Taking Stock Of Share Awards

Share awards have long formed a core part of an employee's total remuneration. This is especially true for executives and is seen not only as a way of incentivising them based on the performance of the company, but also tying them to their employer for the long-term. Many awards for this level of employee have a minimum three year vesting period with a further three year deferral following on from that. For the purpose of this article we will include all share based remuneration such as options, stock units, phantom awards and qualifying and non-qualifying plans.

There has been particular focus on share based income in recent years with governments viewing them as offering too great a reward on top of what is already significant base pay in the form of salary and cash bonuses where executives are concerned. Coupled with the escalating drive to ensure everyone pays their fair share of tax, and the need for countries to continue increasing their tax take to keep up with public spending, it was only a matter of time before the UK tax authorities (HM Revenue & Customs - HMRC) revisited this topic. This will also have consequences for all other countries however where expatriates are concerned.

The rules surrounding the taxation of share awards are complex even when dealing with local employees. There are potentially multiple points of taxation (grant, vest, exercise and sale to name the most common) and income and/or capital gains tax (CGT) may apply depending on the type of award. Generally speaking, a non qualifying award will be subject to income tax and CGT will be payable on a qualifying award, which enables individuals to benefit from the CGT annual exemption and lower tax rates applicable. As discussed below, many countries have separate rules for social security and these add an additional layer of complexity.

For internationally mobile employees the waters are muddied even further. Currently, whether an award is liable to UK income tax largely depends on whether it is considered a legal share option or not and the tax residence status of the individual at the date of grant. An individual may be left in a position where some, all or none of the award is subject to a tax charge in the UK. As a company you need to be aware of the type of award, the correct tax treatment of the award and the residence status of the individual to ensure you correctly deduct any withholding tax that may be due - we will also come on to the social security position later on.

From 6 April 2015, HMRC has announced that the UK income tax position will move to a sourcing based approach; that is to say that where an employee has been resident and/or working in the UK at any point during the life cycle of an award, UK tax will now be due on a portion of the gain. Generally speaking, the amount of gain attributed to the UK period will be subject to UK income tax. For example, where an individual has been resident and working in the UK for twelve months during a total award period of thirty six months, the UK will seek to tax 1/3 of the gain.

This change in position will apply to all awards, even those held prior to 6 April 2015. It is already imperative that employers track awards made to cross border workers. From a UK point of view this requirement has now taken on even greater significance as every employee that works in the UK and has share awards will have some UK income tax to pay on these. The employer will continue to be tasked with ensuring that they withhold the correct amount of withholding tax which can only happen by maintaining accurate records.

Each country has its own rules on how share awards are taxed and these are varied and numerous. It is not uncommon for two or more countries to want to tax the same income. Companies and tax advisors alike need to be clear on the amount of the gain liable to tax in each location and the correct way to alleviate any double taxation on this. This will mostly be set out in the terms of double tax treaties that give clear guidance on which country has the right to tax the income, and how the other country must address this to ensure true double taxation does not occur. Greater uncertainty is more likely where there is no double tax treaty in place however; it will be down to local tax laws and agreement of the competent authorities in those locations to remedy any dual tax position.

This change in UK tax law on the sourcing of share award income will impact how other countries go about giving relief for UK taxed income. HMRC are likely to be of the opinion that the UK will no longer need to give relief (other than in very limited circumstances) for doubly taxed income as it is only the UK sourced element that is being subject to tax. As far as HMRC is concerned the onus will then be on the other countries to ensure any double taxation is avoided. In making this change HMRC is acting in accordance with OECD guidelines and in line with most other major jurisdictions.

National Insurance/Social Security

Historically, there has been no definitive guidance from HMRC on the national insurance/social security position on share awards and we have been left to apply the general social security laws when determining whether a charge arises.

For UK purposes the applicable social security legislation does not allow an apportionment of income and it is therefore an all or nothing levy. Whether social security is due is currently based on a number of factors including residence status when the award is made, liability to social security at grant and exercise, whether tax is due on the award and any countries the individual has worked in through the life of an award.

Again, HMRC has looked to address this from 6 April 2015 and UK social security legislation has been rewritten to specifically cover the amount payable on share based income. This broadly mirrors the income that will be subject to UK income tax and will therefore specifically allow an apportionment when calculating the chargeable amount.

This change in legislation should mean that, as for tax, HMRC will only look to collect social security on what they view as UK sourced income. As for everything related to expatriates however, it is not quite as straight forward as that, due to each country's method for sourcing income and the way the world is split for social security purposes:

- EU countries (including Switzerland, Norway, Iceland and Lichtenstein)
- Countries that have a social security treaty
- Rest of the world.

The majority of issues will arise with rest of the world countries, although countries that sit in the other two categories will not be immune.

As for tax, each country has its own laws and interpretation on how income should be sourced when establishing the social security charge. This can lead to the same income being liable to social security in two or more countries. You can appreciate this is a recurring theme for both tax and social security for all expatriates.

EU Social Security Regulations and any relevant treaties between two or more countries should ensure that ultimately there is no dual social security charge. This is not quite as 'simple' as alleviating double taxation as there is no mechanism to give credit in one country for social security paid in another country. It will be down to the countries involved to come to an agreement as to which country will have the right to charge social security on the income. This process can take some time to work through.

Where one ventures outside the EU and into a rest of the world country, things are less clear cut. The UK tends to continue charging social security for 52 weeks after an individual has been assigned to one of these locations. Invariably the host location will also charge their social security from day one. HMRC has stated that they view the first 52 week period as being 'UK source' and will not cede the right to charge social security for this period. They have accepted that in limited circumstances a true dual social security liability arises with no possibility of remedying this.

UK Reporting

Since 2004, there has been mandatory year end reporting in the UK, notifying HMRC of employees receiving, vesting and exercising share awards. To date the majority of companies have filed paper copies of these forms and HMRC has been fairly relaxed in the format provided it has been agreed up front and supplies all the necessary information.

From 6 April 2015, this reporting is moving to online submission only which must be done using the system put in place by HMRC. Companies must pre-register for online filing so they are ready to go live from April. The filing deadline for the forms is 6th July following the end of the relevant UK tax year (which is 5 April) and automatic late filing penalties apply (£100 initially, moving to £300 quarterly penalties and daily penalties after nine months). Going forward we expect 2015/16 returns to include details and analysis of UK sourced income for expatriates.

All relevant transactions must be declared on these 'end of year' forms both for local employees and expatriates. As for the tax and social security liabilities, it is therefore imperative that companies have robust tracking mechanisms in place to keep a handle on where their employees are resident/working, dates of moving between locations and awards made.

From a UK stand point the change in the way in which share income is taxed is not unsurprising, and aligns it more closely with other sources of 'regular' employment income, such as salary and bonuses. It brings into practice the position that often results after double tax relief is applied anyway in that it is only the UK sourced gain that is subject to UK tax.

There is one group of employees the changes will potentially negatively impact, this group being those individuals who currently hold share options awarded whilst they were non UK tax resident (and not performing UK work duties) who are not presently liable to UK income tax on any gain. This is currently the case even if they return to the UK prior to the option vesting. The new rules from 6 April 2015 will bring at least a portion of these gains into the UK income tax net where the vest occurs post their return to the UK.

The new legislation on social security also brings welcome clarity to an area that has needed addressing for some time. Neither the old or new rules are perfect, both potentially leading to dual social security charges in certain circumstances; however HMRC's position is now clearly set out in law.

Both HR professionals directly involved with the UK tax and social security position and those who are responsible for administering the overseas requirements need to be aware of these changes. They will impact UK tax and social security withholding for all awards from 6 April 2015 which may have a knock on effect on the amounts chargeable and relief available in the overseas locations. Online filing must also be set up to facilitate the mandatory end of year share reporting.

HMRC has had a clear focus on tax compliance for share awards over the past few years and the changes to make the system 'fairer' are being brought in to place in one go. They want to ensure that the right amount of tax and social security is paid and the onus is very much on companies to track and report all awards via these mandatory procedures. With the complexities surrounding share based income this will only add further compliance requirements to internal HR teams and we expect HMRC to be active in ensuring that the new rules are followed and reported.

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