the Cabinet Office longer than intended to finalise the transaction. "The Cabinet Office's early planning of the deal suffered from poor governance; and the original transaction timetable and financial model were over optimistic. Furthermore, the Department and MyCSP still face many large challenges in transforming the service. The biggest challenge is improving data to support the implementation of the new 2015 pension scheme," said the NAO report. The Department believes that MyCSP will reduce the cost of administration by 25 per cent, to £13 per member per year by 2019. Scheme members should receive a better quality of service as a result of significant investment in the business by the private sector partner, **Equiniti** Paymaster, and a payment mechanism that penalises MyCSP if it misses the service standard levels in the contract. MyCSP is 25 percent owned by its employees – almost all of whom are former civil servants. The report said that the Department did not initially make the most of the opportunities to learn from this transaction as a pathfinder, but has now reviewed the lessons learned from executing the transaction and has put in place an evaluation strategy. It told the Cabinet Office that it must ensure it evaluates the longer-term comparative performance of MyCSP and captures and disseminates the lessons learnt from the deal. Amyas Morse, head of the NAO, said: "We recognize there is significant potential value in the MyCSP deal for the Cabinet Office and for scheme members. But, given the challenges and the imminent pension changes in 2015, government will have to remain actively engaged as customer, shareholder and supplier to capture the full benefits of this deal and to ensure the risks do not revert back to government."

Could do better

There is still much to do if government is to make all-employee share schemes as popular as they used to be, said MM&K's executive compensation director **Mike Landon,** writing in the October issue of the well respected journal *Benefits & Compensation International.* Although Mike praised the Office of Tax Simplification (OTS) review of tax-advantaged share schemes for the important reforms it proposed within just six months of its formation, he hoped that it would be followed up by further initiatives to simplify the legislation even further. Notably, he suggested: Removing uncertainties as to whether employee equity plans did or did not qualify for tax relief; Reducing the number of conditions for qualifying for tax relief in SAYE-Sharesave and in the SIP; Increasing plan investment limits in line with price inflation; Reducing the time limit for SIP shares to vest from five to three years; Extending the tax benefits of CSOP to other types of conditional share awards and make it easier to transfer employee shares into ISAs and pension plans. Mike represented the Esop centre on the OTS consultative committee. Here is the link in order to access the full content, which is a very useful technical summary of all the OTS recommended approved share scheme plan changes that have been actioned by the government to date:
www.mm-k.com/content/documents/BandC_Landon.pdf

HMRC victory over tax avoidance schemes

A useful and comprehensive summary of the share scheme changes encapsulated in the Finance Act 2013 can be read in the recent bulletin of Pett, Franklin & Co. LLP See: http://tinyurl.com/pw6p73m

Highlights include: the entrepreneurs' ten percent CGT relief when selling EMI option shares on or after April 6 this year; introduction on or after July 17 this year of a general anti tax abuse rule (GAAR); the ending of the specific retirement age rule for favourable tax treatment of participant exits from approved share schemes and ditto re early withdrawal of SIP shares, or early sale of SAYE options post a cash based company takeover.

Later in the bulletin, partner **David Pett** discussed the apparent breakthrough achieved by HMRC in the war against allegedly artificial tax avoidance schemes: *Tower Radio Ltd and Total Property Support Services Ltd vs HMRC : striking out on the basis of the 'Ramsay' principle.* "This First-tier Tribunal decision (in a lead case heard under 'Rule 18 Direction' – i.e. there are many other cases under formal challenge by HMRC to which this decision will apply) is perhaps the first example of a situation in which HMRC has succeeded in arguing that an artificial tax avoidance scheme based on the award of (restricted) forfeitable shares in a specially-formed company (SPV) should be wholly ignored on the basis of the Ramsay principle," said David.

In the UBS/Deutsche Bank cases – the subject of appeals to the Court of Appeal and in which the schemes adopted were very broadly analogous - the Upper Tribunal upheld the employers' contentions that, insofar as the admittedly tax avoidance schemes had been properly executed (which, in the case of UBS, it was), the acquisition of forfeitable shares, and their subsequent release from forfeiture in circumstances specifically provided for in Part 7 ITEPA 2003, fell to be exempt from charges to income tax by reason of Part 7 and because the Ramsay principle did not apply.

Here, the Tribunal determined that, on the facts, the scheme – involving the acquisition, by the employee/ directors who controlled the employer companies, of valuable shares in an SPV which each employee transferor later wound up – could be struck down on the basis that it was a composite transaction consisting of a series of steps that began with the decision to use what was a marketed (and disclosed) tax avoidance scheme, and ended with the receipt of the liquidation distributions by the employee. By contrast with the Aberdeen Asset Management case (2012), the composite transaction did not in this case end with the transfer of shares to the employees: it ended with the receipt of cash on liquidation of the SPVs. Although the Tribunal accepted that the shares acquired were 'forfeitable' shares (per s423 ITEPA 2003), this was not relevant as the entire scheme, of which the acquisition of those shares formed part, could be ignored. The employees concerned were properly to be treated as being in receipt of cash subject to income tax and NICs under PAYE. The Tribunal found it "inconceivable" that Part 7, applied purposively, was intended to apply to the realistic view of the transaction.

The decision of the Upper Tier Tribunal in the UBS case was distinguished on the grounds that, here, there was a close identity between the employers and their respective employees; it was the employees' decision to implement the scheme proposed by accountants; and the only aim was to extract surplus cash from the employer company (there was, for example, no element of ongoing incentive to the employees). The use of shares in an SPV was irrelevant to the employees: it was merely the mechanism advised by the accountants to be a tax-efficient manner of putting surplus cash into the hands of the employees. The only rationale for the SPV was to put cash in, and then strip it out again as soon as possible thereafter. The decision of the Court of Appeal in the PA Holdings case (2012) – which is now final – was distinguished on the basis that the point in that case was whether dividends paid on the SPV shares were remuneration: the taxpayer there accepted that the award of the shares was remuneration (albeit tax exempt). Here, the contention was whether the award of the shares was a money bonus. "The approach of the Tribunal is neatly summarised in the following passage: 'In UBS, the Upper Tribunal on the facts in that case, considered it needed to respect the existence of the restricted securities and thus apply Part 7 to them. That cannot be a general approach to be applied regardless of the facts of the individual case before the Tribunal – otherwise any planning device, even the most unacceptable and artificial that happened to include employee-related securities would be immune from the Ramsay approach, which is clearly not the case," added Mr Pett.

Clawback

Two former senior executives of Imtech, the struggling Dutch infrastructure company, have agreed to return the total €2.2m in bonuses they received in 2010 and 2011, the *Financial Times* reported.

On the move…

Sarai Verges has just been appointed marketing & communications manager, based in Barcelona, for Centre member **GlobalSharePlans**

Former Clifford Chance share schemes practitioner **Daniel Hepburn** has joined the employee reward team at Centre member **PwC.** "On a day to day basis, I am continuing to provide advice to companies on the full range of employee share schemes issues but in a wider reward team which gives a valuable extra perspective," said Daniel. His email address is: daniel.c.hepburn@uk.pwc.com and phones: +44 (0) 20 7804 9283 mobile +44 (0) 7808 035860

Andrea Hasell has left **Sainsbury's** and is working as a freelance share plans manager taking on short-term contracts (Andrea is helping Equiniti with the Royal Mail clinics), in between lots of travelling. Her email address is: andrea@honoratassociates.com

Stop Press: **Global Shares (Ireland)** has rejoined the Esop Centre. More in the next issue of *newspad.*

An overview of laws regarding FP for 23 countries is available on the website of Paris based **International Association for Financial Participation** (IAFP), courtesy of White & Case. A single click on: http://aipf-association.fr/fr/node/13 is required.

Lifting the carpet….

New regulations are this month in force requiring quoted companies with shares trading on recognised major stock exchanges – although not alternative markets – to include more precise information in their annual directors' remuneration report.

Business Secretary Vince Cable has handed shareholders the power to throw out executive remuneration policies that are too generous and force companies to simplify the data they provide about what they pay top bosses. Mr Cable has given shareholders a binding vote on company pay policies once every three years and an advisory vote every year. He is demanding companies publish a single figure for bosses' pay annually, rather than the wide range of numbers currently provided, which often require expert knowledge to add up.

Since 2002, quoted companies have had to include a directors' remuneration report in their annual accounts, but these have become so complicated that the original purpose for including such information seems to have been lost. Different figures given in reports for different elements of executive remuneration have made it almost impossible for shareholders to learn how much exactly executives were being paid. It is the display of that information in a clearer format that the regulations are striving for, said *Financial Director.*

These regulations aim to simplify these reports, making it easier for shareholders to see what is being paid. In particular, after last year's 'shareholder spring', there is an emphasis on having to show that directors are being paid for good performance of the company (which is in line with shareholders' interests), rather than being paid for failure, as was (and maybe still is) the perception, by the media at least, for certain companies. There is nothing to stop AIM-listed companies from complying voluntarily with the new requirements, perhaps in an attempt to keep institutional investors onside or possibly to attract new investors. There is equally the possibility that these regulations may be extended to AIM-listed companies at a later date.

One of the most fundamental changes is the requirement to include a single figure of remuneration for each director, including base salary, fees, bonuses, any benefits-in-kind, all share incentives and pension contributions. The complexity of share awards alone means this will probably take substantial time and resources to work out. Another important addition is the obligation to include a summary table of the company's remuneration policy. This table must show each element of the remuneration; how each element supports the short-term and long-term strategic objectives of the business; how it is put into practice and any details as to how it is affected by performance. The regulations refer to the need to include detail about the company's policies on recruitment and on payments for loss of office. Linked to the remuneration policy summary table is the requirement to include scenario graphs showing how the components of remuneration would pay out in different situations. This is one area where many quoted companies (about 40 percent of the FTSE 100) have complied already, showing bar charts in their reports which clearly display how much a director would receive following theoretical results.

There are other new disclosures that will need to be made which focus on: communication with shareholders to ensure their needs are taken into account; communication with employees across the wider group; and ensuring that the remuneration policy for executives is not so wildly inconsistent with other employees. Rather than making sure shareholders are appropriately informed, these disclosures focus more on ensuring that stakeholders – other than the directors themselves – have their views heard.

These regulations will apply to periods beginning on or after the first of this month. This means that companies with a financial year end of September 30 will be the first to comply with the new regulations. This will have a big impact on preparing the remuneration report, and a close dialogue with remuneration advisers is crucial to understanding what the new regulations mean for each company and how they can best be complied with. It is important that directors begin this process sooner rather than later.

The new Directors' Remuneration Reporting Regulations will require quoted companies to make new disclosures in their remuneration reports, including:

*a single figure of remuneration for each director (both executive and non-executive);

*a table summarising the company's remuneration policy

*scenario charts showing possible pay-outs in various situations;

*a graph of ceo pay against shareholder return over the past five years;

*fees paid to remuneration advisers;

*measures taken to consider employees' pay across the wider group; and

*measures taken to ensure that a proper consultation process has been carried out with both shareholders and employees.

Shares For Rights rules published

The Labour Party pledged that it would scrap the 'Shares For Rights' legislation, which came into force last month, should it win the 2015 General Election. The pledge, made by Shadow Chancellor Ed Balls, is significant as the UK's archaic parliamentary constituency boundaries (Isle of Wight 111,000 electors and just one MP – whereas seven constituencies, all in Scotland and Wales, have electorates of under 50,000) give the Tories a mountain to climb, if they are to retain power. Mr Balls claimed that the main beneficiaries of Shares For Rights would be executives of smaller companies who would be tempted to use it in order to reduce their tax bills. This new threat to Chancellor George Osborne's Employee Shareholder legislation will make even more businesses think again before implementing the scheme.

Shares For Rights has attracted few takers to date, though anecdotal reports suggest that some SMEs, which are backed by private equity, are interested. Under the new regime, employee shareholders will receive £2,000 or more of shares in the business (of which the first £50,000 will be exempt from Capital Gains Tax on any increases in value, and the first £2,000 exempt from Income Tax and NICs at allocation) in exchange for forfeiting certain employment protection rights (primarily the right to claim unfair dismissal, except where the dismissal is automatically unfair or discriminatory and the right to a statutory redundancy payment).

Meanwhile, HMRC reminded businesses wishing to award shares under an employee shareholder agreement that they:

- do not require approval from HMRC before making the award; and

- may propose a share valuation to HMRC's Shares and Assets Valuation team in advance of the award. Where possible, HMRC will agree this valuation for tax purposes, and this agreement will be effective for 60 days. Businesses wishing to propose a share valuation to HMRC should follow the guidance available at http://tinyurl.com/ole2qv2

Any business or adviser interested in finding out more about the new employment status should see www.gov.uk/employee-shareholders. Detailed guidance on the tax treatment of employee shareholder status is at: www.hmrc.gov.uk/employeeshareholder/index.htm . Other sites which carry set-up info on 'employee shareholders' include: the Department for Business, Innovation & Skills (BIS) www.gov.uk/employee-shareholders and Pinsent Masons: http://tinyurl.com/nfs6682

Accounting issues for share schemes

The reluctance of the International Accounting Standards Board (IASB) to engage with the practical problems of Share Based Payment (IFRS2) accounting is well known, said **William Franklin,** a chartered accountant and partner at Centre member **Pett, Franklin & Co. LLP.** However, in June it was announced that they anticipated issuing, by the end of this year, amendments to IFRS2 which will be primarily concerned with the definitions of vesting and performance conditions. In particular, the IASB confirmed that a performance period could begin before the period of service by an employee. Last May, the Interpretations Subcommittee acknowledged that there were divergent treatments of inter group recharges for share-based payments but decided not to do anything about it. However, in another area in which they recognised that there was divergent accounting, they decided to undertake further study: currently IFRS2 gives no guidance as to whether a transaction is an equity-settled share-based payment or a cash-settled share-based payment if the manner of settlement is contingent on a future event which is outside the control of both the company and the employees. As a result, companies can adopt fundamentally different accounting for similar transactions. In addition, the IASB discussed share based payment accounting in the context of its comprehensive review of the International Financial Reporting Standard for SMEs and re-confirmed the requirement for such companies to use option pricing theory mathematics to determine the accounting expense for options. This is in marked contrast to the UK's own Accounting Standards Board, which has been undertaking a consultation exercise to consider whether to abolish completely the requirement for an accounting expense for options granted by unquoted SMEs.

CONFERENCES

GUERNSEY: October 11

There is still time for trustees to register for delegate places at this year's annual Esop Centre/STEP (Society of Trust & Estate Practitioners) Guernsey seminar, which will take place on **Friday morning October 11** at the St. Pierre Park Hotel, St. Peter Port. Expert speakers will cover a range of topics, tailored towards an audience comprising mainly trust practitioners. The programme for this extended half-day event, with lunch included, is as follows:

Welcome and introduction: **Malcolm Hurlston CBE**, chairman, **Esop Centre**

Employee shareholder contracts: **Graham Muir**, **Nabarro LLP**

Review of unapproved share schemes**: Jonathan Fletcher Rogers**, **Abbiss Cadres**

Trust law update: **Alison MacKrill, Carey Olsen/ STEP Guernsey**

The positive outcomes for those seeking an exit from EBTs: **Paul Malin, Haines Watts**

The role of Eso in macro-economics: **David Craddock**, David Craddock Consultancy Services.

Ensure that you can brief clients with the latest developments in these areas by attending this **CPD-accredited** course. **Attendance prices**: £295 for Centre/STEP members; £425 for non-members. To make a reservation, email esop@esopcentre.com - giving your delegate names and contact details. A member of the Centre team will then respond.

DAVOS: Feb 6 & 7

Registrations are building up for the Centre's 15th annual global employee equity schemes conference, which takes place in the five-star Steigenberger Belvedere Hotel, Davos Platz, Switzerland, on **Thursday, February 6 and Friday, February 7 2014.** The Centre's e-brochure, which gives the preliminary programme**,** is downloadable from: www.esopcentre.com/events/upcoming/

The agenda will include the following topics:

- *The reconstruction of executive incentives: Institutional investors, media reaction, benchmarks and remuneration committees*
- *Risk as a Component in Executive Incentive Plans*
- *Latest legislation and regulatory developments impacting global employee equity*
- *Case studies on recent global and international broad-based employee equity plans*
- *Cross-border equity award taxation issues for mobile employees and their employers*
- *Corporate governance issues in US and EU employee equity plans*

- *Employee share ownership developments in Europe*
- *Trustee panel examines the latest issues*
- *Communicating equity plans to employees in the recession*

The confirmed speakers in Davos are:
Alasdair Friend & Narendra Acharya of **Baker & McKenzie LLP**
Justin Cooper of **Capita Registrars**
Fred Whittlesey of **Compensation Venture Group**
Martin Sheridan & Martyn Drake of **Computershare**
Mike Pewton of **GlobalSharePlans**
Martin Osborne-Shaw of **Killik Employee Services**
Mike Landon of **MM & K**
David Pett of **Pett, Franklin & Co. LLP**
Andrew Cooper of **RBC Wealth Management**
Kevin Lim of **Solium Capital (UK)**
Alan Judes of **Strategic Remuneration**
Peter Mossop of **Sanne Group**
The 2014 conference e-brochure is sponsored by Centre practitioner members **Bedell Group** and **Appleby Global**.
***Appleby** is one of the world's largest providers of offshore legal, fiduciary and administration services. With over 770 lawyers and professional specialists across the Group, operating from 12 offices around the globe. Appleby advises global public and private companies, financial institutions, and high net worth individuals, working with them and their advisers to achieve practical solutions, whether in a single location or across multiple jurisdictions. View the website at :www.applebyglobal.com_and contact: Patrick Jones, partner, Appleby Trust (Jersey) Ltd. Tel: +44 (0) 1534 818390.*
***Bedell** is a leading provider of legal and fiduciary services with more than 300 partners and staff in key financial centres including Jersey, Guernsey, London, Dublin, Geneva, Mauritius, BVI and Singapore. Its offshore law firm, Bedell Cristin, was founded in 1939 and offers comprehensive Channel Islands, Mauritian and BVI legal advice. Its trust company, Bedell Trust, has been providing fiduciary and administration services both offshore and onshore since 1971. Experience and commitment to excellence have earned Bedell a strong client list of world class institutions, corporates, high net worth individuals and intermediaries. Contact: Grant Barbour, Partner, Bedell Group +44 (0) 1534 814627 grant.barbour@bedellgroup.com*
Only two speaker slots remain to be filled. Member service providers can save almost £200 on their package deal admission fee if they opt to fill one of the remaining speaking slots. Plan issuers can make a saving too, if they commit to a speaker presentation based on an in-house international employee equity scheme, which either they have launched, or will be launching shortly. Inform us asap if you have a topic on which you or a colleague would like to speak.
Attendance Fees: The Davos package deal comprises: two nights accommodation in the Steigenberger Belvedere Hotel (on half-board, single occupancy, basis Feb 5 & 6) + entrance to all conference sessions + cocktail party (partners welcome) + coffee break refreshments & bound delegates' handbook: **Speakers -** Centre member practitioners **£955;** Eso plan issuer speakers **£695**. **Delegates** – Centre member practitioners **£1150** for the package deal and non-members pay **£1,495**. Plan issuer delegates pay **£765** for the same package deal. There is no sales tax payable on attendance fees.
This event is CPD accredited and is worth 11 hours. These fee levels are well below those applying in commercially run conference operations, so why pay more elsewhere? Email your Davos delegate registrations now to fhackworth@esopcentre.com with copy to esop@esopcentre.com

UK productivity falling…
Output per hour in the UK was 16 percentage points below the average for the rest of the major industrialised economies in 2012, the widest productivity gap since 1994, reported the Office For National Statistics. *On an output per worker basis, UK productivity was 19 percentage points below the average for the rest of the G7 in 2012. *UK output per hour and output per worker fell in 2012 compared with 2011. By contrast, these measures both increased in 2012 on average across the rest of the G7. *In 2012 UK output per hour was two percentage points below its level in the pre-recession year of 2007, and 15 percentage points below the counterfactual level had productivity grown at its average rate before the recession. *This compares with a productivity gap in 2012 of around five percentage points for the rest of the G7.

Jersey no haven
Prime Minister David Cameron has told the House of Commons that he does not think it is fair to refer to Jersey as a tax haven. The PM's comments followed the progress made on tax transparency at the G8 and G20 summits and came just weeks after the publication in *Newspad* of a report highlighting Jersey's overall value to the UK economy, prepared by the leading independent firm Capital Economics, on behalf of Jersey Finance, with support from the States of Jersey. Mr Cameron specifically highlighted the positive steps taken by Jersey and the other Crown Dependencies and Overseas Territories on international tax matters and he told MPs that the

jurisdictions deserve support for the steps they have taken to promote transparency and fairness. Responding to questions about his statement on the G20 summit in St Petersburg, Mr Cameron said: “I do not think it is fair any longer to refer to any of the Overseas Territories or Crown Dependencies as tax havens. They have taken action to make sure that they have fair and open tax systems.” He added: “It is very important that our focus should now shift to those territories and countries that really are tax havens. The Crown Dependencies and Overseas Territories, which matter so much to the British people and members, have taken the necessary action and should get the backing for it.” The PM’s remarks follow the Centre’s strong advocacy of a British Isles approach to share schemes.

Irish tax rules inhibit Eso succession

Staff costs are a significant factor in any business and one way to help improve cash flow is to allow employees take a portion of their pay in the equity of their employer’s firm. This has the double benefit of reducing a firm’s monthly wage bill while turning the employee into a long-term business owner with all of the substantial benefits that brings with it – as detailed in the UK government-commissioned Nuttall Review. However, the Irish ProShare Association identified an unnecessary roadblock to this innovation being adopted. Under Irish tax laws an employee who takes a pay cut and gets a benefit in return remains liable to tax on the forgone amount. So, an employee who takes shares instead of cash gets taxed as if the shares were cash. This is the conundrum. An employee opts to take shares in his company to help his company and his job survive. But the tax authorities deem to this to be cash and he has to pay tax on this ‘cash’ immediately. The employee obviously has not got the cash so now cannot afford to take shares. Either way, he loses.

Directors’ pensions fest

The average directors’ accrued pension is now £260,000 a year — 25 times the average employee occupational pension of £10,452, claimed the TUC’s annual Pensions Watch survey. Pensions Watch 2013 examined the pension arrangements of 294 directors of FTSE 100 companies. This year’s survey shows that the UK’s top directors continue to enjoy platinum-plated pensions, with most able to retire at 60. Accrued pensions are the amount of pension payable to a director on retirement, based on their service so far. The survey shows that as more directors move away from having defined benefit (DB) schemes, employer contributions to their defined contribution (DC) pensions — as well as cash payments in lieu of pensions — have increased sharply. Average annual employer contributions to directors’ DC pensions increased in 12 months by £15,872 to £160,380 — though several directors received company contributions of more than £500,000. The most popular DC contribution rate towards a director’s pension is 25 percent of salary and 30 percent the next most common rate. The average contribution rate for all workplace pensions is just six percent and workers saving into the National Employment Saving Trust (NEST) under auto-enrolment will receive an employer contribution of just three percent.

Cash payments to directors in lieu of pension contributions have increased too. The average cash payment is now £173,217 a year, up £8,292 on last year. Several directors received cash payments of over half a million pounds, including HSBC chairman Douglas Flint who got £750,000. The average cash payment to directors was worth 29 percent of their salary. The TUC is concerned that cash payments and employer contribution rates to top bosses’ DC pensions are being ratcheted up in a similar way to their bonuses. For many directors’ pensions — and the remuneration committees that set them — a 30 percent contribution rate is becoming the new norm. This rate increase means that employer contributions, which already go up when directors’ salaries rise, are going up far quicker for directors than for ordinary staff. Two in five directors covered by Pensions Watch 2013 are still entitled to some DB pension entitlement. The average pension pot for directors is £4.73m. The TUC is concerned that, while pay and bonuses are now under much closer scrutiny, the complicated arrangements for reporting directors’ pensions make it hard for shareholders and the media to find out how much their pensions are worth. It wants to see greater clarity in the reporting of pensions, including the mandatory disclosure of accrual and contribution rates.

Bonus critics are like the ‘Ku Klux Klan’

AIG ceo Bob Benmosche unleashed a torrent of protest in the US when he compared the government’s campaign against partial bonuses to be paid to hundreds of employees in the AIG financial-products unit - as they unwound massive, ill-fated bets on mortgage bonds - as akin to ‘Ku Klux Klan lynch mobs hunting black people in the Deep South. He said “less than 10” employees were behind the bad trades, but the rest fully deserved their bonuses. “That was ignorance … of the public at large, the government and other constituencies. I’ll tell you why. [Critics referred] to bonuses as above and beyond [basic compensation]. In financial markets that’s not the case. … It is core compensation,” said Mr Benmosche. “Now you have these bright young people [in the financial-products unit] who had nothing to do with [the bad bets that hurt the

company.] … They understand the derivatives very well; they understand the complexity. … They're all scared. They [had made] good livings. They probably lived beyond their means. …They aren't going to stay there for nothing.
"The uproar over bonuses "was intended to stir public anger, to get everybody out there with their pitch forks and their hangman nooses, and all that– sort of like what we did in the Deep South [decades ago]. And I think it was just as bad and just as wrong.
"We wouldn't be here today had they not stayed and accepted … dramatically reduced pay. They really contributed an enormous amount [to AIG's survival] and proved to the world they are good people. It is a shame we put them through that."
The US taxpayer had to hand over billions of dollars at the insistence of the Federal government to save AIG from bankruptcy during the 2008 financial crisis. The analogy Benmosche was making was: *Shaming employees of an endangered firm for keeping bonuses is "just as wrong" as the Ku Klux Klan hunting down and killing people in the Deep South in the 1960s.*

Bonus Corner

For the second year running, **Lenovo** chairman and ceo Yang Yuanqing handed over three-quarters of his bonus to hourly paid employees in China. The boss of the personal computer company was paid US$14.6m last year and owns seven percent of the company. Yuanqing gave US$3.15m of his annual bonus to 10,000 employees, who will each receive about $325, about a month's average wages in China. Last April, Yang's gesture was replicated in the UK by **Next** ceo, Lord Wolfson, who went one better by giving his entire £2.34m bonus to Next's 20,000 employees. The company said that no other UK ceo had ever done this before.
Critics of high pay in the boardroom cited the leaving compensation package granted to former **Diageo** ceo**,** Paul Walsh. He led the spirits and beer giant for more than a decade and left this year with £14.8m — the larger part of which was represented by bonuses in shares. This made Walsh the second highest paid executive in the FTSE 100 behind Angela Ahrendts, the American ceo of luxury fashion group **Burberry**. Arguably Walsh has been worth every penny. He inherited a group that had great brands but suffered from reputational damage due to the **Guinness** £2.6bn bid for Distillers in 1986. Prosecutions for an illegal share support operation were brought against four men: former Guinness ceo Ernest Saunders (the only man in history to have recovered from Alzheimer's Disease); stockbroker Anthony Parnes; the head of the Heron property empire Gerald Ronson and the late Jack (once Sir Jack) Lyons of United Drapery Stores. In 2000 the European Court of Human Rights ruled that the 1990 trial against the convicted 'Guinness Four' was unfair. But the damage had been done. Distillers, despite being the top group in the thriving Scotch whisky industry, had a difficult history too because of its involvement in the manufacture of the drug Thalidomide. In his years at the helm Walsh brought new direction to Guinness-Distillers. The corporate name Guinness was replaced by Diageo. He expanded the group beyond its traditional expertise by buying new brands such as Captain Morgan's rum and moving into emerging markets. Diageo bought Turkey's premier spirits brand Mey Icki and won control of United Spirits in India, owner of the Whyte & Mackay whisky brands. Diageo became one of the first Western companies to be allowed to buy into China where it has a majority stake in Shui Jing Fang, maker of the most upmarket rice wine brand. Shareholders can have few complaints. Despite the eurozone crisis, Diageo shares rocketed under Walsh's stewardship, with the market value of the group tripling to £51bn.

Cooking the bonus books

When **Exelon** earned less than top executives needed to reach their annual cash bonus target last year, the board of directors provided a way to help bridge the gap: they invented nonexistent profits.
The board tacked on six cents a share — equal to $85m — that the Chicago-based power company never made, augmenting earnings solely for the purpose of calculating bonuses. Exelon said that it would have earned the sum except for a regulatory setback on electricity rates and that the pennies helped thousands of employees avoid smaller payouts.
The six cents helped executives receive their fourth above-target bonus in five years as the company's operating profits and its market value fell by more than half. Amid the slide, the board awarded more than $20m in cash bonuses to top managers as tax-deductible 'performance-based pay,' reported *Accounting Today*.
Exelon and dozens of other corporations demonstrate how such tax-advantaged bonuses—which cost the **US Treasury** $3.5 bn a year - can reward even sub-par shareholder returns. Ceos at 63 companies in the **Standard & Poor'**s 500 Index got cash incentive-pay increases last year even though their share returns under-performed the index's, according to data compiled by *Bloomberg.*
"Taxpayers are losing billions of dollars; shareholders are being taken for a ride," said Robert Reich, the secretary of labour under former President Bill Clinton. Even companies with robust income amplify executives' cash bonuses by setting comparatively

low targets, Bloomberg data show. Since 2006, **Marsh & McLennan** Cos., **Valero Energy Corp**. and **Walt Disney Co,** among others, repeatedly paid above-target bonuses after setting profitability goals below analysts' expectations, often by five to ten percent or more. Disney pegged management's targets below consensus estimates each year since 2007, the data show.

The cash performance bonuses are only one component of compensation, said Eric Hosken, a partner at **Compensation Advisory Partners LLC** in New York. Boards and their consultants focus on total pay—including salary and stock-based awards—and they balance varied objectives: attracting and retaining talent, minimizing corporate tax burdens and trying to align managers' interests with shareholders, Hosken said. Deciding how likely a CEO is to hit a particular target "is just different levels of guessing," he said.

Directors at 74 of the S&P companies set targets lower than Wall Street analysts' average earnings estimates at least half the time since 2006, according to data compiled by Indiana University researchers and reviewed by *Bloomberg News*. Analysts interpret corporate earnings goals for investors, so their estimates "should align pretty closely with the company's own predictions for its performance," said Jun Yang, an associate professor of finance at Indiana's Kelley School of Business and one of the researchers who conducted the study. Significant gaps between analysts' estimates and bonus goals may mean directors are "deliberately setting performance targets low so the management doesn't have to meet market expectations in order to get paid," said Robert Jackson Jr., a Columbia University law professor who helped the federal government oversee executive pay at companies bailed out during the financial crisis. On average, management's bonus goals were 2.6 cents a share easier to achieve than the analysts' estimates at the time the goals were set, according to research by Yang and Daniel Kim, assistant finance professor at Peking University. About 40 percent of the S&P 500 companies have used earnings per share to help determine annual cash bonuses since late 2006, according to the academics' as yet unpublished paper on incentive pay targets. "If the performance metric is bogus, then firms are abusing the tax code" to deduct the incentive pay, Yang said in an interview.

At issue is a 1993 federal law that capped tax deductions that public companies take for top executives' pay at $1m each. Former President Clinton, who proposed the limit, agreed to exempt performance awards. After Congress enacted the measure, it was left to the **Internal Revenue Service (IRS)** to enforce. The IRS created rules so vague that any company can define performance "more or less as it chooses" said Michael Doran, a lawyer in the Treasury's Office of Tax Policy under former President George W. Bush. Doran, now a Georgetown University law professor, favours making all compensation tax-deductible and said the current rules have merely served to undermine the concept of 'performance.'

"Officers can receive payments that satisfy the exemption even if the stock price is falling, revenues are falling and earnings are falling," Doran said. "Failure can be treated as success for purposes of the exemption."

House and Senate legislation introduced this year would eliminate the exception for performance pay. "My focus is on making the tax code fairer," Senator **Richard Blumenthal**, a Connecticut Democrat and co-author of the bill, said in an interview. "Not to stop, necessarily, compensation to executives who truly merit it, but to assure that all of us are not, in effect, subsidising tens of billions of dollars in corporate bonuses." Blumenthal's legislation would make all executive compensation subject to the $1m cap for deductibility. A House proposal would halve the limit to $500,000 per person. The IRS rules spurred growth in cash bonuses that outpaced other components of ceo pay, said Mark Reilly, a partner at 3C Compensation Consulting Consortium in Chicago. From 1995 to 2010, the median cash bonus for ceos at the 30 companies in the Dow Jones Industrial Average swelled 227 percent, compared with 159 percent for long-term incentive awards and 153 percent for combined cash and long-term incentives, according to Reilly's research. Exelon, the largest US operator of nuclear power plants, has been challenged to recognise performance that isn't reflected in the stock price, said Gary Prescott, the company's vice president of compensation. Managers' obligations include "keeping the lights on, keeping cities illuminated," he said.

Former ceo John Rowe's incentive cash bonus grew almost 49 percent to $2.5m from 2007 to 2011, his last full year in charge. His total reward in 2011 was $11.7m. Rowe, who retired in March 2012, didn't respond to requests for comment. The 68-year-old former executive collected more than $90m in salary, bonuses and retirement pay through the end of his last five years with the company, filings show.

However, it's not fair to focus only on annual cash incentives, wrote James D. Firth, an Exelon spokesman, in a letter to Bloomberg News. They made up less than ten percent of top executives' total pay last year, while share-based awards accounted for 40 percent, based on company disclosures. The stock-based pay has dropped in value in recent years, reflecting the company's share price decline, Firth wrote. As for the hypothetical profit the board added to the 2012 bonus calculation, directors made the adjustment to offset unexpected rate decisions by

Illinois regulators that cut earnings by about six cents a share, Prescott said. The compensation committee excluded that effect from its bonus calculations "since the outcome of these deliberations was not known at the beginning of the year when the budget was established," according to Exelon's 2013 proxy statement. More than 20,000 employees participate in the annual incentive programme, and they "should not be penalised for a regulatory decision that was beyond their control and did not reflect their performance," he said. The company is suing to recover the lost six cents in state court. Exelon's performance pay meets IRS regulations for being deductible, Prescott said.

Shareholders must approve the broad outlines of a company's performance plan every five years. Still, corporate directors have wide latitude in deciding what constitutes performance and how to measure it. Wynn Resorts Ltd., the Las Vegas-based casino company, bases its bonuses on a form of EBITDA, or earnings before interest, taxes, depreciation and amortisation. It set ceo Steve Wynn's target for a full payout in 2011 and 2012 lower than the prior-year results. He sailed through the targets both years, collecting a $9.1m tax-deductible bonus in 2011 and $10m in 2012, proxy filings show.

UK FATCA stretches its talons

Financial institutions in Jersey, Guernsey and the Isle of Man will soon be obliged to automatically provide information to the tax authorities concerning the financial affairs of UK resident clients from next year onwards. Using the cloak of the US's Foreign Account Tax Compliance Act (FATCA) regime, the UK is signing similar agreements with the Crown Dependencies – e.g. the Channel Islands - so that HMRC can find out about offshore accounts held by UK residents. This is nicknamed 'UK FATCA', based on the US law, designed to prevent tax evasion by US citizens using offshore banking facilities, said Reg Day and David Knight of Centre member **Pinsent Masons**. FATCA requires financial institutions outside the US to provide information to the US tax authorities regarding accounts held by US nationals. Financial institutions which do not provide this information will suffer a 30 percent withholding tax on payments of US source income

To ensure that financial institutions can comply with their FATCA obligations without breaching data protection and confidentiality laws, the UK has signed an Intergovernmental Agreement (IGA) with the US for the information required under FATCA by UK financial institutions to be provided to HMRC to forward to the US. Many other governments, including those of the Crown Dependencies, are entering into similar agreements with the US.

Under UK FATCA, financial institutions in the Crown Dependencies will automatically provide information relating to the financial affairs of UK resident clients from next year onwards. The UK FATCA system will include:

- an agreement providing for automatic exchange of information about UK residents with accounts in the Channel Islands (and residents of the Channel Islands with accounts in the UK):
- an alternative reporting regime for UK resident non-domiciled individuals and
- a tax disclosure facility to enable those with irregularities in their tax affairs to correct matters with HMRC in advance of the exchange of information.

Financial institutions are required to tell their customers about the disclosure facility. The new reporting requirements will apply to offshore bank accounts in existence on or after June 30 2014, held by UK resident individuals. The rules apply too to accounts held by offshore trusts and companies to the extent that there are UK resident settlors, beneficiaries or beneficial owners. Special rules apply to UK resident non-domiciled individuals.

Financial institutions in the Crown Dependencies will be required to automatically provide information in relation to reportable accounts of UK specified persons. The information to be exchanged will be set out in Intergovernmental Agreements (IGAs), which are currently being negotiated but which will closely follow the UK/US FATCA model. 'Financial institution' is defined very widely as an entity that accepts deposits in the ordinary course of a banking or similar business, holds financial assets for the account of others as a substantial portion of its business, engages primarily in the business of investing, reinvesting, or trading in securities, partnership interests or commodities, or conducts certain business as an insurance company. This will include not only banks, insurance companies and broker-dealers but will extend to clearing organisations, trust companies, hedge funds, private equity funds and property funds.

The disclosure obligation applies to accounts held by one or more specified UK persons or by a non-UK person, trust or other entity. Increased disclosure may enable HMRC to 'go after' offshore structures of which it was previously unaware.

A disclosure facility is available for each Crown Dependency to enable those with undeclared assets to come forward and disclose any potential tax liabilities to HMRC, before the automatic exchange of information deadline in September 2016. Full tax on unpaid interest will have to be paid.

Down Under

Australia needs to overhaul the rules around employee share schemes if it wants to create its own Silicon Valley, a tax expert says. "We can't expect to have a Silicon Valley here in Australia if we're not offering the same playing field they are on over there," said Adrian O'Shannessy, an expert panel member of Employee Ownership Australia & New Zealand (EONZ). Employee share schemes enable companies to offer employees a share of the company as part of a salary package, but concerns have been raised about when the benefit should be taxed and the costs associated with implementing and managing a scheme. The new government has pledged to consider changes to employee share schemes. Easing and simplifying the rules around the schemes is high on the start-up sector's wish list. O'Shannessy, a Centre conference speaker, told *StartupSmart* magazine that start-ups weren't able to offer cash to attract talent to their enterprises and could only offer the potential for cash in the form of options in the company. "In the US and UK they recognise that and they don't try and tax people before they get the cash," he said, adding that Australia's rules mean tax is applied on the option before it can be realised. "It might not turn into anything. We need to wait until it turns into something." O'Shannessy said that the new centre-right government was interested in - and would like to do something with – the share schemes tax regime. EONZ said some guiding principles around any review of employee share schemes for start-ups should include several aspects, such as:

- Placing Australia in a competitive position globally and ensuring a level playing field with both the US and UK - any tax provisions should be on par with the global philosophy that employees of start-ups are largely rewarded through employee share scheme arrangements which are taxed on capital account and only when a vesting event occurs;
- prioritising option plans;
- ensuring any changes should not impose greater complexity and burdens on companies;
- simplifying company valuations;
- defining start-ups in a way that is simple and indicative of the actual market;
- aligning share scheme reforms with any other reforms relating to the Corporations Act (for example around prospectus filing requirements).

France: Tax, tax and tax again

The French government announced a new package of tax measures in the draft 2014 Finance Bill that would impact large companies adversely if enacted, reported Centre member **Deloitte.** The measures include an exceptional tax on high remuneration paid by companies, a one percent tax on gross operating profit, a restriction on the deduction of interest paid between related parties and a new transfer pricing reporting obligation for certain business restructurings. If this becomes law, some of the proposals would be applicable in the current financial year. A temporary tax would be levied at a rate of 50 percent on the portion of remuneration paid to employees and directors above euros 1m per year per individual. This new tax would be capped each year at five percent of the company's turnover in the relevant year. The types of remuneration and benefits falling within the scope of the new tax are broad and would include, for example, bonuses (regardless of when the bonus is paid, if it is attributable to 2013 or 2014), as well as stock option and free share grants.

If the proposal is enacted without modification, affected companies would have to pay tax of up to 75 percent of pay above euros 1m (taking into account the exceptional tax and relevant social contributions). This tax is intended to replace the tax that would have required wealthy individuals in France to pay a 75 percent effective income tax rate on professional income exceeding euros 1m, but that was invalidated by the Constitutional Court in 2012.

Worse may be just around the corner as employment minister Michel Sapin announced (or threatened) – in an interview with *Le Figaro* - a major reform programme this autumn for *la participation financiere* (employee share ownership) and for *l'epargne salaire* (workplace savings scheme which allows employees to share the risk by investing in a selected tax-protected portfolio of funds.) In ministers' sights is the '*Sarkozy bonus,'* which enabled companies to award their employees a special dividend without having to pay high 'social contributions' (additional taxes).

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