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INCENTIVES BULLETIN

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One Bunhill Row
London EC1Y 8YY
United Kingdom
T: +44 (0)20 7600 1200

Welcome to the November edition of our Incentives Bulletin, updating you on the latest developments in remuneration and share plans. In this Bulletin, we look at the Office of Tax Simplification's report on potential amendments to Capital Gains Tax, updated guidelines on executive remuneration from the Investment Association and Institutional Shareholder Services for 2021, and HMRC's COVID-19 guidance for tax advantaged share schemes.

OFFICE OF TAX SIMPLIFICATION PUBLISHES A REPORT ON THE SIMPLIFICATION OF CAPITAL GAINS TAX

Following a request from the Chancellor in July 2020 and consultation with advisers, businesses, academics and the public, the Office of Tax Simplification ("**OTS**") has published the first of two reports on the simplification of Capital Gains Tax ("**CGT**"). This report outlines the policy design and principles underpinning CGT; the second will explore key technical and administrative issues and will be published in early 2021.

The purpose of the review was to 'identify opportunities relating to administrative and technical issues as well as areas where the present rules can distort behaviour or do not meet their policy intent'. It is clear that there could be a negative impact on both tax advantaged and non-tax advantaged share plans if HMRC follows through on the suggestions in the report.

The report notes that retaining a substantial difference in tax rates between income tax and CGT may put pressure on the boundaries between the two taxes. Share-based remuneration is identified as a key area in this respect. The OTS notes that while employee share plans can be an important part of a balanced employee reward package, so are salaries and bonuses, which are taxed at normal income tax and NICs rates. The OTS also notes that millions of employees in the public sector, partnerships, or private equity backed companies cannot access tax advantaged all-employee plans and questions whether they are the most cost-effective approach to helping people save or encouraging long term share ownership. There is some recognition of the policy justifications behind tax advantaged plans but overall it is clear that companies will need to be prepared to respond to these points in due course. The OTS discusses the possibility of reducing the annual exempt amount from CGT, which would, if pursued, also have a negative effect on SAYE and CSOP participants.

For non-tax advantaged plans, growth share plans are likely to come under the most pressure. The OTS notes that certain growth shares are made available on better terms than to some investors, yet if employees acquire these shares at a low value, they are not risking significant amounts of their own capital, making the returns look more like rewards for employment than capital investment. This feeds into the OTS's overall observation that, in relation to growth share plans, 'the boundary is hard to delineate' between CGT and income tax which may be taken to justify more closely aligning CGT rates with income tax rates and may herald a more concerted effort to curb the use of these plans.

INVESTMENT ASSOCIATION PUBLISHES ITS PRINCIPLES OF REMUNERATION FOR 2021

The Investment Association's ("**IA**") Principles for 2021 address the impact of the coronavirus pandemic on executive remuneration and set out the IA's view of "best practice" in light of the current crisis. They highlight the need to balance rewarding and incentivising management with the expectations of shareholders and wider society.

The Principles emphasise the importance of ensuring that legal enforcement of post-cessation share ownership guidelines is achievable (and reiterate that the means of achieving this should be stated).

The IA has previously indicated that remuneration committees should consider setting environmental, social and governance ("ESG") conditions for awards of variable remuneration. It recognises that companies are increasingly incorporating the management of material ESG risks and opportunities into their long term strategy, making it appropriate that this forms part of any performance conditions. However, it is imperative that ESG-related performance conditions are clearly linked to the implementation of the company's strategy.

In discussing what it sees as the growing use of strategic targets and/or personal objectives in annual bonuses, the IA states that it expects that financial metrics will comprise the significant majority of the amount of any annual bonus and, where personal objectives are used, companies should demonstrate how they are linked to long term value creation (and personal objectives should not cover actions which form part of the 'day job').

There is no change to the IA's existing approach on pension contribution rates for directors: these should be aligned with those available to the majority of the company's workforce; pension related payments should not be used as a mechanism for increasing total remuneration; new directors (or directors changing roles) should not be given a higher pension contribution than the wider workforce; remuneration committees should have in place action plans to lower existing directors' pension contributions to the general workforce rate by 2022. Where an executive director receives pension contributions of 15% or more of salary, and the remuneration committee fails to disclose a credible action plan to address this, the IA will "red top" the directors' remuneration report.

The IA has also updated its separate guidance on shareholder expectations for executive remuneration during the pandemic, emphasising that companies should not shield executives from the impact of the pandemic more than they would for the wider workforce. They warn that to do otherwise could lower workforce morale and carry reputational risk. Where a company has raised additional capital from shareholders, or has taken government support through the Coronavirus Job Retention Scheme, taken government loans or has used or is using other similar government schemes which offer direct support to companies, the IA states that shareholders would expect this to be reflected in the executives' remuneration outcomes and generally would not expect the payment of any annual bonuses for FY2020 or FY2020/21, unless there are truly exceptional circumstances.

INSTITUTIONAL SHAREHOLDER SERVICES PUBLISHES PROXY VOTING GUIDELINES FOR 2021

Institutional Shareholder Services ("**ISS**") has updated its UK proxy voting guidelines for 2021 and has identified two areas of particular focus in the context of its voting recommendations on resolutions to approve new or amended remuneration policies.

First, directors' pensions should be aligned to the wider workforce (consistent with the IA's views summarised above). This will be a voting issue for them from February 2021 for any new remuneration policies.

Secondly, there should be appropriate post-cessation shareholding guidelines (and ISS references the approach set out in the Corporate Governance Code and in the IA Principles).

HMRC UPDATES GUIDANCE ON COVID-19 ISSUES FOR TAX ADVANTAGED SHARE SCHEMES

HMRC has published Employment Related Securities Bulletin 37, giving some helpful guidance on incentives issues in light of the coronavirus crisis. This has been updated to reflect the extension of the Coronavirus Job Retention Scheme (CJRS) to March 2021.

If an employee is furloughed or has their working hours reduced this will not affect the qualifying status of existing EMI options. Where employees no longer meet working time commitments they can maintain the relevant tax reliefs as if they had continued to work for their employer. HM Treasury may extend the exemption for a further 12 months if the pandemic has not ended by April 2021.

HMRC confirms in the Bulletin that employees working fewer hours than usual and who are eligible for the furlough scheme will be treated as part-furloughed for SAYE purposes. The extended payment holiday will continue to apply to those who miss contributions whilst receiving payments under the furlough scheme.

HORIZON SCANNING

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

31 December 2020	Transitional arrangements under UK-EU withdrawal agreement expected to end unless extended
29 January 2021	End of consultation period for European Banking Authority consultation on revisions to its 2015 guidelines on sound remuneration policies (including amendments introduced by CRD V)
6 April 2021	Off-payroll working rules (IR35) come into force for the private sector

CONTACT

- PADRAIG CRONIN
- PARTNER
- T: +44 (0)20 7090 3415
- E: Padraig.Cronin@slaughterandmay.com

- PHIL LINNARD
- PARTNER
- T: +44 (0)20 7090 3961
- E: Phil.Linnard@slaughterandmay.com

- IAN BROWN
- SENIOR COUNSEL
- T: +44 (0)20 7090 3576
- E: Ian.Brown@slaughterandmay.com