Global Insight

Employment related securities and security options

UK legislation changed on 6 April 2015 and impacts the tax treatment of employment related securities including options, Restricted Stock Units ("RSU") and restricted shares. The legislation imposes UK tax on any such award that relates to UK work.

UK and overseas employees who have invested stock options, or have received restricted shares/stock units and who worked in the UK during some or all of the relevant period, will need to consider the impact of the rules.

Old rules

Stock options

Under the old regime, the taxation of share options awarded to employees generally depended on their UK residency status at the time that share options were granted. Where a non-UK resident received an award of stock options, a later chargeable event (i.e. vesting or exercise) could be tax free, providing the grant was not made in anticipation of the employee's duties in the UK, or the employee had no UK work duties at the date of the grant.

Restricted shares

Special rules apply upon the acquisition of employment related securities that are subject to restrictions, as these can affect the market value of securities. Income tax and National Insurance Contributions ("NICs") charges can therefore arise on subsequent chargeable events. These include the lifting, variation or expiry of the restrictions, or the disposal of the restricted securities. Where an election is not made, a charge arises upon acquisition on the difference between the amount paid for shares and restricted (i.e. actual) market value. Further income tax charges may arise when restrictions are lifted or varied, or shares are sold.

The employer can pass the responsibility for the employers' NICs on to the employee by a joint election or agreement. The employee obtains relief by a deduction from the amount otherwise chargeable as employment income.

New rules

The new rules align the UK tax treatment of employment related securities with international practice.

However, there are some practical difficulties and in some situations UK taxes increase, particularly for those that were previously not resident at grant and not subject to UK tax.

Under the new rules, it may be possible to apportion the share income to exclude the portion that relates to the period an employee spends working overseas between the grant of an option or the award of a restricted security, and the exercise or vest date.

This is provided that one or more of the following conditions are satisfied:

- the employee is UK resident and claims the remittance basis during any part of the relevant period; or
- the employee was not UK resident for some part of the relevant period; or
- the employee was subject to "split tax year" treatment during the relevant period.

The portion of income which relates to overseas duties will be taxed under the remittance basis where these rules apply, i.e. this income will not be subject to UK tax unless it is remitted here. The UK taxable portion of the securities income will be determined on a 'just and reasonable' basis, broadly attributable to the amount of time spent working in the UK.

The relevant period depends on the specific arrangements of the stock plan and market value of the shares. For restricted shares, it is the period from the date of acquisition to the chargeable event. For stock options, it is from the date of acquisition to the earlier of the vesting date and the chargeable event. Finally, for RSU awards it will be the vesting period.

With restricted securities, unless an employee has taxable general earnings in the UK on acquisition of an employment-related security, they cannot make an s431 election. Therefore, non-UK resident employees will not be able to eliminate the tax charge on the lifting of restrictions or sale of the shares.

Currently some RSU plans are taxed as general earnings like salary. However, from the 6 April 2016, all gains from the vesting of RSUs will be taxed as securities option income where the employee has a conditional right to acquire securities (not cash). The taxable gain accruing to internationally mobile employees will still be reported and taxed on a time apportionment basis. However, the change may impact on the liability to National Insurance Contributions and Capital Gains Tax, as well as the treatment of remittances by non-UK domiciled individuals.

Example

Steve is a French employee and on 25 March 2013 he was granted stock options by his employer with a three year vest period. The options were granted to him at a price of £50,000. On 25 March 2014 he transferred to the UK business to help it grow. Steve would like to exercise these options when they vest on 25 March 2016. He anticipates the shares will be worth £110,000 on 25 March 2016.

As the stock options will vest after the 5 April 2015, the new rules will apply. Steve will be chargeable to income tax in the UK on the proportion of the gain which falls in the period where he is considered as resident in the UK. Broadly, on the basis that Steve became resident in the UK from 25 March 2014, two-thirds of the gain will be subject to UK tax, i.e. £40,000.

UK payroll obligations (“PAYE”)

A UK payroll withholding obligation will exist if the employee had any work connection with the UK during the relevant period. This obligation is likely to exist if this is an overseas employee on an overseas payroll.

UK social security taxes (“NICs”)

UK National Insurance Contributions will be due on employment related securities income earned for days during the relevant period when an Internationally Mobile Employee remained subject to UK NICs. In certain scenarios there will be both a UK NIC liability and a foreign social security liability arising on the same employment related securities income when shares vest or stock options are exercised. This could create some issues, for instance, a potential conflict with existing international agreements or EU regulations.

UK corporate tax deduction

Under old rules a deduction was only available if the employing company was within the scope to UK corporation tax at the relevant time. Under the new rules, a corporate tax deduction is available to the host company for the employee seconded to work for them.

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