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# UK Update - HMRC issues guidance on the reporting of net-settlement withholding method

## Reporting Guidance

HMRC has published guidance on how companies should report the net settlement withholding method for shares acquired under non-tax advantaged share plans in their annual returns (reported in the "Other" return). The 2019/20 annual returns are due by July 6, 2020.

Net settlement refers to a withholding method undertaken by some companies to satisfy their PAYE income tax and National Insurance withholding obligations when delivering shares to employees. Instead of delivering the full number of shares in settlement of a share award, a company will calculate the amount needed to satisfy PAYE and National Insurance withholding obligations and deduct a number of shares with a value equal to this amount from the number of shares to be delivered to the employee at settlement. The company will then pay the employee's PAYE tax and National Insurance liability to HMRC directly.

HMRC has advised that it expects companies who use the net settlement withholding method to inform HMRC that they are doing so in their annual returns, by reporting as separate entries on the "Other_Options_V3" tab:

- the number of shares delivered to the employee (net of shares withheld to cover tax); and (on a separate line)
- the value of the shares withheld and paid in cash to HMRC.

Additional reporting therefore is going to be needed where net settlement is used.

## Corporate Tax Implications

Although HMRC's revised guidance does not touch on this point, we envisage that HMRC's insistence on separate reporting of the net settlement withholding method is a warning that there will be increased HMRC scrutiny on the amounts that companies using net withholding are claiming as a corporation tax deduction in respect of the delivery of shares to their employees.

To elaborate, provided a company meets the qualifying conditions, it should be able to claim an automatic statutory corporation tax deduction where it delivers shares to employees. Most employers expect the corporation tax deduction to be (broadly) equal to the amount on which the employee was subject to income tax. However, the statutory corporation tax deduction only applies to the shares actually acquired by the employees (at least with beneficial ownership) and so will only apply on the value of the shares actually delivered to the employees. As noted above, where the net settlement withholding method is used, only a reduced number of shares will be delivered to the employee (although the employee remains, of course, subject to income tax and National Insurance contributions on the full value of the award at settlement).

Companies will therefore need to be prepared to reduce the amount they claim as statutory corporation tax deduction if they use the net settlement withholding method. It may, however, be possible to claim a corporation tax deduction also for the amount of the withheld shares, if the value of such shares was reimbursed or paid by the UK employer (preferably pursuant to a reimbursement agreement) and accounted for as an expense in its profit and loss account.

**Our team would be happy to talk through the implications with you further.**

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