CLIFFORD CHANCE

WELCOME TO THE CLIFFORD CHANCE INCENTIVES 2024 SPRING BRIEFING

Hot on the heels of the UK Chancellor's Spring Budget, we are pleased to issue our own Spring Briefing for 2024.

In this issue we summarise key recent developments relating to remuneration and employee incentives. Now that it is clear that the Investment Association will not be publishing updated remuneration principles this AGM season, we have focused on other legal, regulatory and tax issues relevant to the world of remuneration and share plans.

Key issues

- UK 2024 Spring Budget
- New EU pay transparency rules
- Identifying employment-related securities in the UK and potential tax consequences
- TUPE transfers and impact on all-employee share plans
- Changes to the UK Takeover Code and the operation of share plans

UK 2024 Spring Budget

The 2024 Spring Budget was announced on 6 March, with perhaps less impacting remuneration and share plans than had been anticipated. There were though announcements of measures intended to boost the attraction of the UK as an IPO venue and for shareholders generally. The key changes are:

- A reduction in employee NICs to take effect from 6 April 2024. The main rate of 10% will be cut to 8%. Similarly, self-employed individuals will see their contributions decrease from 8% to 6%.
- The government's initiative to establish the Private Intermittent Securities and Capital Exchange System ("**PISCES**"), which marks a significant step towards enhancing the liquidity of private company securities. By facilitating controlled and intermittent trading, PISCES is poised to bridge the gap between private and public markets, potentially making the UK a more attractive venue for companies in private hands and for future IPOs in the UK. The government is consulting on PISCES until 17 April 2024.
- Reforms aimed at unlocking pension fund capital in a bid to make the UK a more appealing market for technology companies to IPO. This could lead to increased investment in the tech sector and provide new opportunities for growth.
- Introduction of the 'British' ISA, offering an additional £5,000 tax-free allowance for investments in UK equities. This aligns with other ISAs in terms of tax advantages and is aimed at giving additional tax advantages to those willing to invest in UK companies.

A noticeable omission from the Spring Budget was any mention of the expected reforms of employee share schemes. Following the consultation on all-employee share incentive plans ("**SIPs**") and save as you earn plans ("**SAYE**") and the significant lobbying efforts, some changes were anticipated, for example, reducing the SIP holding period. We remain hopeful that change will happen and would like to thank those of you who joined us in submitting recommendations to the government during the consultation process. We understand that a full response is expected in due course.

Comment

Whilst on the surface the Spring Budget does not seem to have given remuneration and incentives the attention that was afforded to the area in 2023, it is clear that many of the policies have been designed to boost the UK for investors, including to be the IPO destination-of-choice. The successful establishment of PISCES would give the UK a steady pipeline of liquid private companies who may then eventually go on to IPO, whilst the pension fund reforms and the British ISA will ensure that, once in place, newly-listed companies will have a good base of suitably-incentivised investors. In a general election year, this was perhaps all that could be expected.

Pay transparency

Companies with EU operations should start to plan ahead and be ready for the implementation of new pay transparency rules.

The EU's new pay transparency regime will become national law by June 2026. The regime will introduce gender pay reporting obligations similar to those which exist in other countries, including the UK, but will also go further. It will include measures to enhance access to justice for victims of pay discrimination, and a compulsory pay assessment in cooperation with workers' representatives where pay reporting reveals a gender pay gap of at least 5% which cannot be justified on the basis of prescribed factors.

Comment

Organisations with EU operations should consider how these new rules will impact them, including how the relevant data will be collated, what their gender pay gap looks like, and any consequential action, including changes required to their internal policies and processes.

Whilst the new regime does not apply in the UK, it may bring into focus what UK companies are doing on pay equity. In this respect, the UK government updated their guidance for employers on gender pay gap reporting on 9 January this year to include advice on understanding the gender pay gap and what actions to take to close it.

Transaction-related issues

Employment related-securities

The debate about whether share options have been granted by reason of employment, triggering income tax and NICs frequently arises on corporate events and transactions.

The recent Vermilion Holdings case helped clarify whether for UK tax purposes share options were granted "by reason of employment".

In Commissioners for HMRC v Vermilion Holdings Ltd, the Supreme Court (Scotland) held that a share option granted by a company to its director was deemed to be an employment-related securities option ("**ERSOs**") and, therefore, subject to income tax and NICs, not capital gains tax.

The Supreme Court stated that the deeming provision is a "bright line" rule and only required an assessment of who granted the ERSO, and not why the ERSO was granted and whether it was by reason of the optionholder's office or employment. The decision also applies to the grant of share options to an employee who is not also a director and where a director or employee acquires shares, or other securities, in their employer or the company with which they hold an office or directorship.

Comment

*When looking at the grant of an ERSO or award of an employment related-security (“**ERS**”) for due diligence or other purposes the checklist of points to consider is as follows:*

- *First, consider if the deeming rules apply. If they don't, only then consider if the option was awarded or security acquired by reason of employment.*
- *If securities or options were acquired or awarded before the relevant employment or office started, or after it ended, the deeming rules will not apply. In this case, the question is whether the acquisition or grant was by reason of employment.*
- *If an ERS has been acquired and it is subject to sale or transfer restrictions and/or risk of forfeiture, check whether a valid section 431 tax election (or similar) has been entered into (or needs to be) to minimise the risk of future income tax and NICs charges.*
- *In relation to the acquisition of an ERS, check that it was valued for tax purposes, whether it was acquired at a discount, and whether all income tax and NICs have been paid.*
- *An ERS and ERSO must be reported to HMRC online by 6 July immediately following the end of the tax year in which the award or grant took place. Penalties and fines may be imposed where a filing is not made, or is made late.*
- *If income tax is due, check whether it needs to be accounted for together with any NICs under PAYE (or overseas equivalent). Penalties, fines and interest may be charged where PAYE has not been applied, or on any late payment.*

TUPE transfers – a right to continued participation in a tax-advantaged share incentive plan

The recent case of Ponticelli UK Ltd v Gallagher highlights the importance of both buyers and sellers properly considering the rights of transferring employees to continue participating in an all-employee share plan following a TUPE transfer.

In Ponticelli UK Ltd v Gallagher the Inner House of the Court of Session (“**IHCS**”) (Scotland) held that when there is a relevant transfer under the Transfer of Undertakings (Protection of Employment) Regulations 2006 (“**TUPE**”) the requirement that all of the transferor's “rights, powers, duties and liabilities under or in connection with” a transferring employee's employment contract pass to the transferee, can include an employee's right to continue participating in a tax-advantaged share incentive plan (a “**SIP**”).

This continuing right of participation can arise where there is an evergreen plan with an open-ended invitation and offers under SIPs or similar schemes where eligible employees have the right to apply to participate at any time and may continue to participate until the company stops the offers or the employee withdraws from the plan. In these circumstances, if participation confers a right to be awarded free (or discounted) shares or buy shares, the arrangement may be regarded as part of the employee's overall package and “in connection with” employment under TUPE.

Comment

This is an important decision in the context of transactions that include a transfer of employment under TUPE, although the decision may be appealed. Subject to a successful appeal, the key headline takeaways are as follows:

- *Discretionary share schemes should not be caught by this decision.*
- *Schemes and arrangements that do not confer any additional benefit on the participant (e.g. the award of free or discounted shares, or some form of cash payment) should not need to be carried over post TUPE transfer.*
- *If participation in a SIP or similar scheme includes features that are considered part of an employee's overall package, the sale agreement should include an agreement between the parties that the buyer will establish and offer participation in a scheme that is substantially equivalent to the one transferring employees participated in.*
- *The case should not be read as suggesting that any SIP or similar scheme results in the buyer needing to put a substantially similar scheme in place and the nature of the plan and how it is offered should be considered (there was a slightly particular fact pattern in Ponticelli).*
- *Unless the buyer already operates a SIP or other scheme on terms substantially equivalent to the seller's scheme, consider carefully whether the buyer should offer participation in a SIP or if it may be more commercially acceptable to put in place a scheme that is substantially equivalent.*

Changes to the UK Takeover Code

Changes to the UK Takeover Code (the "**Code**") took effect on 11 December 2023. These changes will make it easier on any Code-related transaction for companies to continue to operate their employee incentive schemes during a relevant period (see below). These changes are likely to be particularly helpful for transactions that are subject to long offer periods.

The changes apply to Rule 21.1 which, at high level, restricts offeree companies from taking actions during an offer period which could frustrate the deal. There is often concern about whether an offeree can continue to run its share plans or take other remunration-related decisions in an offer period and the changes provide some helpful clarity.

Due to the changes, an offeree company may take or agree to take a "restricted action" including the grant of an option or award, or the issue, or transfer out of treasury, of shares to satisfy an option or award during a "relevant period" (see below) if the action is in the ordinary course of the offeree's business.

For the purposes of the Code, a relevant period is defined as being the period from the earlier of (i) an approach by a potential offer, and (ii) the beginning of the offer period, until the expiry of the offer period or where the offer period has not begun, 5pm on the seventh day following the date on which the latest approach was rejected.

In contrast if the restricted action is considered not to be in the ordinary course of the offeree's business the consent of the Takeover Panel will be required, and potentially the approval of the offeree company's shareholders in general meeting.

In addition to the changes to Rule 21.1 the Notes have also been amended and guidance issued. In particular, the Panel will normally consider the restricted actions listed below as being in the ordinary course of business.

- The grant of options and awards over shares in the offeree company provided the timing and level are in accordance with normal practice under an established scheme or the publicly disclosed proposed practice under a new scheme.
- The issue or transfer out of treasury of shares to satisfy the vesting and exercise of options and awards granted before the start of the relevant restricted period.
- The grant of an option or award over shares in the offeree company in connection with a promotion or new hire.
- A divergence from normal practice in the grant of options or awards over shares in the offeree due to a change of law or best practice.

On offer-related retention arrangements, the Panel must be consulted if the proposed retention arrangement is considered not to be in the ordinary course of business under Rule 21.1, relates to a period prior to the end of the relevant offer period, and either is significant in value (1% of the value of the offeree company calculated by reference to the offer price) or relates to a director or management.

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