

Global Rewards Update

United Kingdom – Tax and social security treatment of conditional share awards from 6 April 2015

May 2015

Background

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

These changes require that where a relevant “chargeable event” (e.g. exercise of share options or vesting of restricted shares) occurs for IMEs on or after 6 April 2015, the UK income tax treatment will generally be based on the apportioned income earned in the UK over the grant to vest period. UK social security on share based gains will generally also be apportioned, based on the amount of time during the grant to vest period for which the employee was *UK insured* (i.e. chargeable to UK social security).

The issues arising for employers in connection with various types of share awards were discussed in our previous GRUs. This GRU, however, is specifically focused on the application of the new rules to the taxation of *conditional share awards* (also known as restricted share units).

Charging provision applicable to restricted share units (RSUs)

By RSU, we mean an incentive arrangement whereby a company will deliver shares to the participant after a certain period (the vesting period) generally if the individual is still in employment and/or performance conditions are met. The employee does not have ownership of the shares during the vesting period but, on vesting, the shares are automatically delivered to the employee – i.e. the employee does not have a choice on when to crystallise their gain.

For many years, there has been uncertainty as regards what UK charging provision should apply to such awards – in particular, should they be taxable under either:

- The “securities option” legislation in Part 7, Chapter 5 Income Tax (Earnings & Pensions) Act 2003 (‘ITEPA’); OR
- The “general earnings” legislation in Section 62 ITEPA (‘s62’)?

A “securities option” is defined in the legislation as the employee having a “right to acquire securities”.

Notwithstanding some uncertainty in the legislation, HM Revenue & Customs (‘HMRC’) guidance states that RSUs will normally be taxed under s62 but where s62 does not apply on vesting, the securities option legislation can apply instead. It is unclear which charging provision should take precedence for RSUs vesting on or after 6 April 2015.

With effect from 6 April 2015, the distinction between “securities options” and “general earnings” broadly

disappeared for *income tax* purposes. However, the distinction remains potentially important for both social security ('NIC') and capital gains tax purposes. In particular:

- If RSUs are taxed under the securities option legislation, NIC will be apportioned as above – i.e. based on the period for which the employee was UK insured over the grant to vest period; OR
- If RSUs are taxed under s62, there will be no NIC apportionment – it will be payable on the full gain or no NIC will be due, as is generally the case under the legislation that applied before 6 April 2015. (This would also be the case for cash based plans).

Determining the charging provision

Companies therefore need to consider how the new legislation impacts the way their RSU awards are treated for tax and social security purposes, if at all. Factors to consider include:

- How have the awards for IMEs been taxed historically? Has the company previously agreed the treatment with HMRC?
- Does the company transfer the employer's social security cost to employees? If so, this would indicate that the RSUs are taxed under the "securities option" provisions.
- Does the RSU plan/award agreement allow the company to settle the RSU in cash or can the award only be settled in shares?
- If there is a cash alternative in the plan rules, is it a 'genuine' cash alternative or would the company settle in shares unless delivery of shares was not possible in practice?
- How has the company treated the awards from an accounting perspective? HMRC have previously stated that where a company has accounted for the awards as equity settled awards, this could be taken as evidence (although not conclusive) of the award being a securities option.
- How has the company reported the RSUs on their previous share plan returns (form 42)?

It is necessary to consider these factors 'in the round' and in many cases it will not be clear which provision should apply. Unfortunately, HMRC's guidance also does not make clear which charging provision they expect would apply to a 'normal' RSU plan. Deloitte are discussing this issue with HMRC but pending further clarification, companies must determine what provision they will apply to their awards and then make sure they apply it consistently for inbound and outbound employees.

Action

As noted above, these rules came into effect on 6 April 2015 so companies operating RSU plans will quickly need to review the plans and determine which charging provision applies. Pending further clarification, companies may wish to continue with the tax treatment they have applied historically but consider the impact if HMRC confirm a change in their stated position. Where appropriate, companies may also need to:

- analyse whether the company's costs could increase due to new/increased NIC charges. If necessary, ensure that appropriate provisions are made for the increased costs;
- communicate with employees impacted by any changes; and
- ensure that 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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