

Global Rewards Update

United Kingdom – Changes to the social security treatment of share plans for internationally mobile employees

February 2015

Background

As discussed in our GRU of **July 2014**, significant changes to the UK taxation of share awards for internationally mobile employees (IMEs) will take effect from 6 April 2015.

These changes require that where a relevant “chargeable event” (exercise of share options and vesting of conditional share awards and restricted shares) occurs for IMEs on or after this date, the UK income tax treatment will generally be based on the apportioned income earned in the UK over the grant to vest period. These changes are, in certain circumstances, a significant departure from the existing rules. The new legislation will apply to all chargeable events occurring on or after 6 April 2015, regardless of the date of grant of the award.

In July 2014, the Government consulted on whether/how the UK social security (National Insurance or NIC) rules should be changed. Based on the recommendations of the Office of Tax Simplification, the broad intention was to “align” the NIC provisions as closely as possible to the income tax treatment. However, it was recognised that alignment may not always be possible to the differing NIC provisions that existed. Following the consultation, the Government has confirmed that NIC will be based on the amount of time during the earnings period for which the employee is insured for social security in the UK. As with the income tax, the new rules will apply to all “chargeable events” occurring on or after **6 April 2015**.

The new rules remain complicated and further guidance is needed from HMRC. However our expectation is that employers will need to spend additional time analysing the new NIC treatment in the short and medium term, to ensure they are able to comply with the new rules. We also anticipate that NIC costs for UK employers will generally increase as a result of these changes as a result of more share related income falling within the NIC net (the rate of employer’s NIC is 13.8% uncapped; the rate of employee’s NIC is generally 2% uncapped).

It should be noted that these provisions will apply to taxable amounts arising under Part 7 of the Income Tax (Earnings & Pensions) Act 2003 (broadly, the UK share plan legislation). Any tax charges arising pursuant to other parts of the UK legislation - notably including cash-based awards will not be affected by these measures.

Share plans for internationally mobile employees

Whilst the changes to the income tax treatment were legislated for last year as part of Finance Act 2014, the changes to the NIC treatment have only just been confirmed, and will take effect from the same time as the changes to the tax treatment (i.e. 6 April 2015).

Current NIC rules

The current NIC rules relating to share income for IMEs are complex. The NIC position can depend on a number

of factors such as:

- whether an income tax charge arises;
- whether the employee moves to an 'agreement' country, an EU country, or a 'non-agreement' country;
- whether the employee holds a Certificate of Coverage or A1 to remain in a specific social security regime; and
- whether the employee moves location as an assignee or permanent transfer.

In addition, under the current rules the NIC position does not always follow the income tax position, and is generally due on share income on an "all or nothing" basis – i.e. NIC is not generally apportioned.

New NIC rules

Under the new rules, liability to NIC on share income will be based on *the amount of time during the earnings period for which the employee is insured for social security in the UK*, regardless of the employee's social security position at grant or vesting/exercise of the share awards.

The new rules may therefore result in both UK inbound and outbound employees, who would not currently be liable to NIC on their share income, becoming liable to NIC on a proportional basis. This could trigger increased NIC charges, as illustrated in example 1 below:

Example 1

Currently inbound employees who were granted share options before arrival in the UK (and where the grant was not made in respect of UK duties) do not incur a NIC liability as there is no charge to income tax.

Under the proposed new rules, a NIC charge would arise for inbound employees for any part of the grant to vest period when the employee is UK insured.

Comparison with the new income tax rules

Under the income tax rules, any apportionment will be based, broadly, on UK residence/workdays. Under the new NIC rules, however, any apportionment will be based on periods for which the employee is UK insured. Whilst UK insurability and tax residence may sometimes be the same, this will not always be the case. For example:

- Where the employee has moved to a 'non-agreement' country as an assignee, the IME remains subject to UK National Insurance for an additional 52 weeks (the "52 week rule").
- Where the employee is subject to a Certificate of Coverage/A1 arrangement, they remain within their home social security systems regardless of a change in tax residency.

Example 2

A UK outbound IME is assigned to Singapore

A share option is granted to a UK resident employee and vests on the third anniversary of the date of grant. The employee is assigned to Singapore one year after the grant of the option. The employee then exercises the option immediately on vesting.

UK income tax would be due on the apportioned gain based, broadly, on UK residence, i.e. 1/3 of the gain. From 6 April 2015, NIC would also be due on the apportioned gain based on the period for which the employee was UK insured. The employee is UK insured for year one (when in the UK) and year two (due to the "52 week rule"). As such NIC will be due on 2/3 of the gain.

Under the current rules, there would be no NIC payable as the employee would be outside the scope of NIC at the tax point.

A US outbound employee is assigned to the UK but is covered by a Certificate of Coverage and remains within the US social security system for two years before being localised to the UK

A share option is granted at the end of year one of the UK assignment and exercised immediately on vesting on the third anniversary of the date of grant.

UK income tax would be due on the full gain at exercise on the basis that the employee is UK resident and working in the UK only throughout the grant to vest period. From 6 April 2015, NIC would be due on the proportion of the gain at exercise which related to the period for which the employee was UK insured, i.e. 2/3 of the gain, as the individual was insured for only two out of the three years (in the first year they were covered by a Certificate of Coverage and therefore not UK insured).

Under the current NIC rules, there would be no charge to UK NIC on exercise as the employee is not UK insured at the point of grant.

In both of the scenarios above, there will be both:

- continued complexity – as the amount liable to NIC is not the same as the amount on which income tax is paid; and
- increased NIC costs.

Double charging of social security

As a result of these changes there will be instances where there is a risk of a double charge to social security arising on the same share income. This is shown in example 3.

Example 3

A UK outbound employee is transferred to the US

A share option is granted to a UK resident employee and vests on the third anniversary of the date of grant. The employee is transferred to the US one year after the grant of the option. The employee then exercises the option immediately on vesting. Under current rules, HMRC practice is not to pursue NIC in these circumstances.

UK income tax would be due on the apportioned gain based, broadly, on UK residence, i.e. 1/3 of the gain. Based on the new UK domestic legislation, UK NIC would also be due on 1/3 of the gain. However, the US authorities are likely to expect that US social security be due on the full gain as the employee is US insured at the tax point.

HMRC have acknowledged this risk and are expected to provide guidance on how EU legislation and bi-lateral agreements can be relied upon in most cases to ensure that a double charge to social security does not arise. However, with less than two months before the new rules take effect, employers will face continued uncertainty as regards when, and on what amounts, NIC will be charged. HMRC have not stated when their guidance will be issued but, once it has been released, we will issue a further Global Reward Update.

Action

These changes are significant and will affect many IMEs holding share awards. As the rules take effect soon, prompt action will be needed to ensure compliance from 6 April 2015 and this will include:

- assessing how the NIC changes will impact the share awards held by your IMEs;
- identifying employees who will be impacted, and if appropriate, communicating with them, in respect of the proposed changes;
- ensuring that social security positions for mobile employees are tracked (in addition to tax residency). This may require understanding the historic positions of employees who may no longer be on assignment but have share income that will vest or be exercised after 6 April 2015;
- analysing where the company's costs may increase due to new/increased NIC charges. If necessary, ensure that appropriate provisions are made for the increased costs;
- considering the impact of the changes on future assignment costs, and whether a change in assignment policy is needed;
- ensuring payroll teams are notified and can manage their withholding and reporting obligations.

People to contact

For assistance with these issues, or any other issue related to the operation of your global equity plans, please contact your usual Deloitte adviser or email us at globalshareplans@deloitte.co.uk, and an adviser will contact you.

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