

Client Alert

Latham & Watkins
Tax Department

April 2012 Key Changes to UK Employment Law and Employment Related Tax

In the UK, the tax year runs for 6 April to 5 April and each year the UK government's March budget announcement heralds changes to be implemented in the upcoming tax year. This Client Alert summarises the key changes to UK tax rules and employment law announced or due to be implemented in Spring 2012.

Service qualification for unfair dismissal

The period of service that UK employees are required to have in order to be eligible to bring an unfair dismissal claim increased from one year to two with effect from 6 April 2012. The UK government hopes that this will decrease the number of employee claims in the UK and give employers more flexibility to manage their staffing needs without encountering excessive "red-tape".

Note that the change will only affect employees whose employment commences after 6 April 2012, employees employed before that date will still qualify for protection from unfair dismissal after they have accrued one year's service.

In certain protected circumstances a dismissal can still be "automatically unfair" regardless of the employee's length of service. For example, a

dismissal can be automatically unfair if the employee can demonstrate that he was dismissed as a result of making a "protected disclosure" under UK whistleblowing legislation or if the dismissal was connected to pregnancy or maternity/paternity leave, asserting a particular statutory right, health and safety, trade union or other employee representative activities.

Compensation for unfair dismissal includes a basic award (currently capped at £12,900) and a compensatory award (currently capped at £72,300), however the compensatory award limit will not apply if the employee can demonstrate that he was discriminated against on a protected ground (*i.e.* age, race, sex, sexual orientation, disability or religion or belief) or that he is a protected "whistleblower".

Statutory maternity, paternity and adoption pay and sick pay

The UK statutory maternity, paternity and adoption pay and sick pay rates are reviewed annually. With effect from 6 April 2012, statutory sick pay increased to £85.80 per week (from £81.60) and with effect from 1 April 2012 the statutory maternity, paternity and adoption pay rate increased to £135.45 per week (from £128.73).

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Employment related tax changes

Following the chancellor's announcement of the UK budget on 21 March 2012, the following changes will take place to employee taxation which employers of UK employees should be aware of:

- The top rate of income tax in the UK which applies to UK tax payers with an income in excess of £150,000 per annum, will reduce from 50 percent to 45 percent with effect from 6 April 2013. This amendment to the controversial "additional rate" of tax was widely predicted following pressure on the government from several directions since the introduction of the tax rate in April 2010. Employers may wish to consider offering employees the opportunity to defer the payment of bonuses or exercise of share awards so that a tax charge arises after 6 April 2013 although it remains to be seen whether HMRC will try to introduce rules to prevent such deferrals.
- With effect from 6 April 2012, the personal allowance which an eligible UK tax payer under the age of 65 is entitled to earn before income tax becomes payable increased by £630 to £8,105 per annum. Note that this personal allowance is not available to employees earning over £116,210 per annum in the 2012/13 tax year. The government also announced that this personal allowance will increase to £9,205 in the 2013/14 tax year.
- Conversely an individual's annual capital gains tax exempt allowance remains unchanged at £10,600. This will be relevant to employees disposing of company shares which fall within the capital gains tax regime.
- There will also be no change to the annual tax free allowance which applies to pension savings in a registered pension scheme — this will continue to be £50,000 despite widespread speculation that the government would seek to change this, at least for additional rate tax payers. However, the lifetime pensions tax relief allowance

decreased from £1.8 million to £1.5 million with effect from 6 April 2012.

Share Schemes — changes to EMI Option rules

Enterprise Management Incentive (EMI) options are a particularly tax efficient type of share option available to UK based employees of certain companies. There are strict qualifications that companies must meet to be eligible to grant EMI options, (in particular companies engaged in certain sectors such as financial services are not eligible to grant options). However, for companies that meet the EMI criteria, granting EMI options is a particularly tax efficient way of incentivising employees. In broad terms, as long as a qualifying EMI option is granted with an exercise price equal to or greater than the fair market value of the underlying shares on the date of grant, no income tax or National Insurance contributions are payable in respect of the option gain.

The UK government's budget announcement on 21 March 2012 included the following improvements to the EMI option landscape which will be welcome news to those employers eligible to grant EMI options:-

- The individual limit on EMI options will be increased from £120,000 to £250,000. This change should take effect as soon as possible although no fixed date has been given. This will allow employers to grant more lucrative EMI options awards and benefit from the EMI tax relief on more generous option awards.
- Entrepreneurs' relief will be extended to apply to shares acquired by employees following the exercise of EMI options.

In broad terms, entrepreneurs' relief allows relief from capital gains tax arising in respect of the sale of shares where the individual holds (and has held for at least 12 months) at least 5 percent of the company's ordinary share capital. Entrepreneurs' relief is subject to a lifetime limit (currently £10 million) but can be very useful

for employees with substantial shareholdings when disposing of shares.

This change will apply to options exercised on or after 6 April 2012, so, EMI optionholders may wish to consider whether they can delay the exercise of their EMI options until after 6 April 2012 to benefit from entrepreneur's relief. Note that the individual will need to hold the shares for 12 months following exercise of the EMI option in order to qualify for the relief. Therefore the introduction of entrepreneurs' relief to shares acquired on exercise of EMI options will not benefit optionholders whose EMI options are only exercisable upon a change of control, where the shares will be disposed of immediately.

- HMRC have committed to developing new guidance and resources for start-up companies wishing to grant EMI options and will also consult on extending EMI options to academics employed by companies. This may be achieved by relaxing the working-hours requirements that employees must meet to be eligible to receive EMI options.

Payroll — change to the PAYE tax code applicable to post-termination share related payments

With effect from 6 April 2012, when an employee's employment terminates any earnings arising from shares or options held by the employee and realised after their employment has terminated should be taxed under the 0T Pay-As-You-Earn (PAYE) tax code. The 0T PAYE code requires income tax to be withheld on a non-cumulative basis at 20, 40 or 50 percent (as applicable depending on the employee's usual tax rate), applying no personal income tax allowance.

The 0T PAYE code was originally introduced on 6 April 2011 with respect to payments made to employees following the termination of their employment. However, at that time, the new code did not apply to employee securities and options related earnings realised after the employment terminated. These remained taxable at the basic rate of tax (20 percent). HMRC has now extended the 0T PAYE rate to share related payments with effect from 6 April 2012.

Coming soon...further reform on the horizon

The UK government has also announced that it will shortly be issuing a consultation on the different approaches available for integrating the operation of income tax and National Insurance contributions for UK tax payers in an effort to simplify the tax landscape. In addition, the government intends to introduce its reforms to the tax residency rules with effect from 6 April 2013. We will report on these developments as and when more information becomes available.

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