Changes to the UK income tax and National Insurance treatment of share incentives awards for internationally mobile employees

Employers need to consider and take action before 6 April 2015

The taxation of certain share incentives for internationally mobile employees (IMEs) will change from 6 April 2015. The legislative changes have been introduced by the UK Government in an effort to align the tax treatment of different types of share incentive awards.

The changes may have a significant impact on IMEs who have equity awards and who 'touch' the UK. Employers need to understand the legislative changes in order to ensure that they have the correct tracking mechanisms in place to comply with the new rules.

A corresponding change to the UK National Insurance contributions (NICs) law will apply a new apportionment to any awards that are not exempted from NICs by the European Economic Area (EEA) social security coordinating regulations, reciprocal agreements, or because UK domestic law residence conditions are not met for moves to rest of world (ROW) countries. Disappointingly, the apportionment is based on different principles from those applied for UK tax, so alignment of the figures that have to be subject to UK tax and NICs is likely to be rare in practice unless the IME has no workdays outside the country in which he is tax resident.

The legislation will apply retrospectively and will impact taxable events from 6 April 2015, regardless of the date that awards were initially granted. The tax treatment pre- and post-6 April 2015 can vary considerably.

In addition, a new requirement to register all share plans with HMRC by 6 July 2015 and the introduction of on-line reporting for awards from 2014/15 onwards are likely to intensify HMRC scrutiny of share plans and compliance with associated reporting requirements.
Key issues and impact

The key issues and impact of the change in legislation are best addressed through the use of examples pre and post 6 April 2015. We have used share options as a sample share award as these are one of the more prevalent share plan arrangements that are impacted by these changes. Please note that other types of share award are impacted in a similar way.

Example 1
IME granted a share option in March 2011 whilst working in France. IME not resident or working in the UK in March 2011 and grant not made in contemplation of UK duties. In March 2013 the IME comes to the UK to work for a UK employer and becomes UK tax resident. The option vests in March 2014.

Current rules Option exercised before 6 April 2015: No UK income tax and NI payable at the date of exercise because the employee was not resident in the UK at the date of grant.

New rules Option exercised on or after 6 April 2015: UK income tax is payable based upon the period of time spent in the UK during the grant to vest period. For tax, an apportionment may be possible to exclude the part of the gain attributable to any non-UK workdays. If the employee transfers to the UK on a local contract and so becomes liable to NICs, under the proposed new law NICs will also be payable on the gain for the whole period from March 2013 to March 2014, regardless of where the employee has actually worked during that period.

Example 2
IME granted a share option in March 2011 whilst resident and working in UK. In March 2013 the IME leaves the UK to work for a new local employer in the United Arab Emirates (UAE). The option vests in March 2014. Option is exercised in UAE when the employee has ceased residence in the UK.

Current rules UK income tax is payable on the date of exercise on the full gain because the employee was resident in the UK at the date of grant and no treaty is available to limit the UK’s taxing rights. No NICs are due under existing UK law because the IME is not subject to a NIC’s liability from date of departure.

New rules UK income tax is payable based on the time spent in the UK during the grant to vest period. As the employee has moved to a new employer in UAE, the employee will cease to be within the scope of UK NICs from the date the employee leaves the UK. Under the proposed new law, NICs will be payable on the gain for the period up to March 2013 only.
Example 3
IME granted a share option in March 2011 whilst working in US. Employee is not resident or working in the UK in March 2011 and grant not made in contemplation of UK duties. In January 2012 the IME comes to the UK on assignment and becomes UK tax resident. The employee ceases residence in the UK in January 2014 and returns to the US. The option vests in March 2014.

Current rules Option exercised before 6 April 2015: No UK income tax and NICs payable at the date of exercise because the IME is not resident or working in the UK at the date of grant.

New rules Option exercised on or after 6 April 2015: UK income tax is payable based upon the period of time spent in the UK during the grant to vest period – even though the employee is not in the UK at grant or exercise (assuming no treaty can be applied to exempt the income). Again, for tax, an apportionment may be possible to exclude the part of the gain attributable to any non-UK workdays. Provided that the employee was assigned to the UK from the US the employee would normally remain insured under FICA and exempt from UK NICs.

Example 4
IME granted a share option in March 2011 whilst resident and working in India. Employee Not Resident or working in the UK in March 2011 and grant not made in contemplation of UK duties. In March 2013 the IME comes to the UK to work for a UK employer and becomes UK tax resident. The option vests in March 2014.

Current rules Option exercised before 6 April 2015: No UK income tax and NICs payable at the date of exercise because the IME is not resident or working in the UK at the date of grant.

New rules Option exercised on or after 6 April 2015: UK income tax is payable based upon the period of time spent in the UK during the grant to vest period. If the employee transfers to the UK on a local contract and so becomes liable to NICs, under the proposed new law NICs will also be payable on the gain for the whole period from March 2013.
Next steps

Review your share plans in order to confirm how the share arrangements are impacted by the changes to UK legislation.

- Review your population of IMEs to understand which employees may be impacted by the changes. If you have a large tax equalised population of inbounds, this could significantly increase your costs (including employer NICs in some cases).
- Consider the operation of your tracking systems for IMEs residence and NIC or other country social security status - are COCs / A1 forms held? How will these systems need to change in order to ensure compliance?
- Following a review of your share plans and IME population, assess whether there may be opportunities to minimise the tax and NICs impact of these new rules.
- Consider whether you want to communicate the changes to your employees to ensure that they understand the impact of the changes and enable them to decide whether to exercise prior to or on/after 6 April 2015.

The forthcoming changes do not impact cash incentives e.g. bonuses. This means that the NICs treatment is likely to be different for trailing cash and share based awards.

Further information

For further information, please contact one of the following or your usual EY contact:

<table>
<thead>
<tr>
<th>Name</th>
<th>Email</th>
<th>Phone</th>
</tr>
</thead>
<tbody>
<tr>
<td>Catherine Bond</td>
<td><a href="mailto:cbond@uk.ey.com">cbond@uk.ey.com</a></td>
<td>01189 281681</td>
</tr>
<tr>
<td>Nigel Duffey</td>
<td><a href="mailto:nduffey@uk.ey.com">nduffey@uk.ey.com</a></td>
<td>020 7951 9586</td>
</tr>
<tr>
<td>Lorna Jordan</td>
<td><a href="mailto:ljordan@uk.ey.com">ljordan@uk.ey.com</a></td>
<td>01189 28 1688</td>
</tr>
<tr>
<td>Andrew Morgan Jones</td>
<td><a href="mailto:amorganjones@uk.ey.com">amorganjones@uk.ey.com</a></td>
<td>01179 812136</td>
</tr>
<tr>
<td>Eleanor Meredith</td>
<td><a href="mailto:emeredith@uk.ey.com">emeredith@uk.ey.com</a></td>
<td>01179 812 088</td>
</tr>
</tbody>
</table>