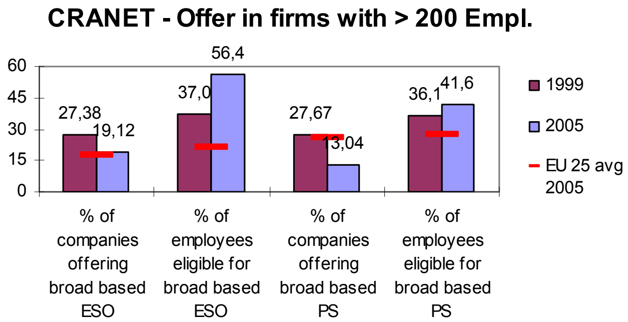
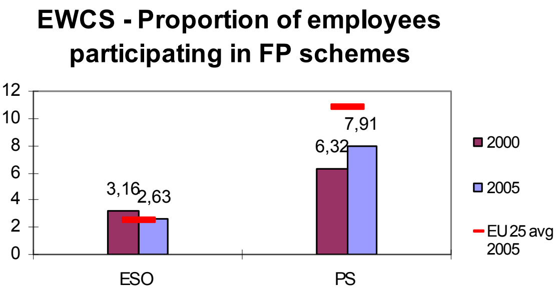
XXIX. United Kingdom

Profit-sharing plans first appeared in the UK at the end of the 19th century, while employee share ownership plans were introduced in the 1950s. These plans, however, remained small in number until the introduction of tax incentives in 1978. Approximately 5,000 companies currently maintain Inland Revenue-approved employee financial participation schemes.[213] With the abolishment of the last approved profit-sharing plan (Profit-Related Pay (PRP) or Approved Profit-Sharing Scheme (APS)) in 2002, the remaining approved plans, as well as numerous unapproved plans, are all share-based.

Approved plans operated in a 2006 breakdown as follows: Share Incentive Plans (SIP) - 830 (IR tax cost GBP 320 million); Savings-Related Share Option Schemes (SRSO), Sharesave or SAYE Schemes - 960 with approximately two million employees (IR tax cost GBP 412 million); Company Share Option Plans (CSOP) – 3,030 but with many fewer employees than SRSO (IR tax cost GBP 205 million), and Enterprise Management Incentives (EMI) - 2,570 with 27,000 employees (IT tax cost GBP 170 million).[214]





Many companies combine several approved plans and also operate unapproved plans. (No statistics available.) Since approved plans are based on long-term holding and withdrawals which are not reported to HM Revenue and Customs, it is impossible to determine the exact number of employees participating in plans at a given moment.

213 <www.ifsproshare.org>, Log-in: 19 October 2007.

214 <www.hmrc.gov.uk/stats/emp_share_schemes/menu.htm>, Log-in: 9 October 2007. The difference between the data in the comparative tables and in the country profile is attributable to the last update of statistics by the HM Revenue and Customs. The costs of the plan are comprised of tax losses and National Insurance Contribution (NIC) losses.

1. General Attitude

The Confederacy of British Industry (CBI) and other employers' organisations generally support the employee participation plans proposed by the government, especially employee share ownership plans, but they have also criticised some approved plans for lack of flexibility. The government responded to this criticism by introducing the more flexible Share Incentive Plan. The CBI also set up a special task force to discover why employee shareholding has been declining since the 1990s. The government used these research findings to design new employee financial plans to reverse this decline. Trade unions over the years have taken a dim view of employee financial participation on the grounds that it would undermine the traditional collective bargaining process. This was their reason for strong past opposition to Profit-Related Pay Schemes. Recently, however, they have changed their attitude. The Trades Union Congress (TUC) has declared itself in support of employee financial participation schemes that are broad-based, and if both employees and employee representatives are consulted before introduction. Recently some trade unions have themselves proposed new schemes of financial participation.

Successive governments have committed themselves to supporting employee financial participation plans and promoting widespread share ownership for reasons both ideological and pragmatic. These include making enterprise more democratic, developing financial markets and fostering social welfare. The present government, together with the London Stock Exchange and a consortium of major companies, were the original founders of IfsProShare. This is an independent organisation which promotes wider share ownership and financial education. It still plays an important role in promoting the interests of companies having financial participation plans, disseminating information on best practices and consulting with companies interested in setting up such plans.

2. Legal and Fiscal Framework

All employee financial participation plans fall into one of two categories: approved by the Inland Revenue or not approved. Plans introduced under the annual Finance Acts must be approved by and registered with Inland Revenue; they enjoy substantial tax and NIC exemptions, enumerated in the Income and Corporation Taxes Acts, especially for employees. Unapproved plans may be introduced at the employer's discretion, but receive no special tax incentives. Approved plans must conform to law; unapproved plans are more flexible. Under current legislation, all approved plans (and typical unapproved ones as well) are employee share ownership plans. Unapproved plans are used for granting shares, options or cash equivalents that exceed legal maximums to individual employees or to employees not UK tax subjects. Unapproved plans are usually combined with approved plans. It is also possible to design a hybrid model containing provisions both approved and unapproved.

a) Share Ownership

Share ownership plans may be approved or unapproved. Under current legislation there are four approved plans, one direct share ownership plan with several modifications, SIP and three stock option plans (SRSO, CSOP and EMI). SIP and SRSO are broad-based, while CSOP and EMI may be restricted. Although not regulated, some forms of unapproved schemes are quite widespread: Long-Term Incentive Plans (LTIP), restricted Shares Plans and Unapproved Option Plans. Whereas LTIP and Restricted Shares Plans are predominantly confined to executives, Unapproved Option Plans are often broad-based complements to an approved plan. The following section will cover only approved plans.

Inland Revenue Approved Share Ownership Plan – The *Share Incentive Plan (SIP)* was introduced under the Finance Act of 2000 to replace the PRP on which it is partially modeled. Several possible modifications make it more flexible than earlier plans; also longer holding periods discourage tax evasion. The employer company sets up a trust to serve as an intermediary in allocating shares to employees. The share may be allocated without cost ('free shares'), at a discount, or at full price ('partnership shares'); also the employer may match the employee's partnership shares ('matching shares'). Dividends paid on all shares may be reinvested in additional shares ('dividend shares'). Each plan modification is subject to specific requirements which, if met, confer substantial tax advantages on both employees and the employer company. These generally take the form of exemption from both the personal income tax and national insurance contributions. The plan must include all employees, with the possible exclusion of those employed less than 18 months, and the same general provisions must apply to all participants. Tax exemptions are valid for all versions of the plan after the shares have been held for five years, or earlier if the employee terminates his employment on account of injury, disability, redundancy, retirement or death; also if transferred under the Transfer of Undertaking (Protecting of Employment) Regulations of 1981, or on the employer company ceasing to be an associated company. Shares sold immediately after withdrawal are exempt from a capital gains tax. Regulations specific to each plan are as follows:

Free shares cannot be withdrawn from the trust during a holding period of three to five years. However, if the employee withdraws the shares or his or her employment ceases between the third and fifth year for reasons other than above, personal income tax and national security contributions are payable on the lesser of market value on the award date and the market value on the withdrawal/cessation date. If the employment ceases for other than the stated reasons before the end of the three year holding period, full personal income tax and national security contributions are imposed. An employee share in the plan is limited to GBP 3,000 per annum.

Partnership shares are purchased by the trust from a part of the employee's pre-tax remuneration according to the employee's agreement with the employer company. The shares are purchased either within 30 days of pay deduction or at the end of a specified accumulation period of up to 12 months. If the latter, the share price is the lowest market price of the period. An employee is limited to GBP 1,500 per annum. After the five-year holding period or termination of employment for the given reasons, the employee is exempted from personal income tax, and the employer exempt from national security contributions. However, the employee is only exempted from paying national security contributions if his total earnings fall below the ceiling on national security contributions. If the employee withdraws the shares or his employment ends for a reason other than those stated between the third and fifth year, personal income tax and national security contributions are exacted on the lesser of the amount of the employee contributions for purchase and the market value of shares on the date of withdrawal/cessation.

Matching shares can be offered by the employer company up to two matching shares for each partnership share. These are allocated to the employee on the same day as partnership shares are acquired. The holding period is the same for matching shares as for free shares.

Up to GBP 1,500 of dividends per annum can be used to purchase *dividend shares*. The general holding period for dividend shares is three years. If these shares are withdrawn or employment ends for other than stated reasons within five years of their acquisition, the employee is liable for personal income tax on the dividends used to purchase the shares. However, there is no liability for national insurance contributions.

Inland Revenue Approved Stock Option Plans – *Savings-Related Share Option Scheme (SRSO) or Sharesave or SAYE Scheme*, introduced by the Finance Act 1980, is currently the most popular plan judged by the number of participants. It must apply to all employees, except possibly those with relatively short service. The basic structure of the plan is as follows: the employee enters into a Save-as-you-earn (SAYE) contract with a designated bank or building society, agreeing to save a specified monthly amount (GBP 5 to 250) by deduction from after-tax remuneration for 3, 5 or 7 years and the employer company grants him share options for the maximum number of shares he will be able to purchase at the exercise price with his SAYE savings. The SAYE contract always includes a tax-free bonus added to savings on completion, the amount depending on the term of the contract and the rates are set by the Treasury. The share exercise price can be up to 20 per cent under the market value of the underlying shares at the time of the grant. At maturity of the SAYE contract, the employee is entitled to choose whether to exercise the option and retain or sell the shares or take the savings and bonus in cash. These requirements fulfilled, the employee is not liable for personal income tax at grant or exercise. However, he must pay capital gains tax on the sale of shares.

Company Share Ownership Plan (CSOP) was introduced in 1984 as Discretionary Share Option Scheme (DSOP) and re-launched in 1996 under the current name with amended requirements. It is a discretionary plan which is often limited to the executives but can also be broad-based. It is often connected to performance results, that is, a certain goal must be reached before the option can be exercised. The following requirements also apply: the value[215] of outstanding options per employee must not exceed GBP 30,000 at grant; the exercise price may not be less than market value at grant; the exercise period may not be shorter than three nor longer than ten years after grant.[216] These requirements fulfilled, the employee is not liable for personal income tax at grant or exercise.

Enterprise Management Incentives (EMI) was introduced by the Finance Act 2000 in order to help small, higher risk companies to recruit and retain highly qualified employees. It ap-

215 The value is equal to the number of shares multiplied by the exercise price.

216 Before 2003, an additional requirement had to be fulfilled: the exercise period had to be not less than 3 years after any previous tax-free exercise. This requirement was abolished.

plies to companies with gross assets of less than GBP 30 million.[217] The plan can be selective. Approval of the Inland Revenue is not required, but it must be notified of each stock option grant under EMI within 92 days. Options granted must not exceed a total market value of GBP 120,000 per employee or GBP 3 million for the company. These requirements fulfilled, neither employees nor the employer company are subject to personal income tax or national insurance contributions at grant or exercise. However, they must pay capital gains tax at the sale of shares.

b) Profit-Sharing

At present there are no approved or conventional unapproved financial participation plans in the form of profit-sharing plans. However, a few unapproved bonus schemes might be both broad-based and profit-connected; if so, they could be considered as cash-based profit-sharing plans. There used to be an approved profit-sharing plan - Profit-Related Pay (PRP) or Approved Profit-Sharing (APS) - which was exceedingly popular until terminated in 2003.[218] There were 14,275 of these plans in 1998, covering 4.6 million employees. The plan, however, was mainly used as a means of avoiding taxation. Since it did not lead to a wider employee shareholder base, while causing heavy tax loss, the government phased it out in 1999, and completely abolished it in 2002. It was replaced with the SIP. Some employees, however, may have yet to withdraw their shares from the earlier plan.

c) Participation in Decision-Making

There is no direct connection between participation in decision-making and employee financial participation; in particular, financial participation plans cannot extend existing rights in decision-making. General provisions of labour law, for example, equal pay and prohibition of discrimination, also apply to financial participation plans.

217 Originally, the volume of assets was GBP 15 million (until 2003), but it was considered necessary to substantially increase it.

218 This plan was a broad-based deferred share-based profit-sharing plan introduced in 1978. The employing company had to set up a trust and pay contributions, so that the trustees were enabled to purchase shares of the company to be attributed to employees. The employees were not entitled to withdraw the shares within two years; if the shares were withdrawn after three years, no personal income tax was to be paid on the benefit. The participation of an employee connected with tax relief was limited to 10 per cent of the earnings or GBP 3,000.