



## STRATEGIES FOR EMPLOYERS TO MITIGATE THE 50% SUPERTAX

The introduction of the 50% "supertax" from April 2010 for those earning over £150,000, together with the forthcoming changes to tax relief for pension contributions and the tapered withdrawal of personal allowances for those earning over £100,000, means that high earners are facing the most unfavourable UK tax environment for over 20 years. Indeed, from April 2010, the difference between the effective tax rate on employment income for high earners compared to the tax rate on capital gains will be nearly 40%.

In this update, we provide an outline of a number of tax-efficient remuneration strategies that seek to limit the impact of the new 50% supertax on high earning executives.

### Remuneration Planning Breakfast Seminar

Given the importance of these tax changes, we will also be giving a Remuneration Planning Breakfast Seminar at our New Street Square offices on Friday 16 October 2009. This will cover the strategies mentioned below in detail, and will provide you with the opportunity to explore other innovative solutions with our expert speakers.

If you would like to attend, please email: [seminars@rawlinson-hunter.com](mailto:seminars@rawlinson-hunter.com). We look forward to seeing you there.

### Remuneration Planning Strategies

The new 50% supertax is likely to impact severely on the remuneration of senior executives and, in particular, on the amount of their after tax bonuses. Hence, in the interests of retaining the best talent, many employers are considering how to help these individuals minimise their tax liabilities. A number of potentially suitable strategies are detailed below.

#### *Paying bonuses early*

This strategy is to bring forward bonuses to before April 2010 in order to avoid the introduction of the 50% supertax. Accordingly, where part of a high earning executive's remuneration is in the form of cash bonuses, the possibility of paying this bonus in March 2010 should be considered. Whilst the tax will be due earlier, the bonus will only be taxed at the lower rate of 40% rather than at 50%. Furthermore, for those executives earning around £100,000 per annum, the tax saving will be even more pronounced as they will avoid the impact of the tapering of personal allowances.

#### *Salary sacrifice arrangements*

For those executives earning around £100,000 per annum, the cost of the abatement of personal allowances will be extreme as they will suffer an effective tax rate of 61% in the abatement band of £100,000 to £113,000. In these circumstances, salary sacrifice arrangements can be used to minimise the severe tax impact. For example, a salary reduction could be accepted by the executive in lieu of the employer increasing employer contributions into the executive's pension plan, thus saving tax equal to 61% of the sacrificed amount.

#### *Company share option plans ("CSOPs")*

Another tax efficient way of remunerating key executives is via a CSOP, which is an HM Revenue & Customs ("HMRC") approved share option scheme. A CSOP enables executives to receive rewards that are taxed under the capital gains tax rules (at only 18%) rather than under the Income Tax rules (at 50% plus National Insurance contributions ("NIC")).

Under a CSOP, options over shares of up to £30,000 can be granted to each executive. Provided that the options are exercised between three and 10 years after the date of grant, and provided that a number of other conditions are met, no Income Tax charge will arise on the exercise of the option. Instead, Capital Gains Tax will arise on any subsequent disposal of the shares.

Eighth Floor  
6 New Street Square  
New Fetter Lane  
London EC4A 3AQ

and at  
Lower Mill  
Kingston Road Ewell  
Surrey KT17 2AE

T +44 (0)20 7842 2000  
F +44 (0)20 7842 2080

[firstname.lastname@rawlinson-hunter.com](mailto:firstname.lastname@rawlinson-hunter.com)  
[www.rawlinson-hunter.com](http://www.rawlinson-hunter.com)

## **EMI option schemes**

An EMI option scheme is another HMRC approved share option scheme, and enables key executives to receive rewards that are taxed under the Capital Gains Tax rules (at 18%) rather than under the Income Tax rules (at 50% plus NIC).

EMI option schemes differ from CSOPs in that up to £120,000 shares can be issued to each executive, compared to £30,000 under a CSOP. However, the EMI rules are more restrictive in relation to the characteristics of the employer company, which must be a “small” company with less than 250 employees and must not be under the control of another company.

Under an EMI option scheme, provided that certain conditions are met, no Income Tax charge will arise on the exercise of the option. Instead, Capital Gains Tax will be due on any subsequent disposal of the shares.

## **Restricted share schemes**

Where a CSOP or EMI option scheme is not available or is not suitable, then a similar type of commercial arrangement can be achieved by issuing “restricted” shares to executives at market value. The shares are “restricted” because they will be subject to forfeiture in certain circumstances – for example, if the executive leaves employment within, say, three years.

The favourable capital gains tax treatment is achieved by the executive and the employer entering into a tax election within 14 days of the “restricted” shares being issued. The effect of the election is to apply Income Tax and NIC to the unrestricted market value of the shares at the date of share issue. The quid pro quo is that any future growth in value of the shares will only be subject to Capital Gains Tax.

## **Joint share ownership plans (“JSOPs”)**

The disadvantage of restricted share schemes is that they require the executives to subscribe for the shares at market value at the outset. This means that the executives may need to stump up significant cash at the beginning, and risk losing some or all of their cash if the shares subsequently fall in value. JSOPs have therefore been designed to deal with this problem by enabling executives to invest in their employer’s shares at little cost.

JSOPs work by arranging for both the executives and an employee benefit trust (“EBT”) to jointly subscribe for shares in the employer company. The EBT provides the vast majority of the cash for the share subscription, but the executives enjoy the vast majority of the future growth in the value of the shares.

The executives will be liable for Income Tax on the initial value of their interest in the shares. However, as this initial value is generally low, there should be very little tax payable upfront. Then, after a specified time, the executives’ shares will be sold, and their sale proceeds will be subject to Capital Gains Tax.

## **Employee benefit trust (“EBT”) loans**

The EBT loans strategy is relevant to an employer company that wishes to pay cash bonuses to executives, but does not wish to pay Income Tax nor NICs, and is not concerned about forgoing Corporation Tax relief on the bonus payments. The idea is that instead of paying a bonus, the money is contributed to an EBT. From there, the money is loaned interest-free to the relevant executives.

The loans must be repaid by the executives to the EBT at some stage. However, in the meantime, the executives enjoy the benefit of having the cash, and the ongoing tax cost will be very low. At current interest rates an annual tax charge of approximately 2.5% of the loan balance will arise, this being the tax arising on the notional annual benefit of receiving an interest-free loan.

## **Corporation Tax relief for underwater share options**

Corporation Tax relief for share options is normally denied until the options themselves are exercised. The amount of the eventual relief is the difference between the market value of the shares at the date of exercise and the exercise price. However, due to current market conditions, many share options are now underwater as the exercise price is greater than the current market value of the shares. In these situations, the options may never be physically exercised, although the company’s profit & loss (“P&L”) account will have suffered charges over the vesting period.

An innovative tax strategy is therefore to claim a Corporation Tax deduction for the P&L charges for the underwater options, even though the options have not been (and may never be) exercised. This is on the basis of a quirk in the tax legislation which does not appear to envisage a situation involving underwater options.

## **Summary**

The recent Income Tax changes have the potential to massively hit high earners, and to discourage prudent retirement provision. Nevertheless, there are a number of ways for key executives to benefit from much lower tax rates via the appropriate use of share schemes, and by giving due consideration to the timing and make-up of bonus payments. However, because time is short, executives and employers should be discussing these matters now with their tax advisers in order to put in place suitable arrangements before the beginning of the next tax year.

Our Remuneration Planning Breakfast Seminar on 16 October will discuss these strategies in more detail, and will provide you with the opportunity to explore other innovative solutions with our expert speakers. Please feel free to join us. Alternatively, if you are unable to join us but would still like to discuss these issues further, please speak to your usual Rawlinson & Hunter contact.

Rawlinson & Hunter  
Chartered Accountants

### Partners

Philip Prettejohn FCA  
Bob Drennan FCA  
Simon Jennings FCA  
Chris Bliss FCA  
James Kelly FCA  
Mark Harris FCA  
Frances Stephens ACA  
David Barker CTA  
Kulwam Nagra FCA  
Ben Melling FCA  
Paul Baker ACA  
Sally Ousley CTA  
Derek Rawlings FCA  
Andrew Shilling FCA

### Directors

Mike Cunningham ACA  
Craig Davies ACA  
Nigel Medhurst AIT  
Graham O’Connell ACA

### Consultants

Ken Dent FCA  
Ralph Stockwell FCA

The information contained in this bulletin does not constitute advice and is intended solely to provide the reader with an outline of the provisions. It is not a substitute for specialist advice in respect of individual situations.

Registered to carry out work and regulated for a range of investment business activities by the Institute of Chartered Accountants in England and Wales.