Incentives Bulletin

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Directors' remuneration - draft regulations published

Summary and key practice point: The draft Companies (Directors' Remuneration Policy and Directors' Remuneration Report) Regulations 2019 were published on 9 April 2019.

The regulations implement Articles 9A and 9B of the Shareholder Rights Directive as inserted by the Shareholders Rights Directive II (SRD II, which came into force on 9 June 2017).

If approved, the regulations will come into force on 10 June 2019 - the deadline for transposition into national law.

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More detailed analysis/commentary: The draft regulations amend the Companies Act 2006 and the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 to implement those requirements of SRD II that do not already apply in UK law. (References below to sections are to sections of the CA 2006, and references to paragraphs are to Schedule 8).

The changes on publication requirements apply to reports/policies first required to be made available on/after 10 June 2019. Amendments to the content of the remuneration report in Schedule 8 apply to reports for a financial year beginning on/after 10 June; and changes to policy content apply to policies approved under section 439A on/after 10 June. Amendments to section 226 take effect for the first date on/after 10 June when a remuneration policy approved under section 439A takes effect.

The Government has published transposition notes, setting out in table form the requirements of SRD II and showing which are already in UK law and which are enacted through the draft legislation.

<u>Directors' remuneration policy</u>

- If the company loses a shareholder vote on a proposed remuneration policy, it must bring a new remuneration policy to a shareholder vote at the next accounts meeting or other general meeting (amendment to section 439A).
- The date and details of the results of a shareholder resolution to approve the policy (including number of votes cast and proportion of company's issued share capital represented by those votes, number of votes for and against, and abstentions) must be made available on the company's website as soon as reasonably practicable, and kept available for as long as applicable (amendment to section 430).

- The policy must explain the decision-making process for its determination, review and implementation, including measures to avoid/manage conflicts of interest and the role of the remuneration committee. (This is intended to ensure that any advice to the remuneration committee is independent.) The policy must also explain all significant changes compared to any previous policy (amends paras 24 and 42).
- For share-based remuneration, the policy must include details on vesting periods and any deferral and holding periods (amends para 26).
- The policy must indicate the duration of directors' service contracts (new para 30A).

Directors' remuneration report

- The report must be kept available on the company's website for 10 years (amendment to section 430).
- The single figure entry must show the split of fixed and variable remuneration awarded to each director each year (amendment to para 5(1)).
- The report must set out any change in the exercise price and date for the exercise of shares or share options by directors (para 14).
- The report must compare the annual change in directors' (not just CEO's) remuneration to the annual change in pay of the company's employees and of the company's performance (measured in terms of total shareholder return) by a rolling comparison over the previous five years, not just with the previous year (para 19).

Directors' remuneration payments

- Sections 226B and 226C, which provide that shareholders must approve any remuneration or loss of office payments to directors that are not consistent with the approved directors' remuneration policy, are amended so that a payment may only be made if an amendment to the policy authorising the company to make the payment (rather than the payment itself) has been approved by shareholders.

Other minor and technical changes

- The scope of the reporting requirements is extended to include unquoted traded companies. Currently, only traded companies which are quoted companies are covered under section 360C. (An unquoted trading company would be very unusual. An issuer must separately apply to the UKLA for admission to the Official List and to the LSE for admission to trading. It is very unlikely that an issuer would do one but not the other.)
- Definition of "director" for reporting requirements (section 226A) - amended to include a person who is not a director but is the CEO or deputy CEO (again, rare in practice).

Accounting debits relating to grant of share options to employees were deductible as trading expense

Summary and key practice point: the Upper Tribunal has upheld the decision of the First-tier Tax Tribunal (FTT) that employing companies were entitled to a deduction as a trading expense in respect of accounting debits relating to the grant of share options to their employees by an employee benefit trust (EBT).

The decision will be of interest to those companies who have made historic "lapsed option relief" corporation tax deduction claims (which relief is now barred by statute). The decision also indicates that where other costs are incurred in connection with an employee share plan (such as cash cancellation payments on a transaction) and no statutory deduction is available it is likely that a corporation tax deduction will be available under general principles.

Facts: In **HM Revenue and Customs v NCL Investments Ltd & Smith and Williamson Corporate Services Ltd [2019] UKUT 0111 (TCC)**, HMRC appealed on a number of grounds against a decision made by the FTT, which held that in principle accounting debits in relation to the grant of share options by the trustees of EBTs that were recognised in the respondents' respective income statements pursuant to International Financial Reporting Standard 2 (IFRS 2) were deductible for corporation tax purposes as expenses against trading profits for accounting periods to 30 April 2010, 2011 and 2012.

HMRC contended that no corporation tax deduction was available in respect of the IFRS 2 debits on the following main grounds of appeal:

- the FTT had erred in holding that IFRS 2 debits were "expenses" for the purposes of the Corporation Taxes Act 2009 (CTA 2009) and misdirected itself in relation to the meaning of "incurred" in the CTA;
- the IFRS 2 debits were not incurred "wholly and exclusively" for the purposes of the taxpayer's trade, with the result that a deduction was barred under the CTA; and
- the IFRS 2 debits were capital in nature so were not deductible under the CTA.

HMRC also contended that the FTT should have concluded that the amendments made to Part 12 of the CTA for accounting periods ending on or after 20 March 2013 were for the avoidance of doubt only.

Decision:

The Upper Tribunal upheld the FTT decision. The fact that the expense required to be recognised under IFRS2 did not reflect monies actually spent was irrelevant. No particular significance should be given to "incurred". The deductions were not capital in nature - they were clearly revenue transactions.

Commentary:

The decision will be of interest to those companies who have made historic "lapsed option relief" corporation tax deduction claims (this relief is now barred by statute) in accounting periods ending before 20 March 2013. The Upper Tribunal confirmed the availability of these historic deductions.

However, the decision is helpful to employers more broadly because it also indicates that where other costs are incurred in connection with an employee share plan (cash cancellation payments on a transaction, for example) and no statutory deduction is available, it is likely that a corporation tax deduction will be available under general principles.

HMRC updates disguised remuneration guidance

Summary and key practice point: HMRC has updated two of its guides on disguised remuneration with a link to the online service for individuals and employers to report disguised remuneration loan balances outstanding at 5 April 2019.

The guidance now specifies the information individuals must provide and, where employers make the report, the details they must give employees if not included on a P60.

More detailed analysis/commentary: Finance (No 2) Act 2017 introduced a charge applicable to certain loans made on or after 6 April 1999 which remain outstanding on 5 April 2019.

The purpose of the charge is to tackle loans made before the disguised remuneration legislation came into force and to encourage employers to settle unpaid tax liabilities in relation to them. There are certain exclusions from the charge.

The disguised remuneration loan charge may be postponed for certain fixed term loans approved by HMRC (these are broadly loans which were made before 9 December 2010, have a period not exceeding ten years and are not a replacement loan or a loan whose terms have been amended to meet the criteria).

HMRC has updated two of its guides relating to the disguised remuneration loan charge, namely:

- Disguised remuneration: settling your tax affairs; and
- Report and account for your disguised remuneration loan charge.

The guidance now specifies the information individuals must provide and, where employers make the report, the details they must give employees if not included on a P60.

These guides also include a link to the online service for individuals and employers to report disguised remuneration loan balances outstanding at 5 April 2019.

Taxpayers who are not in the process of settling and did not provide HMRC with the information requested by 5 April must calculate and report their outstanding disguised remuneration loans online by 31 October 2019 or, for employment-based schemes, give relevant details to the employer.

Option granted by company to a director was not an employment-related securities option

Summary and key practice point: The First-tier Tax Tribunal (FTT) has ruled in *Vermilion Holdings Ltd v HMRC [2019] UKFTT 0230 (TC) (8 April 2019)* that an option granted to a director otherwise than as a reward for employment was not deemed to be an employment-related securities option (ERSO).

In the view of the FTT, the scope of the deeming provision in section 471(3) of the Income Tax (Earnings and Pensions) Act 2003 (ITEPA 2003) – which provides that an option "made available" by the employer will be deemed to be made available by reason of employment and is therefore an ERSO unless certain limited circumstances apply – should be limited if its effect does not reflect the facts of the case.

More detailed analysis/commentary: This case concerned the interpretation of section 471(3) of ITEPA 2003, which provides that a securities option made available by the employer will be deemed to have been made available by reason of employment, and is therefore an ERSO, unless certain limited circumstances apply.

In this case, an option was granted by Vermilion Holdings Limited (Vermilion) to a consultant as compensation for corporate advisory services it provided to Vermilion. That option was accepted by HMRC as not being an ERSO.

The owner and director of the consultant company was subsequently appointed as a director of Vermilion and it became necessary to change the terms of the original option.

In 2007, a new option was granted on revised terms to replace the original option, which provided that the individual would be the option holder, rather than his consultant company.

HMRC argued, relying on a literal interpretation of section 471(3) ITEPA 2003, that the new option was deemed to be an ERSO because it was granted by the individual's employer, and it did not fall within the limited exemptions under the legislation. Vermilion argued that the option was not "made available" for the purposes of section 471(3) ITEPA 2003 and that a purposive interpretation should be applied.

The view of the FTT was that the new option was not, as a matter of fact, made available by reason of the individual's directorship or to confer on him value earned by his employment but instead it was made available by the surrender of the existing 2006 option. Therefore, it was not made available by Vermilion as the individual's employer.

The FTT considered that "the ambit of the deeming provision should be limited where the artificial assumption from deeming is at variance with the factual reason that gave rise to the right to acquire the option". Accordingly, the FTT ruled that the new option was not an ERSO.

Given that the deeming provision is fundamental to HMRC's interpretation of Part 7 of ITEPA 2003, it seems likely that there will be an appeal.

Horizon scanning

What key dates and developments in employee incentives should be on your radar?

31 May 2019	UK to leave the EU if the UK does not hold EU elections on 23 May 2019
10 June 2019	Companies (Directors' Remuneration Policy and Directors' Remuneration Report) Regulations 2019 will come into force
31 August 2019	Final settlement date for disguised remuneration loans
31 October 2019	UK to leave the EU (potentially with no deal) if the withdrawal agreement is not ratified by this date
1 January 2020	Companies must start reporting their CEO pay ratios

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