SHARE INCENTIVES FOR INTERNATIONALLY MOBILE EMPLOYEES

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Our client is a UK listed company with multinational operations and regularly sends employees to work in different countries for varying lengths of time. The company grants share options and other types of share incentive to these employees and wants to know how the tax treatment for employees moving into and out of the UK is going to change with effect from 6 April 2015. The company also wants to know whether there are any measures that it can take before 6 April 2015 in order to secure more favourable tax treatment for such employees.

BACKGROUND

The changes to the tax regime for share incentives held by internationally mobile employees (IMEs) arose out of the recommendations by the Office of Tax Simplification (OTS). Under the current rules for employment-related securities, liability to UK income tax is broadly determined by reference to whether the employee is UK resident at the time share options are granted or restricted shares are awarded. This is different to the tax rules for employment income which is taxed as general earnings (such as cash bonuses), the tax treatment of which depends on the residency status of the employee over the period during which the income is treated as earned. Further, in some cases HMRC may seek to tax share-related income under the general earnings rules rather than those applicable to employment-related securities. In their report, the OTS highlighted that the current regime leads to inconsistency in the tax treatment of inbound and outbound IMEs, and uncertainty as to how different types of awards may be taxed. Therefore, it proposed changes that would more closely align the tax treatment of employment-related securities with other forms of employment income.

NEW RULES TO APPLY FROM 6 APRIL 2015

The new regime for the taxation of employment-related securities acquired by IMEs is contained in a new Chapter 5B of Part 2 ITEPA 2003. Chapter 5B takes effect from 6 April 2015 in respect of all employment-related securities and employment-related securities options within Chapters 2 to 5 of Part 7 ITEPA 2003, regardless of when they were acquired. In respect of securities options, Finance Act 2014 also repeals section 474 ITEPA 2003 from 6 April 2015. Therefore, there will no longer be an exemption from taxation under Chapter 5 of Part 7 ITEPA 2003 for individuals who are not UK resident at the date of grant of a securities option. Although Chapter 5A of Part 2 ITEPA 2003 (which deals with the effect of the remittance basis on employment-related securities income) is also repealed, equivalent provisions are included in Chapter 5B.

The government has also published draft legislation for consultation which would make changes to the National Insurance contributions treatment for IMEs acquiring employment-related securities.
APPLICATION OF THE NEW RULES

Chapter 5B applies to any amounts that count as employment income under Chapters 2 to 5 of Part 7 ITEPA 2003, and therefore it applies to both restricted securities (Chapter 2) and securities options (Chapter 5), amongst others. In order to come within Chapter 5B, an employee must meet one of three ‘international mobility conditions’. They are (i) the employee is taxable on the remittance basis at any time during the relevant period, (ii) the employee is not resident for the whole of a tax year during the relevant period, or (iii) any part of the relevant period falls within the overseas part of a split year. In respect of securities options, the relevant period is the period between the grant date and the vesting date (or a chargeable event if earlier). In respect of restricted securities, the relevant period is the period between the acquisition of the securities and the chargeable event.

OPERATION OF THE NEW RULES

In summary, the starting point under the new rules is that the whole amount of any securities income (e.g. the chargeable gain on the exercise of an option) is potentially subject to UK income tax. However, when calculating the tax charge for IMEs, there are deductions for (i) in periods of non-residence, income apportioned to non-UK duties (referred to as unchargeable foreign securities income (FSI)) and (ii) where the remittance basis rules apply, the overseas workdays portion of the income that is not remitted (referred to as chargeable FSI).

In order to calculate chargeable FSI and unchargeable FSI the securities income is first apportioned across each day of the relevant period. If part of a relevant period is in a tax year during which an employee is not resident (or the overseas part of a split year) any securities income for that part of the relevant period will be apportioned between duties performed in and outside of the UK (with the income apportioned to duties performed outside of the UK being unchargeable FSI). Chargeable FSI is broadly calculated on the same basis as is currently the case under Chapter 5A of Part 2 ITEPA 2003. Therefore, it applies to non-domiciled UK residents who have claimed the remittance basis and meet the section 26A ITEPA 2003 requirement and some or all of the duties are performed outside of the UK. For any year that applies, then such employees can apportion the securities income between duties performed in and outside of the UK (with the income apportioned to duties performed outside of the UK being Chargeable FSI). If non-domiciled employees claiming the remittance basis for a particular year do not meet the section 26A requirement, securities income for that year will only be Chargeable FSI if there is a foreign employer and their duties are performed wholly outside the UK.

For employees holding restricted securities who were not UK resident at the date of acquisition but subsequently moved to the UK, the new rules may give rise to a tax charge under Chapter 2 of Part 7 ITEPA 2003 when any restrictions fall away (assuming that no election under section 431(1) ITEPA 2003 was made). However, any amount that was charged to non-UK tax on the acquisition of those securities will be deductible for the purpose of calculating any tax charge under Chapter 2 of Part 7 ITEPA 2003 (ss 428(7)(bb) and 428(7A) ITEPA 2003 with effect from 6 April 2015).
WHAT DO THE NEW RULES MEAN IN PRACTICE?

Employees who were granted share options when they were non-UK resident, and then moved to the UK to work, will now be subject to UK tax if they exercise those options after 6 April 2015. When those employees were granted those options, they would not have expected any UK tax liability to arise so companies may wish to let affected employees know about the forthcoming changes. In respect of options that are already exercisable before 6 April 2015, it may be advantageous for those options to be exercised before that date so that the new rules do not apply. Further, in respect of options that may become exercisable shortly after 6 April 2015, companies may consider whether there is scope for accelerating the vesting date so that employees can choose to exercise their options before the new rules come into force.

On the other hand, employees who were granted options while they were UK resident, and subsequently moved to work abroad, may have a reduced UK tax liability under the new rules.

Companies will also need to change their payroll withholding processes in order to reflect the new rules. However, given that most companies with IMEs will already have processes in place for tracking an employee’s residence status and UK/non-UK workdays, it should not be too difficult for companies to apply the new requirements. Companies will also still need to consider the impact of any reliefs available under double tax treaties.

Finally, it’s worth noting that the new rules do not completely address the problems highlighted by the OTS, as they only apply where the tax charge arises pursuant to Part 7 of ITEPA 2003. There may still be situations where a general earnings charge (under section 62 ITEPA 2003) arises on the acquisition of employment-related securities, and in such cases the apportionment mechanism may be different.

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