ProShare

# Policy Paper – "Super-charging share ownership"

## Contents



## Executive Summary

The UK has a proud and long-standing tradition of fostering Employee Share Ownership ('ESO'), with tax-advantaged share plans on the statute books since the late 1970s. Over the years, many millions of employees have benefitted from owning shares in the companies that they work for (2.4 million employees participated in SAYE and/or SIP in 2018, according to the ProShare SAYE & SIP Report), and their employers have benefitted from the correlated productivity boost that these plans in particular bring (see Appendix 1 for the HMRC & Oxera study on productivity & tax-advantaged share schemes).

But times change, and so do workforces, workplaces and the nature of work itself. Tax-advantaged share plans do still work well, but they could work much better – and this paper sets out how to achieve this, through some 'big picture' proposals, as well as through a selection of technical changes to the operation of current plans.

Our seven key 'asks' to super-charge share ownership are highlighted on page 2, and set out in greater detail later in the document.

## Introduction

Save As You Earn ('SAYE' or 'Sharesave') was introduced in the Finance Act of 1980, with the first plans being approved by shareholders at plan issuer companies' AGMs the following Spring. The Company Share Option Plan ('CSOP') came into force via the same mechanisms in 1995. The Share Incentive Plan ('SIP') and Enterprise Management Incentive plan ('EMI') both came into force in 2000.

These plans – collectively, the UK's tax-advantaged plans – all operate in different ways, with varied tax advantages for participating employees and employers, as set out in the relevant legislation (ITEPA 2003, schedules 2, 3, 4 and 5). What they all set out to do is to achieve combinations of the following:

- Increased productivity;
- Shared financial reward with the company's employees;
- Increased employee motivation;
- Increased employee engagement; and
- Improvement of employees' financial wellbeing.

For further detail on how these plans work please refer to the information in Appendix 3. For detailed statistics on how these plans are operated in practice, market and industry trends on take-up and participation rates, please refer to the accompanying 'ProShare SAYE & SIP Report' (additional copies available on request from ProShare – see contact details on page 11).

Whilst all of these plans have undoubtedly helped employees and employers considerably over the years of their operation, some of their design features are very much the product of their respective times – and times change, rendering some of these features irrelevant or actually counter-productive. We shall cover these issues in the next two sections, setting forward proposals and ideas on how to mitigate and overcome them.

## Our Seven Key 'Asks' to super-charge share ownership

1. Reduce the Share Incentive Plan holding period from 5 years to 3 years (see page 6)
2. Make resignation a 'good' leaver reason for SAYE & SIP (see pages 6 and 7])
3. Introduce a 'lookback' feature for SAYE option exercise prices (see page 4)
4. Abolish the working time requirement for EMI participation (page 7)
5. Review and increase the £30k limit for CSOP (page 8)
6. Link the availability of the corporation tax deduction on executive share plans to the offer of all-employee share plans to the broader workforce (page 9)
7. Re-introduce tax-advantaged cash profit-sharing schemes for companies and organisations who are unable to offer shares to their workforces (page 9).

Supporting details for these requests may be found as referenced above.

## ‘Bigger picture’ proposals

In this section we put forward three key ideas:

1. Facilitating a ‘whole workforce’ approach,
2. Employee shareholder dividends, and
3. A ‘life event’ drawdown opportunity for share plan participants.

**Facilitating a ‘whole workforce’ approach**

The central premise here is that whilst the compositions of UK workforces have changed, radically, over the past forty years, most of the related employment benefits have not. Entitlement to an array of workplace benefits depends largely on one’s employment status. Are you an employee? A worker? Are you on a fixed-term contract? Do you work in the ‘gig’ economy? Are you on a zero-hours contract? Are you self-employed? This maze of different statuses affects what companies are permitted to offer to each subset within their workforce.

The inconsistencies and complexities that bedevil these varied statuses have already been covered at length in The Taylor Review, so we will not reiterate them here. The forthcoming IR35 legislation is intended to tackle deliberately inappropriate treatment on the border between employees and contractors, and reduce tax ‘leakage’.

What we seek to focus on here is the inability of companies to offer share schemes to certain growing sections of their workforce, because individuals in these subsets do not fit neatly into the definition of ‘employee’ as set out in the relevant share schemes legislation. Many of the large employers that ProShare is proud to call members would like to have the choice of whether to offer share plans more broadly within their workforce, as they recognise the motivational and productivity boosting effects these plans bring, but the law, as it currently stands, prevents them from doing so.

To turn this aspiration into legal reality would require analysis and re-working of the employee share schemes exemption from shareholder pre-emption rights within the Companies Act 2006. There may be little appetite to re-visit an Act of its size and complexity but this is definitely the right place to start, followed by analysis of the changes required within the relevant schedules of ITEPA 2003. We strongly believe that the financial, productivity and wellbeing benefits of offering share plans more broadly within companies’ workforces would be considerable, for the employer, for the workforce, and for the UK economy as a whole.

**Employee Shareholder Dividends**

Getting employee shareholders higher up the list of Boards’ priorities – and indeed, creditors – is at the heart of this particular proposal. It would involve the creation of a new class of shares, specifically for employees / members of the company’s workforce, with certain enhanced rights attached. These rights could entitle holders of this share class to a higher dividend rate than other share classes and to higher priority in the event of corporate failure (rather like preference shares or bonds). In cases of corporate failure, such as Thomas Cook’s very recent demise, employees and members of the workforce pay a much higher price than other stakeholders, relying as they do on the company for their employment/work, perhaps their pension, their share plans (if offered by the company): most if not all of their financial security. In their 2017 report ‘Deadline to the Breadline’, Legal & General found that the average UK employee could last just 32 days financially if they lost their main source of income.

**'Life event' drawdown opportunity**

The legislation supporting tax-advantaged share plans in the UK is very specific in terms of dealing with the point at which a plan participant may access their shares. If their employment ceases, the participant will fall into one of two groupings – known colloquially as 'good' and 'bad' leavers. 'Good' or eligible leaver reasons are set out in the legislation as: redundancy, retirement, ill-health, and death. 'Bad' or ineligible leaver reasons are set out as: resignation and dismissal.

There are other events which, whilst not having an impact on employment status, still have a significant (financial) impact upon employees, such as starting a family, moving house, moving an elderly parent or dependent into residential care, entering into a civil partnership, or getting married or divorced. At these life events it could be extremely helpful for plan participants to be able to access some or all of the assets they have accrued at that point under a share plan. As the law currently stands, they are unable to do so and it is frequently found that the financial and/or emotional stress precipitated by these life events drives some people to leave their employment in any case. In such circumstances, these leavers usually fall into the 'bad' leaver category by resignation.

It would surely be more enlightened to permit plan participants to drawdown on their share plan assets as these life events occur – primarily to mitigate the financial and linked emotional impact. An important associated benefit would be that ensuring that an employer is able to give this support to their employees would increase the loyalty that the employee may feel to their employer and increase their likelihood of staying with that employer.

This is not a new idea, especially outside of the UK – French legislation in particular permits employees in their domestic financial participation plans to access their assets early when certain life events and changes to personal circumstances occur. For further information please refer to Appendix 4.

## Share plans technical proposals

In this section we will review each tax-advantaged plan in turn, putting forward proposals to mitigate or resolve known issues with their operation, and citing the relevant supporting evidence.

**Save As You Earn (SAYE)**

- ***Introduce a 'lookback' feature for SAYE share option exercise prices***
- ***Make SAYE more flexible by allowing earlier exercise with a reduced option price discount***
- ***Re-classify resignation as a 'good' leaver reason***

**SAYE** is essentially a savings scheme, facilitated through company payroll, with an option to use those savings to buy shares at a discounted option price. The act of saving itself is made that much easier for employees to achieve by the fact that savings are made by direct post-tax deductions from employees' pay via payroll. A recent piece of research by YBS Share Plans, the University of Durham and the University of Leeds (see Appendix 5) found that amongst employees they surveyed, 28% had no other means of saving and 40% said that they would otherwise spend the money without their employer's SAYE scheme as a means of saving it.

Based on monthly payroll deductions, SAYE makes it easy for employees to save, which improves their financial and mental wellbeing and in turn correlates strongly to improved focus at work and productivity. Employee share ownership is achieved if the participant saves for their agreed 3 or 5 year term and then opts to use those savings to buy shares at the option price. Participants who choose to exercise their option have no further income tax or NICs to pay on the exercise, but may have a CGT liability on any gain. ProShare's latest SAYE & SIP Report found that 55% of SAYE participants chose to keep their SAYE shares at maturity, though they had the opportunity to sell them.

Whilst SAYE has stood the test of time, and continues to benefit 1.3 million UK employees [source: ProShare SAYE & SIP Report], in the current period of declining share prices it is for some employees - and their employers' finance directors - little more than a glorified savings scheme, with some fairly unfriendly accounting treatment attached. In the current prolonged near-zero interest rate environment, some would argue that it's not even a particularly beneficial savings arrangement.

It is, however, a brilliantly easy way for employees to save (most of whom wouldn't save at all otherwise) and also a very 'safe' plan from a risk-profile viewpoint – their savings are held by a licensed savings carrier, accessible to participants at any time, and covered by the Financial Services Compensation Scheme. Capital is only at risk from the point that the participant decides to use their savings to buy the shares under option (and even then, this is cushioned by the option price discount of up to 20%). Both of these factors are incredibly important in the current and foreseeable environment.

So – how to make SAYE work more efficiently regardless of prevailing market conditions? Our members have put forward a number of suggestions, bullet-pointed at the start of this section. We'll take of these in turn, starting with the introduction of a 'lookback' feature for SAYE share option exercise prices.

Currently, if a company's share price has not performed well, and the option price set at the start of a 3 or 5 year share option term is higher than the market price at the end of that term (the maturity date), the only rational course of action for participants is to accept the repayment of their savings and allow the option to lapse six months on from the maturity date. Some – but not many - companies offer their participants the facility to use those savings to buy shares at the (lower) market price. ***A 'lookback' feature*** would involve the option price being reset to the market price at the maturity date, if the option price as calculated at the grant date was underwater, with the relevant option price discount being applied to calculate the new, reset, option price.

This would mean that companies avoid the situation where SAYE becomes a glorified savings scheme, which has a de-motivating effect on participating employees and is burdensome to the P&L in terms of the associated accounting treatment.

It would ensure that employees were able to exercise their options and acquire shares, regardless of the company's share price performance, thereby enabling the scheme to deliver on its overriding objective of employee share ownership. It would also ensure that companies could avoid the P&L impact of the arbitrary and punitive nature of IFRS2 share-based payments accounting treatment of lapsed options in this circumstance. Appendix 6 sets out an example of the accounting costs of SAYE & SIP compared – we can provide the 'live' spreadsheet on request should you wish to alter the inputs/assumptions to model different scenarios.

***Making SAYE more flexible***, responsive and realistic in relation to employees' average (reducing) tenure will encourage greater participation and engagement.

We propose a sliding scale on the option price discount available to participants, depending on how long they wish to save for:

| Maturing after x years of saving: | Suggested maximum discount to option price |
|---|---|
| 1 year | 0% |
| 2 | 5% |
| 3 | 10% |
| 4 | 15% |
| 5 | 20% |

The days of working for one or perhaps two employers for the entire length of one's career are far behind us. The *average* UK employee's tenure per employer is currently 5 years [according to life insurance firm LV]. In the US, average tenure across the entire workforce is 4.1 years, whereas for those aged 25 to 34, the average is 2.8 years [source: BBC]. Equivalent UK-only statistics specifically concerning employment tenure are hard to source, however ProShare's 'Attitudes to Employee Share Ownership' research study released in January 2018 found that 16% of all non-participants surveyed cited the reason 'I won't be with the company long enough to benefit' as their reason for not joining the plan. SAYE savings periods of 5 and even 3 years are well out of step with this attitude and urgently need an injection of realism, and flexibility.

***Re-classifying resignation as a 'good' leaver reason*** would help employers who take the more progressive and pragmatic view that employees usually have more than one reason for moving on to a different employer. In the experience of employer members, it is rare that a pending SAYE maturity will override all other reasons driving an employee to resign. Employees' reasons for resigning are many and varied – a new role with a new employer may present the opportunity of a pay-rise, new challenges, career progression and other more appealing or relevant workplace benefits such as flexible working patterns. Currently, at least as far as their SAYE plans are concerned, an employee who resigns from their employer is treated in the same way as one who is dismissed for gross misconduct – this cannot be right.

**Share Incentive Plan (SIP)**

- ***Reduce the 5 year holding period down to 3 years***
- ***Simplify and make the SIP dividend share tax treatment fair***
- ***Re-classify resignation as a 'good' leaver reason***

**SIP** encourages employee share ownership from the outset of an employee joining the plan, and does so through four different share elements (Free, Partnership, Matching and Dividend shares), which companies may choose to offer. These shares, once awarded (Free, Matching) or purchased (Partnership, Dividend) are required to be held in a SIP Trust on behalf of participating employees, for at least three years (Dividend) or five years (Free, Partnership, Matching) before they may be sold without attracting an income tax charge or NICs for the employee (and usually the employer too, in the form of ERs NICs).

ProShare's research study 'Attitudes To Employee Share Ownership' released in January 2018 found that, far from encouraging retention, ***the five year holding period for SIP shares*** actively discourages eligible employees from participating in the plans. 24% of non-participants surveyed said that they didn't join their employer's SIP because the five year holding period was too long.

The differing tax treatments for Free, Partnership and Matching shares up to 3 years, and between 3 and 5 years (as set out in Appendix 7), are confusing and hard for most eligible employees to understand. This makes the plan challenging for employers to communicate effectively to their workforces, and in turn lessens take-up rates and undermines the plan's primary intention to create and foster broad-based employee share ownership.

ProShare strongly recommends the removal of the 5 year holding period, and the retention of a single, simpler to understand, communicate and administer 3 year holding period for all SIP shares. The tax treatment during this year 0 to 3 period should be the 'lower of' valuation approach that is currently applied to shares withdrawn during the year 3 to 5 period.

***The tax treatment for dividend shares exiting the SIP*** is anomalous and unfair, especially in its interaction with the recent reduction of the annual dividend tax allowance from £5,000 to £2,000. It penalises individuals who have, in good faith, saved and invested through their employer's SIP, many of whom would not normally ever have to complete a self-assessment tax return. SIP participants who withdraw their shares from their plan (as anything other than a 'good' leaver) currently suffer tax on up to three years' worth of their dividend shares, the cumulative value of which may only be set against that single tax year's dividend tax allowance, and must be reported via self-assessment tax return. Please refer to Appendix 8 for further details.

A fairer way of taxing dividend shares when they are withdrawn from the SIP in taxable circumstances i.e. where a participant leaves their employer as a 'bad' leaver, would be to allow their cumulative value to be set against the value of the taxpayer's dividend tax allowance for the three preceding tax years.

The fairest way of treating SIP dividend shares would be to carve them out from tax entirely when they are withdrawn from their SIP trust on/after three years. These are shares which have been acquired solely as a result of the employee's participation in their employer's tax-advantaged SIP, after all, and will have been awarded in proportion to their other SIP shares (be they Free, Partnership or Matching shares, and pre-existing Dividend shares).

***Re-classifying resignation as a 'good' leaver reason*** would help employers who take the more progressive and pragmatic view that employees usually have more than one reason for moving on to a different employer. In the experience of employer members, it is rare that a pending SIP share 'maturity' date will override all other reasons driving an employee to resign. Employees' reasons for resigning are many and varied – a new role with a new employer may present the opportunity of a pay-rise, new challenges, career progression and other more appealing or relevant workplace benefits such as flexible working patterns. Currently, at least as far as their SIP shares are concerned, an employee who resigns from their employer is treated in the same way as one who is dismissed for gross misconduct – as with SAYE leaver treatment, this cannot be considered fair or just.

**Enterprise Management Incentive Scheme (EMI)**

- ***Abolish the working time requirement for EMI participation***

**EMI** helps SMEs in certain trades and industries to attract, incentivise and reward key members of their workforce, using options over the company's shares rather than precious cash in the form of higher salaries or bonuses. Key employees are granted an option over the company's shares using a valuation approved by HMRC's Shares & Assets Valuation team. At grant the option may be worth up to £250,000 per employee (subject to a £3m limit overall per employing company), and it will usually have certain performance conditions attached – achievement of this performance condition results in the option becoming available for the employee to exercise after a period of time after the date of grant specified by the company and the terms of its EMI scheme. If all conditions and terms are met, the employee will not have to pay any income tax or NICs on the exercise, and may also qualify for Entrepreneurs' Relief on the gain.

In order to qualify for an EMI option, the recipient employee must sign a declaration confirming that they work at least 25 hours a week for the employing company, or 75% of their working time if that is less. This working time declaration is usually incorporated into the option agreement and a copy of the declaration must be provided to the optionholder employee within 7 days of signature. The working time requirement itself is bureaucratic and irrelevant, it discriminates against those working fewer hours on a part-time basis, and serves no practical or policy purpose that we can discern.

The consequences for failing to meet this requirement are disproportionate, involving the option becoming disqualified and the associated tax advantages falling away entirely. We therefore propose that the working time requirement for EMI be abolished.

**Company Share Option Plan (CSOP)**

- ***Review and increase the £30k limit***

CSOP is an option plan which gives qualifying companies the ability to grant tax-advantaged options worth up to £30,000 per employee per tax year, referencing the company's market share price at grant. Participants are permitted to exercise their options on/after the third anniversary of the date of grant, and with no liability to income tax or NICs. CGT may be payable on the gain.

ProShare and in particular our member, Pett, Franklin & Co. LLP, note that the £30,000 limit has remained unchanged since CSOP's inception in 1995. This is in contrast to the limit for Enterprise Management Incentive (EMI) options, which currently still rely on EU State Aid approval - these have a current individual limit of £250,000 (having been increased from £100,000 in 2012).

This disparity has caused many smaller UK companies to prefer to award their qualifying employees EMI options instead of CSOP options. We recommend that in order to boost the use of CSOP options and therefore increase employee participation in company growth (particularly for large UK companies), it would be sensible to increase the current individual limit on CSOP options to at least reflect indexation increases since 1995. The new individual limit should at least be £60,000 which represents what the figure would be had indexation increases been applied to the individual limit from the inception of CSOPs in 1995.

Whilst EMI is an innovative way to encourage companies to continue to grow and attract talented recruits, its use is limited to small and medium size companies who do not carry out any of the excluded trading activities set out in ITEPA 2003, Sch. 5. This means that larger companies who may wish to grant tax-advantaged discretionary share options have to default to utilising the CSOP, which does not offer as much value to the employee or executive as an EMI would due to the lower CSOP grant limits.

**Cross-plan proposals**

- ***Link the availability / rate of the corporation tax deduction on executive share plans to the offer of an all-employee share plan to the broader workforce.***
- ***Re-introduce tax-advantaged cash profit sharing schemes for companies who are unable to offer all-employee share ownership to their workforces.***
- ***Review the restricted securities regime in relation to UK-inbound restricted securities-holding employees.***

**Corporation tax deductions** are generally available (and relevant) to profitable companies (via statue and/or case law) and can help to offset the cost of providing any type of share plan to executives and to employees. Given the significant values typically involved in executive share plans, this is where a CT deduction generates the greatest value for a company. 91 of the FTSE100 operate a share plan of some description for their employees, as well as discretionary share plans for their executives. Outside of the FTSE100, however, all-employee share plans are offered by around 65% of listed companies. This means that many hundreds of thousands of employees are missing out on the opportunity to own a part of the company that they work for, and to share in the success that their expertise and effort helps to create. All these companies, without exception, operate discretionary share plans for their executives.

The path to introducing an all-employee share plans is a well-trodden one, especially for listed companies, and in our view there is no excuse for not operating an all-employee plan of some sort if you already operate a share plan for your executives. Thanks to the support of successive governments over many decades, in the UK companies have a range of different employee share plans to choose from, to suit their business model, workforce and budget. They should be encouraged to make the most of this plurality of options.

ProShare's mission of course is to encourage and facilitate greater employee share ownership through education, support and networking – but we cannot achieve this entirely on our own. Effectively incentivising companies to do the right thing by either a) only permitting them to claim a CT deduction on executive plans if they are also operating an all-employee plan (of any type) or b) increasing the rate of the CT deduction on their all-employee plan, would create many thousands more employee shareholders, with all the attendant benefits for them and their employers as outlined at the start of this paper.

For companies whose ownership structure or entity status prevents them from issuing shares to employees, the reintroduction of legislation supporting a **tax-advantaged cash-only profit sharing plan** would be a popular and helpful development. Profit-sharing schemes (primarily involving shares with optional cash alternatives) used to be available through legislation that was introduced in 1979 but these were abolished in 2000 when the SIP legislation came in. Whilst this wasn't an issue for companies who were able to offer shares to their employees via the new SIP, those who could not do so felt the loss keenly (as did their employees).

Profit-sharing is a fundamentally different proposition to the payment of cash bonuses. As the name suggests, profit-sharing is a) closely linked to the company's financial performance and ability to generate cash and b) a fair and equal means of sharing financial success across a diverse workforce rather than concentrating it in the hands of fee-earners or salespeople in the form of bonuses. Companies will be more likely to successfully adopt profit-sharing if it is linked to tax-advantages for the employee and the employer.

A relatively modest income tax and NICs-exempt limit per eligible workforce member per tax year (we suggest aligning this with the £3,600 Free share award limit under the SIP), with an accompanying NICs exemption for the employer, would help share financial success more fairly and broadly with those who help to create it.

Appropriate drafting would also ensure that employers are able to offer profit-sharing on a 'whole-workforce' basis, as discussed in our section on 'Bigger Picture' proposals on page x of this document, rather than having to restrict it to those in their workforce with employee status.

At present, the **restricted securities income tax regime** makes no provision to accommodate any internationally mobile employee (IME) who acquires restricted securities while non-UK resident and then comes to work in the UK before a restricted securities taxable event occurs. HMRC and HMT quite deliberately excluded non-UK residents who acquire restricted securities from making a section 431 election, but it is not clear that this was a proportionate response to any related tax abusive behaviour, and it can have harsh results, especially for employers and employees who are not well advised on UK tax issues.

In the context of encouraging international trade and international investment post-Brexit, the current approach for IMEs regarding their employment-related restricted shares should be reconsidered.

## Conclusion

ProShare and members of the share plans industry all remain keen to work with policy makers, decision makers and all those with profile and influence in Westminster. We are always keen to help with further assessment, research, evidence-gathering and analysis of the impact of employee share ownership. In particular, we wish to help quantify the economic benefits and cost savings for businesses against any estimated potential cost to the Exchequer linked to the adoption of any of these proposals.

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## Appendices

**Appendix 1** – HMRC-commissioned report by Oxera on productivity effects of tax-advantage dshare schemes https://www.oxera.com/wp-content/uploads/2018/07/Tax-advantaged-employee-share-schemes—report-1.pdf.pdf

**Appendix 2** – 'Attitudes to Employee Share Ownership' research study published by ProShare in January 2018, available here: https://www.proshare.org/research

**Appendix 3** – Factsheets on all of the UK's Tax-Advantaged Share Plans available here: https://www.proshare.org/about-share-plans

**Appendix 4** – Information on employee financial participation in France and the EU: https://www.worker-participation.eu/National-Industrial-Relations/Countries/France/Financial-Participation

**Appendix 5** – Financial Behaviour & Decision Making – Sharesave Participant Study https://www.ybsshareplans.co.uk/company/latest-news/financial-wellbeing-news.html

**Appendix 6 –** SAYE & SIP Accounting Cost Model – worked example comparison

| Company XYZ | |
|---|---|
| Number of employees | 10,000 |
| Takeup | 15% |
| Average monthly saving | £250 |
| Average monthly saving (if given flexible options) | £125 |
| Current share price | £8.00 |
| Exercise price discount | 20% |
| Savings term (fixed at 36 months) | 36 |
| Share Price Growth (over whole period) | -10.0% |

| SIP Matching Schedule | |
|---|---|
| 0 | 0% |
| 12 | 33% |
| 24 | 67% |
| 36 | 100% |

| | Accounting Cost | Cost (per employee) | Gain (per employee) | Cost as % of gain (per employee) |
|---|---|---|---|---|
| Traditional SAYE | £4,521,780 | £67.83 | £1,125.00 | 6% |
| SAYE with lookback | £6,410,114 | £96.15 | £2,025.00 | 5% |
| SAYE with flexibility of monthly savings | £2,260,890 | £33.91 | £562.50 | 6% |
| SIP with sliding scale of match | £4,300,318 | £64.50 | £2,446.70 | 3% |

**Appendix 7** - SIP shares income tax & NIC treatment

| | **Years 0 - 3** | **Years 3 - 5** | **Years 5+** |
|---|---|---|---|
| | *Full tax* | *'Lower of' tax* | *No tax* |
| **Free shares** | Value at date shares withdrawn from SIP | Lower of value at award and at date shares withdrawn | No tax |
| **Partnership shares** | Value at date shares withdrawn from SIP | Lower of deductions used to purchase and value when shares withdrawn | No tax |
| **Matching shares** | Value at date shares withdrawn from SIP | Lower of value at award and at date shares withdrawn | No tax |
| **Dividend shares** | Tax on dividend received | No tax | No tax |

**Appendix 8** – Detail on the impact of changes to the dividend tax allowance on SIP dividend shares.

**Summary of change:**
The 2018/2019 tax year changes saw a reduction in the Dividend Allowance from £5,000 to £2,000.

**What does it mean for UK tax advantaged Share Incentive Plan ('SIP' or 'Plan') participants?**

- **Cash dividends:**
  The impact on participants receiving cash dividends on their Plan shares aligns with that for shareholders receiving cash dividends, i.e. SIP dividend income counts towards the reduced annual Dividend Allowance of £2,000.
- **Reinvested dividends:**
  The current income tax advantages (1) linked to holding Dividend Shares continue, so reinvested dividend income will not count towards the annual £2,000 Dividend Allowance as long as Dividend Shares are held for three years or more, or taken out of the Plan due to a 'good' leaver reason.
- **Reinvested dividends – where participants withdraw their Dividend Shares before the end of the three-year holding period due to a 'bad' leaver reason:**
  Reinvested dividend income received in the three years prior to leaving will count towards the participant's current tax year's £2,000 Dividend Allowance in conjunction with any other dividend income received within that tax year. There will be no tax to pay on the first £2,000 of dividend income, however, dividend income exceeding the Dividend Allowance will be subject to income tax even if the participant is a basic rate tax payer.

For 'bad' leavers, reinvested dividend income received in the **three** years prior to leaving will count towards the participant's current tax year's Dividend Allowance. With a reduction to £2,000, more participants will exceed the Dividend Allowance and will be required to pay tax as per the instructions at:
https://www.gov.uk/tax-on-dividends
For a number of participants not currently filling in a Self-Assessment tax return, this will add a layer of complexity to their SIP participation. The consequences are that either fewer participants will choose to reinvest their dividends, or where reinvestment is a compulsory feature of the Plan, participants may be faced with paying additional tax.

As an 'extreme' example of a participant whose only dividend income is received from their SIP shares:

| | |
|---|---|
| Dividends received 10 April 2015 and reinvested | £1,000 |
| Dividends received 10 October 2015 and reinvested | £1,000 |
| Dividends received 10 April 2016 and reinvested | £1,000 |
| Dividends received 10 October 2016 and reinvested | £1,000 |
| Dividends received 10 April 2017 and reinvested | £1,000 |
| Dividends received 10 October 2017 and reinvested | £1,000 |

Participant leaves employment on 8 April 2018 as a 'bad' leaver, shares are removed from the Plan and kept
Dividend income received on shares held outside of the Plan

| | |
|---|---|
| Dividends received 10 April 2018 | £1,000 |
| Dividends received 10 October 2018 | £1,000 |

For tax year 6 April 2018 to 5 April 2019, reinvested dividend income received in the three years prior to leaving (£6,000), plus the cash dividend income received in that tax year (£2,000), count towards the participant's £2,000 Dividend Allowance. As total dividends attributed to that tax year are £8,000, after taking into account the Dividend Allowance, tax is due on £6,000. Had dividend income not been reinvested in the SIP, each year's Dividend Allowance could have been used, with no additional tax to pay.

**What's the proposal?**
Dividends received on shares held in an Individual Savings Account (ISA) are tax free and do not count towards that tax year's Dividend Allowance. Dividend Shares taken out of the Plan due to a 'good' leaver reason are tax free and do not count towards that tax year's Dividend Allowance.

The proposal is to treat all dividends in a SIP in a similar way, with no tax to pay on dividend income **reinvested** in the Plan, even if the resulting Dividend Shares are held for less than three years.

We are not proposing that tax on SIP cash dividends should change and we are not proposing to amend the usual three-year Holding Period requirement for Dividend Shares. However, where Dividend Shares are no longer subject to the Plan because of a 'bad' leaver reason, we are proposing that the reinvested dividend income remains tax free and not counted towards the Dividend Allowance for that tax year, even when Dividend Shares have been held for less than three years. (In the example above, the £6,000 of reinvested dividends are not counted towards the Dividend Allowance when the Dividend Shares are removed from the Plan.)

**What are the pros and cons of this change?**
+ Simplicity
    - easier for SIP participants to understand the tax implications of reinvesting Plan dividends

+ Fairness
    - the current situation means some participants pay more tax because they reinvest their dividends in a tax advantaged SIP; the proposed change will address this anomaly

+ Alignment
    - regarding treatment of dividends reinvested in the SIP (Dividend Shares), tax advantages of SIPs are aligned to ISAs
    - regarding treatment of dividends reinvested in the SIP (Dividend Shares), tax advantages for both 'good' and 'bad' leavers are aligned
    - regarding treatment of cash dividends (not reinvested), this continues to be aligned to shareholders receiving cash dividends

+ Cost of change for issuers and Plan administrators
    - the cost to issuers and Plan administrators is minimal as system development is not required, although there will be an initial outlay to update SIP documentation

+ Positive message
    - evidences continued support for employee share plans

– Cost to the Exchequer
    - an estimate of the cost of lost income tax revenue would need to be carried out; SIP administrators and ProShare will help with any further analysis if required.