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Expert Updating and Guidance on Reward & Corporate Governance

Contents

Mind The Gap - Gender Pay Reporting and Reputational Impact

Jennifer Millins and Emma Woollcott at law firm Mishcon de Reya take a look at what we can learn from the first year of gender pay reporting and its reputational impact.

The Gender Pay Reporting Regulations deadline expired at midnight on 4 April 2018. At the end of the first year of reporting and as the snapshot date for next year's figures passes, what can remuneration committees, legal and HR departments learn for next year's reporting - and how can they prepare in the longer term for the public scrutiny that many businesses have experienced so far this year?

What can we learn from this year's reporting?

After a flurry of last minute reporting, just over 10,000 companies have published their data. It is reported that more than 1,500 businesses failed to publish. While there are questions about the efficacy of the body desig-nated to enforce the Regulations, the Equality and Human Rights Commission intends to "name and shame" companies that did not comply. In future, the Commission is likely to have the power to fine companies for non-compliance, but in the meantime the media is at the forefront of policing the results. Not far behind are employees, present and future, who have a keen eye on the statistics and what they might mean for them.

In the first year of reporting, 78 per cent of companies who reported have a median pay gap in favour of men. The median gender pay gap across all reports was 9.7 per cent, but for many companies the figure was far higher. Pay gaps among certain sectors were heavily scrutinised. Perhaps unsurprisingly, companies in the fi-nance and insurance activities sector reported large gender pay gaps. Companies in the aviation, professional services and - perhaps surprisingly - retail sectors also received considerable attention for significant gender pay gaps.

It is worth pausing here to remember that having a gender pay gap is not in itself unlawful. A lot of the media coverage on the Regulations has conflated the issue of gender pay reporting with equal pay, but this is mislead-ing. The right originally enshrined in the Equal Pay Act for women and men to be paid equally for equal work has been around for decades. Alongside the advent of the Regulations, its resurgence into the spotlight can be attributed to the recent high profile equal pay complaints within the BBC, and a number of class actions against the large supermarkets. Fuelled further by very public campaigns such as #TimesUp and #PayMeToo, this all feeds into the wider socio-economic debate around pay disparity and women's rights in the workplace in the 21st century. The most forward-thinking and media-savvy businesses will have this firmly in mind when looking at future years' gender pay gap narratives and how they improve their statistics.

Gender pay statistics are of little use to employees who are concerned that they may have an equal pay claim, as they only measure pay across an organisation. The statistics do not look at pay between comparable jobs. Nevertheless, the reporting has confirmed something that is arguably more fundamental: that systemic inequali-ties remain within the hierarchy of UK workforces. The gender pay gap is driven by disparity in the types of jobs carried out by men and women respectively. Ryanair and Easyjet explained their large pay gaps by pointing out that pilots are almost exclusively men, whereas cabin crew are almost all women. We also learned that retailers such as Phase Eight have large gaps because of a mainly female workforce on the shop floor, com-pared to a more evenly balanced management team at head office. Professional services firms attribute their gender pay gaps to the fact that secretarial and support roles are performed predominantly by women.

Across the board, women remain under-represented in top-paid jobs. Even in organisations which have a pre-dominately female workforce, on average 30 per cent of female employees are in the bottom quartile of their employers' payrolls, while just 19 per cent make it to the top quartile. By way of example, HSBC Bank's UK workforce is 54 per cent female, yet only 23 per cent hold senior leadership positions, while women make up 67 per cent of HSBC's junior roles.

Recent research from the Institute for Fiscal Studies confirms that children are a key reason for the gender pay gap. While this is not news to most businesses, the IFS' findings go further than that and report that part-time working is a particular culprit in perpetuating the gender pay gap. By the time the first child is aged 20, women have on average been in paid work for three years less than men and have spent ten years less in full-time paid work.

Part-time work remains dominated by women: around 41 per cent of women work part-time, compared to just 13 per cent of men. The IFS reports that part-time working tends to shut down wage progression for women, particularly for highly-educated women (i.e. those who otherwise would have seen the most pay pro-gression). This is reflected in the disparity in average UK hourly pay: £13.94 per hour for full-time workers, £9.12 per hour for part-time workers. The IFS is particularly interested in understanding why part-time work attracts lower wage growth over the course of a career relative to full-time work, and it is this sort of issue that employers may wish to take a closer look at when seeking to explain and improve their statistics. The IFS questions whether part-time em-ployees receive less training and development, whether part-time roles allow for less accumulation of skills and whether part-time employees miss out on networking and promotion opportunities. Fundamentally, do com-panies simply fail to ascribe the same value to part-time employees?

The Chartered Management Institute looked specifically at the pay gap for managers, and found that even where women do make it to managerial roles, they are still paid less, and that by the time they reach director-level positions, the gender pay gap rises to £34,144. The report goes on to reveal that the gender bonus gap for managers stands at 46.9 per cent, and that "[t]his increases considerably at C-suite level, where the average bonus for a male CEO is £89,230 compared to £14,945 for a woman - an 83 per cent bonus pay gap."

The problems with the statistics

While the Regulations have ensured that the debate around gender imbalance in the workplace remains firmly in the spotlight, the Regulations themselves are by no means perfect and the 14 separate data points that em-ployers are required to master and deploy are a blunt instrument.

For example, the average bonus pay gap for most sectors has come out higher than their gender pay gap. Un-like the basic salary comparison, the bonus pay comparison required by the Regulations does not allow for part-time working. Many employees receive pro-rated bonuses (new joiners, part-time employees, those on maternity or other family-related leave). As we have seen, higher proportions of women work part-time, and of course they also take maternity leave. Many businesses will therefore have had to report artificially large bonus pay gaps. The fact that bonuses would be pro-rated in such circumstances is unsurprising - and certainly not necessarily discriminatory - and yet there is currently no way of adjusting for this within the reporting re-gime. Until the government addresses this, businesses need to continue to think carefully about how to ex-plain these anomalies.

The Regulations also do not make any provision for group-wide reporting. Instead, each legal entity within a group must produce its own separate report. Large organisations often have more than one employing entity within its corporate group structure. Provided that no one single entity employs at least 250 people, such a group could, in theory, have many hundreds of employees and yet be outside the scope of the Regulations. The Acas Guidance, Managing Gender Pay Reporting, suggests group-wide reporting and additional narrative where it would be informative and appropriate, but this is purely voluntary.

This loophole could lead to the adoption of creative payroll structures to avoid the problems of reporting male-dominated senior leadership teams and to narrow the overall gender pay gaps. Unless and until anti-avoidance provisions are introduced to deal with this, companies may find themselves having to report data in circumstances where their less scrupulous competitors have not. It remains to be seen the extent to which the media will pick up on businesses who take advantage of this loophole.

How to prepare for future years

The first year's reporting was all about getting a grip on the various data points, the reporting mechanism and how to explain the initial statistics. This is likely to change going forward. Deloitte reports that, without action, the UK's gender pay gap will not close until 2069. As the dust settles on the first year's reporting, future scru-tiny is likely to focus on how seriously companies take this issue and what meaningful steps they are taking to reduce their own gender pay gaps. The Regulations are designed to provide year on year comparisons in the hope that companies will demonstrate progress.

Understanding the terminology, and the data, is crucial, but only the first step. Those businesses that fared best in the media this time round were prepared to explain their data, to pre-empt or otherwise respond con-structively to any criticism or concerns.

The relevant "snapshot" date for next year's reporting has already passed (5 April 2018 for private sector, 31 March 2018 for public sector), so businesses looking for quick fixes over the next year will be disappointed. Companies looking for longer-term solutions would do well to work out whether they need to focus on improving recruitment practices, developing reward and incentive structures, revisiting family-friendly policies, or generally work towards developing a stronger pipeline of female talent. This, combined with an effective media strategy, should stand most businesses in good stead.

Depending on the prominence of the business, some might assume that they can avoid the spotlight; that journalists will share a business's nuanced grip on its particular figures; perhaps also that bloggers will tire of sensationalist headlines. Those are all dangerous assumptions.

Businesses should agree well in advance of next years' reporting not only what data will be disclosed but also, crucially, the narrative explaining the statistics. This is the chance to put the numbers in context and in particular to explain any anomalies. A business might, for example, have a large volume of women in the lower quartiles and/or more women working part-time and being paid bonuses that are pro-rated. Explaining the reasons behind a gap need not look defensive, especially if coupled with specific ideas and a commitment to reduce it.

Reminding the reader that a gender pay gap does not indicate direct discrimination and nor does it mean that men are being paid more than women to do the same job is important. Many reporting companies included narrative in their reports this year to correct any misconceptions and reassure the reader that they pay equal pay for equal work. When planning the next narrative, try to spot areas any potentially hostile media may focus on and consider the perspective of others. A female-focused brand, for example, or female-led business, may come under greater scrutiny than a corporate bank.

Once the narrative is agreed, think carefully about who will explain or answer any questions on it and the pub-lication of your data. Who is authorised and ready to speak on the company's behalf, and what is the chain of command? Next, think about who can be contacted proactively ahead of any general release and making sure the messages are appropriate for your audiences. Relevant stakeholders may include business partners, regula-tors and specific groups or communities. Engaging with these groups early on should minimise the risk of unfa-vourable reactions when the data is released more widely.

Arguably a business's most important stakeholders are its existing employees. Drafting a short briefing may explain the figures and training or informal discussion groups or "forum halls" may help answer any questions arising. Similarly to external communications, the more thought that is given in advance to who speaks for the business the easier it will be to reassure staff that the company takes seriously not just its reporting obliga-tions, but also pay issues more generally. Proper dialogue with employees also provides the opportunity to explain what lies ahead, for example plans to release further data, or new initiatives aimed at closing the gap.

Timing is also important. Businesses were criticised this year for waiting until the eleventh hour to report, hoping that their statistics would never hit the headlines or that by then their competitors would have taken the fall. There is much to be said for getting out ahead of the competition by publishing a good news story of improved statistics or effective policies that narrow the gender pay gap.

Finally, all businesses should beware the legal and reputational implications of trying, albeit with good intentions, to address any gaps with quick fixes. If the issue is equal pay, then offering "back pay" or pay rises might seem like an easy fix, but bear in mind that salaries should typically be reviewed across the board and that random, knee-jerk reactions to address individual grievances can cause their own problems. Accumulated back pay can also be substantial and awarding without looking at the bigger picture may have knock-on effects elsewhere. Imbalances cannot be corrected overnight and often reflect broader societal trends. It is better to step back, take stock, and fully understand the issues before you respond.

Businesses that come out on top in future years of gender pay reporting will have learned how to shape and control the handling of compulsory reporting while at the same time considering, implementing and reporting on longer-term strategies to close the gap. Being comfortable with the data and knowing its vulnerabilities al-lows a business to be prepared and to refine its strategy. Those companies will be better equipped to manage any reputational fallout, both internally and on the public stage. Identifying and responding to the specific chal-lenges of their sector and organisational demographic in order to address gender imbalances will enable busi-nesses to formulate long term solutions. It is those businesses that, year after year, will reap the benefits not only of positive publicity but, crucially, of a more balanced and ultimately successful workforce.

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In The Media

With the AGM season in full swing, the tenor of some headlines has been predictive rather than factual:

More revolts expected on bosses' pay [at Direct Line, Rentokil, William Hill and Melrose]

Pressure on [Metro] *bank boss before AGM*

With some outcomes as expected:

Persimmon investors stage revolt over bosses' excessive pay

Investors revolt over 'excessive' pay awards [at Inmarsat and Unilever]

Others not so:

Metro revolt flounders

Some meet trouble halfway:

Funeral chiefs reject bonuses in profits fear [at Dignity]

Others react:

Royal Mail defends male boss's salary [£100,000 more than departing Moya Greene, but with lower pension contributions]

Still others are reacted upon:

£2m penalty for Barclays chief Staley [an "up to" scenario of claw-back and the regulators' displeasure]

Centrica chief pays for share price crash with loss of £600,000 bonus

With former leading stories beginning to fade:

Boss is paid £178,000 for defunct job [at universities regulator]

XpertHR Salary Survey Analyses Bonuses

The XpertHR salary survey has data from 368 organisations that provided information on 128,858 individuals from entry level positions to chief executive on the availability and value of bonus payments. The figures exclude commission payments and non-cash rewards. Headline findings on the number of employees receiving a bonus and the value of these payments include:

Of those organisations specifying the basis on which bonuses are available, more than half (54.9 per cent) operate a scheme based on a mix of organisational and personal performance and one-fifth (18.9 per cent) on personal performance alone.

The average bonus payment across all individuals in receipt of a payment was £4,154, worth 10.4 per cent of the £39,849 average basic salary.

Bonuses increase with seniority

The job level most likely to receive a bonus is function head, where 62.7 per cent of incumbents collected a payment, worth an average £17,402. However, the highest average payment of £89,855 was made to chief executives. Entry-level employees received an average £628 bonus, worth 3.3 per cent of the average salary.

Bonus payments are infrequent in the public sector, where just 6 per cent of employees received a bonus. This compares with 63.3 per cent of employees in private-sector-services organisations and 40.4 per cent in manufacturing-and-production firms. Bonuses are not commonplace among charities and not-for-profit organisations, with just 11 per cent receiving a payment. The value of bonus payments between the sectors also varies widely.

In the services arm of the private sector, 62.2 per cent of employees in the financial sector received a bonus, followed by 64.9 per cent in the retail and wholesale sector (although payments here were small, typically £1,854). Bonus payments were highest in the finance (£8,221) and facilities, and security and support (£5,342) sectors.

47.3 per cent of men received a bonus, compared with 31.1 per cent of women. At every age breakdown, men are more likely than women to be paid a bonus.

While the men received an average bonus of £4,783, payments to women were worth just £3,218. Overall, both men and women are most likely to receive a payment worth less than £1,000 on average. However, men are much more likely to receive a bonus of £5,000 or more - 21.3 per cent did so, compared with 13.1 per cent of women.

Bonus predictors

Payments in previous year. The majority (95.3 per cent) of individuals who received a bonus last year also received one the year before, making the payment of a bonus in any year the highest predictor of receiving one again.

Organisation size. Individuals employed in the largest organisations were most likely to have been paid a bonus. In organisations with more than 1,000 people, more than four in 10 (40.5 per cent) employees received a bonus, compared with 32.3 per cent in companies with between 250 and 999 employees and 31 per cent in organisations with fewer than 250 staff.

Age. The likelihood of receiving a bonus increases with employee age up to 44-47, where 38.7 per cent of employees get a payment. Just 25.1 per cent of the youngest employees aged 20-23 received a bonus, compared with 34.1 per cent of those aged 64-66.

Length of service. The longer an employee has been with their employer, the more likely they are to receive a bonus. Employees with up to three years' service were least likely to receive a bonus, as only 32.3 per cent did so, whereas 68.3 per cent of employees with 40 years' service received a payment.

Reporting Remuneration

Consultancy Company Reporting, a Wolters Kluwer business, notes that **Senior**, this year, within its directors' remuneration report, discloses a summary of proposed changes to its remuneration policy. The company discloses proposed changes under categories such as shareholding guidelines, introduction of post-vesting holding period in respect of long-term incentive plan awards and an increase in bonus targets. In relation to the shareholding guidelines, the company states that it proposes to increase the holding for executive directors from 100 per cent to 200 per cent of basic salary. In respect of the LTIP awards, the company outlines that it proposes to introduce a two-year post-vesting holding period, thereby creating a five-year period between the grant date of the award and its final release. For the earnings per share element of the LTIP, the company proposes to increase the target for growth in adjusted EPS on which 25 per cent of the award vests from the current 10 per cent to 15 per cent. Further, the company outlines that it proposes to increase the target for growth in adjusted EPS for 100 per cent vesting from 25 per cent to 30 per cent. In respect of the bonus plan, the company states that it proposes to increase the individual award opportunity from 105 per cent of basic salary to 125 per cent of basic salary. The company states that this would reward the employee appropriately for their improved performance. The company also states that under the proposed policy, the remuneration committee would have the authority to adjust the bonus targets in exceptional cases if the bonus outcome feels perverse.

Termination Payments - HMRC Changes

ECB readers will be aware that changes to the taxation of certain termination payments and benefits took effect from 6 April 2018. Some termination payments and benefits are now chargeable to income tax as general earnings and no longer benefit from the well-known £30,000 threshold available in section 403 ITEPA 2003. The team at EY note that HMRC has published guidance in its Employment Income Manual which can be found at **EIM13874** to EIM13898. Termination payments and benefits which meet a number of criteria are "relevant termination awards" which are split into two elements, post-employment notice pay calculated using the PENP formula and relevant termination awards subject to the £30,000 exemption. A worked (and helpful) example of how sections 402A to 402E ITEPA 2003 interact in relation to relevant termination awards received on or after 6 April 2018, including the availability of the £30,000 threshold, is given at **EIM14000**.

HMRC has also updated its **NIC guidance** in line with the new tax changes. From 6 April 2018 an element of a termination payment paid to an individual who has their employment terminated without notice will now be treated as earnings for NICs purposes. This means that Class 1 NICs will be due on a PILON even if it is not a contractual or customary payment.

Finally, employees whose employment terminated on or after 6 April 2018 and who receive a payment or benefit in connection with that termination will not be eligible for tax relief in respect of any period of foreign service undertaken as part of their office or employment if they are UK resident for the tax year in which their employment is terminated. HMRC has also updated its **guidance** in this respect.

WTW Survey Of Private, Public Company Remuneration

A new report from Willis Towers Watson accepts that privately-owned companies face the same talent-related challenges as publicly-traded organisations, but analyses key differentiators in how private companies successfully compete for and reward top talent.

Whether a company plans to stay private or intends to sell at some point plays a key differentiating role in executive compensation. Companies planning to stay private include family and founder-owned companies, employee stock ownership plans, co-ops, partnerships and some limited liability companies. The compensation survey databases include extensive data on compensation practices for these companies.

Pay elements

Base salary: The survey data show very clearly that private companies' base salaries closely track public companies' pay for virtually all positions (adjusted for size and industry). This includes the CEO, CFO, general counsel and other positions whose responsibilities can differ significantly between public and private companies. The data clearly demonstrate that their salaries are virtually the same.

Annual incentives: The survey data and experience indicate that private company annual incentives are also very similar to those at public companies. Target levels are the same, or slightly lower. Threshold and maximum pay-out levels are also about the same, as are the required levels of performance relative to target. There are some differences in performance measures.

The most common performance measure used by private companies is EBITDA or some other measure of pre-tax profit. Top line measures and after-tax net income are common but less prevalent than in public companies. Return measures are used by about 20 per cent of private companies, which is slightly more than at public companies.

In WTW's experience, private companies are somewhat more likely to weigh subjective factors and exercise discretion in determining annual incentive awards. This practice varies widely by company.

Long-term incentives: This is where private and public company practices differ most noticeably. Private companies are significantly less likely to provide a regular long-term incentive programme. About 60 per cent of private companies that participated in the survey say they have an LTIP, particularly larger companies. This does not mean that the remaining 40 per cent do not provide some sort of customised ownership stake, deferred compensation programme or special retirement arrangement, all of which are commonly provided on a periodic, one-off basis at many companies.

Structurally, LTIP programmes of private companies are very different from public company practices:
- LTIP grant values are about 30 per cent lower (varies by position and level)
- 80 per cent of LTIPs are performance cash plans
- Much less likely to use real stock or options
- Much less likely to use value-based performance measures

Major similarities, however, also exist:
- LTIP grants made annually
- New performance cycles start annually
- Vesting over three to four years

Lastly, private companies tend to grant LTIPs to a greater percentage of the employee population, at lower salary levels than their public company counterparts. This is contrary to common perception, but is clearly borne out in the data.

LGIM Annual Report On Governance Attacks Gap Between General Workforce And Executives

Legal & General Investment Management increased its votes against management in 2017, according to its most recent corporate governance report.

Highlights include:

- Opposed the re-appointment of 2807 company directors (2362 in 2016); voted against at least one resolution at 59 per cent of companies (56 per cent in 2016)
- Voted against 37 board chairs or chairs of nomination committees in the UK in relation to poor diversity
- Opposed 215 remuneration resolutions in the UK (a 40 per cent increase on 2016) and 277 in the US, 52 per cent up on 2016
- Voted in favour of 95 per cent of climate change resolutions in the US in 2017

The report, Active Ownership, details LGIM's efforts throughout the year to encourage "positive change in the companies and markets in which it invests".

Board composition, executive pay, climate change and succession planning were among the top themes discussed, with transparency also rising up the agenda. In the UK alone, LGIM voted against at least one resolution at 36 per cent of companies, up from 23 per cent in 2016, with the top three votes against management on remuneration, board effectiveness and shareholder rights. 2017 marks the sixth year in a row that LGIM has not abstained when voting in the UK.

Sacha Sadan, director of corporate governance at LGIM, said, "Due to the media spotlight on failures in corporate stewardship, it can seem as though many companies are not doing a good job addressing ESG-related matters. In fact, the vast majority of companies are making significant progress - we simply believe there is more to be done. The same is true of asset managers. We, too, need to intensify our efforts to help deliver long-term value for clients by actively engaging with companies and regulators.

"Our clients are increasingly asking us about a broader range of topics, which has helped us to enhance our approach and to put emerging issues on the agenda. There are, however, themes that continue to resonate and throughout the year we've seen a focus on gender diversity, climate change and governance and culture, all of which we are continuing to engage on with companies."

Executive pay

In the UK LGIM opposed 215 remuneration resolutions, a 40 per cent increase on 2016, while there was a 52 per cent increase in the US year on year, to 277 in 2017.

Sadan continued: "We want companies to reward talent and success appropriately, but we worry when pay rises reflect short term performance. In 2017, we strengthened our US policy to press more companies to focus on pay for long-term performance and limit the number of restricted shares and options granted in remuneration packages. We made it clear that we will not support increases in base pay for executive directors that are out of line with the workforce, unless there is a genuine rationale that we consider acceptable, such as promotion."

"We are engaging with companies to encourage them to reduce income inequality. In the first three working days of 2018, top bosses earned as much as the median employee will earn over the entire year19. We first wrote about growing income inequality in our publication Mind the Gap in 2016, when we strengthened our UK pay policy to stop supporting significant increases in executive pay.

"We want companies to reward talent and success appropriately, but we worry when pay rises reflect short-term performance. In 2017, we strengthened our US policy to ensure more companies focus on pay for long-term performance and limit the number of restricted shares and options granted in remuneration packages.
"In our consultation process with the UK government, we have pushed for the mandatory disclosure of the pay ratio between CEOs and employees. We were encouraged when it was announced this would be part of secondary legislation to be introduced in 2018. We have made it clear that disclosures should be based on a single, comparable figure for the remuneration of the CEO and the median employee, to provide a truer picture of the level of disparity.

"We sent a letter to the remuneration committee chairs of UK companies in the FTSE 350, asking them to consider the compensation offered for the rest of the workforce and the pay ratio when reviewing pay for senior and executive management. We wanted companies to listen to their employees, by appointing a member of the committee to meet with an employee representative at least once a year.

"Furthermore, we made it clear that we will not support increases in base pay for executive directors that were out of line with the workforce, unless there is a genuine rationale that we considered acceptable, such as a promotion.

"Equally, we will no longer support increases in variable pay without a valid justification. We reaffirmed *(PTO)*

this tougher stance on pay increases at an event we held for non-executive directors and company secretaries in September 2016.

"…Our tougher stance in the US is highlighted by the divergence in voting compared to the recommendations from the Institutional Shareholder Services, the influential and global proxy adviser.

"There was evidence throughout the year that the efforts we made in 2016 may be starting to result in changes. A number of top UK companies reduced their executive pay, including Anglo American, BP, Burberry, GlaxoSmithKline, Reckitt Benckiser and the Royal Bank of Scotland.

In fact, it was reported that the total pay outcome for the FTSE 100 CEOs dropped by 17 per cent in 2016 compared to 2015. However, we have not yet seen any significant gains for the pay of the median employee Deloitte data, which highlights the need for more work in this area.

Shareholding requirements

"In order to better align the interests of executives with those of long-term shareholders, we continued to ask companies to introduce post-exit shareholding requirements. By requiring executives to hold shares in their company for a minimum period after they leave the firm, we believe they will be incentivised to keep the long-term prospects of the company in mind. We are updating our global policies to reflect this position.

"The number of companies introducing post-exit shareholdings is increasing, with four new UK companies introducing them in 2017, making 10 in total: we will continue to track this.

Pensions

"In our letter to FTSE 350 companies, we highlighted pensions as an area where the remuneration committee could reduce inequality between executive and employee pay by lowering the pension provisions for executives and, where possible, increasing provisions for the rest of the workforce.

"More than 35 companies in the UK reduced pension provisions for their executive directors in 2017. In some cases, these were for new executives, but there were also some companies that went further by reducing the pension for existing directors. The extent of the reductions varied greatly between companies, with the largest reduction coming from Capital & Counties, from 24 per cent of salary to 10 per cent of salary. Examples of other companies that reduced pension provisions include Barclays, Burberry, Diageo and Marks & Spencer.

Longer-term objectives

"The objective of our remuneration policy is twofold. First, we want to ensure executive pay is predominantly based on long-term performance and that the executive has sufficient equity in the company to align their interest with the long-term shareholders. Second, we want to encourage companies to examine their culture and reduce the growing gap between the general workforce and the executive team.

"By strengthening and enforcing our remuneration policy and influencing government debate and the collective investor voice, we are seeking to help tackle this widening divide".

LGIM is one of Europe's largest asset managers and a major global investor, with total assets of £983.3 billion.

"That's No Excuse" - HMRC On Expenses Claims

Every year, following the 31 January self-assessment deadline, HM Revenue & Customs receives a number of excuses for not completing tax returns on time. ECB readers may like to know that if they missed the deadline, they are not alone. Recent excuses have included:

- I couldn't file my return on time as my wife has been seeing aliens and won't let me enter the house
- I've been far too busy touring the country with my one-man play
- My business doesn't really do anything
- My ex-wife left my tax return upstairs, but I suffer from vertigo and can't go upstairs to retrieve it

As well as the excuses, HMRC also receives some questionable items which taxpayers have tried to claim as a deductible expense:

- A three-piece suite for my partner to sit on when I'm doing my accounts
- Birthday drinks at a Glasgow nightclub.
- Vet fees for a rabbit.
- Hotel room service for candles and prosecco
- £4.50 for sausage and chips meal expenses for 250 days

The excuses and expenses listed above were all rejected.

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Changes To Investment Policies At LGIM

As well as the retrospective analysis of interactions with its investee companies reported elsewhere in this issue of ECB, Legal & General Investment Management has also published an updated version of its Corporate Governance and Responsible Investment Policy for UK companies; Matt Higgins at FIT Remuneration Consultants examines the changes.

This new policy was last updated in September 2016); a summary of the most significant changes to the policy regarding executive pay is set out below.

The timing means that it is too late to have a significant impact on the 2018 AGM season for 31 December year-end companies, but it will be a key resource for companies with AGMs taking place later in 2018 and 2019.

Gender pay gap: We expect all companies to disclose a breakdown of board directors, executive directors, managers and employees by geography, main skill set and gender, along with the information on its gender pay gap and what initiatives it has in place and action it is taking in order to close any stated gap.

Gender pay gap reporting has been high on the agenda of most boards during the last year. It is unclear whether LGIM expects gender pay gap reporting to form part of a company's annual report and accounts (or as a stand-alone report). In our experience most companies are not including the full gender pay gap report in their annual report.

Shareholder dissent: A large voting opposition (>20 per cent) to remuneration proposals should not be ignored. The remuneration committee should publish an explanation for the dissent including what the board is doing to address concerns and a copy of this should be sent to the Investment Association.

This statement reflects the new requirements introduced by the Investment Association in October 2017. However, it also appears that LGIM have removed the previous suggestion (included in the 2016 LGIM policy) that a company should re-tender its remuneration consultant contract in the event of a significant vote against.

Pay ratio: All companies should produce a pay ratio of their UK employees, comparing the median employee with the CEO's single figure total pay. Global companies should also explain how this compares with the ratio when all employees are taken into account.

The 2016 LGIM policy also included a reference to the importance of the pay ratio between the CEO and median employee. The updated policy says that the comparison should be to a median UK employee. The current published UK government proposals are for the ratio to be between the CEO and an average UK employee.

The secondary legislation implementing pay ratio analysis has yet to be published, but clearly the methodology for comparison will need to be developed to ensure consistency of disclosures.

We note that LGIM also suggests that global companies should explain the ratio if all employees (i.e. including those employees outside the UK) are included.

Restricted share schemes still require justification and when considering the appropriate discount rate LGIM consider 50% to be the "absolute minimum" with historic vesting rates also operating as a useful guide.

Following the recent success of Weir (reported in this issue of ECB) in gaining investor approval for a restricted share scheme, we anticipate that other companies will be exploring the possibility of introducing similar schemes.

Most of the LGIM commentary regarding restricted share schemes remains the same as set out in their 2016 policy.

The significant change to note is that when LGIM is considering if a proposed discount rate is appropriate, LGIM will also consider historic vesting rates.

This suggests that LGIM will look beyond the simple mathematics and consider context. For example, why would a company with high LTIP vesting move to restricted stock? Is it calling the top of the market? Similarly, would a history of nil LTIP vesting prove the rationale for not being able to set meaningful performance targets?

Relocation expenses should mirror what is being offered to employees (and any additional benefit should be limited to two years).

The updated LGIM policy reflects the position taken by other investor bodies, like the Investment Association and ISS, that relocation benefits should be time limited. It also goes further in that it advocates that those benefits be brought in line with what is being offered to employees generally.

This is similar to the position that investors have reached in recent years regarding pension contributions, i.e. they should be offered to directors on the same basis as to other employees.

Earnings per share metrics used in incentive plans should be adjusted to strip out any enhancement that has resulted from buy-back activity.

The 2016 LGIM policy made a general observation that performance targets could be adjusted for capital changes such as buy-backs. This comment in the 2018 policy is arguably more specific and prescriptive, in that it explicitly requires that the impact of share buy-backs be stripped out for the purpose of EPS performance measures.

This also reflects a concern of some investors (in both the UK and US) that executives are sometimes using share buy-backs to manipulate performance outcomes and therefore executive remuneration. Indeed, in January of this year the UK government announced a review "to understand how companies use share buybacks and whether any further action is needed to prevent them from being misused". The results of this review are expected to be published later this year.

Whether valid or not, there is clearly a perception that share buy-back can be used to game EPS performance measures. However, we think that there is a risk that prescribed adjustments to EPS measures (albeit to address a perceived mischief) interfere with how companies manage their balance sheets.

For example, if EPS measures are adjusted to add back the shares repurchased by the company, how will the related cash-flow impact of the buy-back also be taken into account? It doesn't seem right that it should be added back to earnings, but if not then there is no "credit" for the fact that shareholders have received a return (and the company has foregone the opportunity to reinvest the funds in the business).

Consider a simple example; two companies have exactly the same earnings, issued share capital and EPS. Company A decides to carry out a buy-back using surplus cash, but Company B decides to reinvest it within the business. If EPS is adjusted for the effect of a buy-back, both companies will have the same EPS.

However, Company B will be at a comparative advantage for future EPS growth because it has reinvested in its business (whereas Company A has returned cash to shareholders).

The risk is that an adjustment to "strip out any enhancement" to EPS is potentially asymmetric and could create a disincentive for executives to return cash to investors.

The use of buy-backs is a complex issue that is driven by broader considerations that, we think, need to be considered in the round.

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DRRs of the Month

Cliff Weight, ECB editorial board member and NED at ShareSoc and MM&K, commends progress at Persimmon and highlights issues at RBS.

Persimmon

At Persimmon, 48.5 per cent of shareholders voted against the remuneration report and quite a lot abstained. But the vote is backward-looking and non- binding, so Persimmon have to go on the Investment Association's naughty list. There are arguments both ways - I explained them in January's ECB.

I met the interim chairman Nigel Mills and the remco chair Marion Sears on 19 April. This was part of the Persimmon charm offensive to try and minimise the negative impact of the 2012 LTIP which is due to pay out so massively. They and their proxy advisors Boudicca deserve congratulations for avoiding a vote against. Nigel and Marion were not responsible for the 2012 LTIP. That was done before they joined Persimmon. Those responsible have resigned and Nigel and Marion are trying to make the best of an awfully difficult situation.

The remco sought legal advice (the cost should have been disclosed in the annual report but was omitted) and were told they could not vary the 2012 LTIP awards unilaterally. Instead they have frozen salaries and said they will not make bonus or LTIP awards in 2018. In addition, they have secured agreement on the numbers of shares that cannot be sold before 2021.

These are all positive steps. In my opinion, shareholders do not need to worry about the incentivisation of the top team, as they have huge share holdings, vested share awards and unvested share awards. This will be true so long as they do not sell their shares.

There has been comment on the lack of clear disclosure of the LTIP over the years. Suffice it to say that all the information is now there, so long as you know where to look. (For example, in the 2017 results announcement there was a note to the financial statements mentioning a tax payment of £88 million, so transparency was there.)

I welcome the improved transparency of reporting of the 2012 LTIP. The annual report on page 64 estimates the total LTIPs payments at £438 million, which is correct with the assumptions they have used; this is a good example of how to use the disclosure regulations to come up with as small a figure as possible. However, I estimate that the total payments from the 23.3 million LTIP award shares will be £600 million assuming the share price new cap of £29 is achieved and the exercise price is reduced to zero if capital distributions hit the targets.

Note: The author holds a small number of shares in Persimmon, having sold most of his shares in the past 6 months, which he had held for many years.

RBS

In contrast with Persimmon, although RBS regularly receives a very high percentage of votes for their remuneration report and policy, I have a number of concerns:

- Sir Howard Davies, the chairman, is paid unnecessarily highly at £750,000 and owns very few RBS shares, only 41,000. His pay should be less and it should all be paid in shares until he owns at least £2 million of RBS shares. This would increase his alignment with shareholders.

- The CEO receives a pension allowance of 35 per cent of salary. His pension allowance should be the same as for employees, or £10,000 p.a., the HMRC upper limit of pension contributions. As well as being unnecessarily high, the allowance sends the wrong cultural message of elitism in relation to the top team.

- Soft targets have been set. The LTIP vesting percentages for the past 5 years have been 73 per cent, 62 per cent, 56 per cent, 89 per cent and 60 per cent. The share price performance has been distinctly worse than average, but the highly complex remuneration formulae have paid out far too generously.

- The new remuneration policy means that 30 per cent of the CEO's pay is in cash and 70 per cent in shares. This is a good ratio of split and aligns him with shareholders. But in the remuneration report there is no projection of his shareholding and potential gains from his current shareholding and those shares he is likely to receive over the next several years: 21 pages of other stuff but the most useful information is not there. (I raised this concern with RBS and they told all the information is there for any shareholder inclined to work it out.) So I did some basic arithmetic, which suggests he will have about 8 million shares by December 2023, assuming he does not sell any. If the RBS share price doubles he will have £40 million of RBS shares, if it trebles about £65 million and if it halves about £10 million. This certainly creates a good alignment with shareholders! However, I think it also suggests his pay is unnecessarily high and should be reduced. It is a good example of hiding the most useful information and should avoid most shareholders voting against….

- The rules on the CEO selling shares allow him to sell too early. Best practice is that directors should not sell shares until two years after they leave the company, so as to prevent any bulling up of the shares to get a good sale price. (It should be noted there is a conflict here as this is exactly what 70 per cent shareholder UKGI would like!)

Note: the author is a shareholder in RBS. His last trade was a buy in February 2017. He is also the ShareSoc RBS Shareholder Committee Campaign co-ordinator and has requisitioned Resolution 27 at the RBS AGM. He will be attending the RBS AGM and asking questions and hopes to see ECB readers there….

Contentious Votes

This month, the team at independent corporate governance and proxy voting service Manifest looks at companies which received high shareholder dissent (against votes plus abstentions) on remuneration-related resolutions at a AGM held in April.

FTSE 100 housebuilder **Persimmon** narrowly avoided a defeat after it received 64.45 per cent shareholder dissent (30.94 per cent abstain plus 33.51 per cent against) on its remuneration report at its April AGM. The resolution passed, as abstentions are not counted towards the resolution outcome. In its AGM statement, Persimmon acknowledged that a sizeable number of shareholders remained concerned over the level of remuneration that resulted from the vesting of awards made under the 2012 LTIP. Nonetheless, despite the dissent, the board considered that owing to the passing of the resolution a line had been drawn under the 2012 LTIP debate.

The 2012 LTIP was intended to be a ten-year plan with awards of share options vesting based on the achievement of cumulative cash return targets with the exercise price of options to be reduced by an amount equal to the value of the cash returns made during the period from date of grant to exercise. No annual awards were granted under the plan; instead, the initial grant was designed to vest across multiple years until 2021. All targets under the plan are now expected to be achieved by July 2018 and the first 40 per cent of the award vested on 31 December 2017 with the remainder due to vest in July 2018.

Although the company included a performance underpin, cash return decisions are ultimately at the discretion of the board and no cap on earnings was included in the plan. The plan resulted in a potential £100 million pay-out for CEO Jeff Fairburn, since reduced to £75 million. The company reported remuneration single figures of £47.1 million for CEO Fairburn, £36.7 million for finance director Michael Killoran and £20.4 million for managing director David Jenkinson - this compared to single figures ranging £1.4-£2.1 million in the previous year.

The company faced criticism over the size of awards and some shareholders highlighted that Persimmon has been a beneficiary of the government's Help to Buy scheme, which boosted profits and share price and therefore pay outcomes. In addition, a coalition of institutional investors working with ShareAction raised concerns over pay equality at Persimmon ahead of the AGM and called for the firm to accredit with the Living Wage Foundation.

Board chairman Nicholas Wrigley and remuneration committee chairman and lead independent director Jonathan Davie tendered their resignations in December 2017 in recognition of the lack of cap on payments in the plan. Further, the executive directors have voluntarily reduced their entitlement under the second vesting by 50 per cent and Fairburn has said he would donate a proportion of his award to charity. The committee have also extended holding periods and capped the value of any future exercises at £29 per share. In addition, no annual bonuses or salary increases will be granted to executives in 2018, the 2018 bonus will instead be distributed to staff (excluding participants in the 2012 LTIP or 2017 PSP). The 2017 PSP was approved by shareholders at the 2017 AGM and no awards will be granted to directors until all awards under the 2012 LTIP have vested. The dissenting vote indicates that despite the mitigating measures put in place the majority of shareholders retained concerns.

The Persimmon case is examined further by Cliff Weight elsewhere in this issue.

British American Tobacco, the FTSE 100 tobacco company, recorded an against vote of 23.90 per cent on its remuneration report at its recent AGM with a further 1.73 per cent of shareholders abstaining. This is an increase on the 8.76 per cent dissent received in 2017 and 11.78 per cent in 2016.

A factor contributing to the high level of dissent was disclosure on the annual bonus. The company did not disclose the performance targets used under the bonus during the year as they were considered commercially sensitive; instead, targets are disclosed with a one-year lag. As such, the 2016 targets were disclosed in the 2017 remuneration report with the 2017 targets to be disclosed in next year's report. Although the company did disclose the outcome of each metric, the lack of disclosure of the actual targets used does not allow shareholders to assess whether awards were appropriate and targets sufficiently stretching. In addition to corporate performance targets the bonus is subject to an individual performance modifier and the remuneration committee applied the full +20 per cent upward lift in the year. Shareholders will have also noted that bonus pay-outs to the CEO for the last three years have been at 100 per cent, 100 per cent and 98 per cent of maximum respectively and may have been disappointed with the lack of transparency in light of the size of these awards.

Shareholders will have also noted the consecutive above employee salary increases granted to CEO Nicandro Durante. Durante has been granted a 4.8 per cent salary increase and finance director Ben Stevens a 3.5 per cent increase, effective from 1 April 2018, while the average increase for UK employees was 3 per cent. The committee cited company performance and increased complexity of the organisation following recent acquisitions and organic growth as the justification for the above employee salary increases. In the previous year Durante received a 5 per cent increase and Stevens a 3 per cent increase compared to average employee increases of 3 per cent.

The company commented in its AGM statement that it will continue to engage with shareholders to understand the concerns of those who voted against. A full review of remuneration arrangements with shareholder consultation will be undertaken in 2018 in preparation for the presentation of a new remuneration policy to shareholders at the 2019 AGM.

FTSE 250 oil and gas service provider **Hunting** received more than 25 per cent shareholder dissent on its remuneration report at its AGM, with 23.95 per cent voting against and 1.40 per cent abstaining. The remuneration policy in contrast received 95.55 per cent votes in favour. Shareholders had been concerned with the loss of office payment received by outgoing CEO Dennis Proctor. Proctor retired from the board on 1 September 2017 with chief operating officer Jim Johnson succeeding him.

Proctor was accorded good leaver status and was therefore entitled to a payment of $1,688,350 in accordance with his service contract provisions. $785,600 related to his service contract obligations, with the balance reflecting a settlement in connection with the cessation of his employment. He also received a pro-rated bonus totalling $1,047,467 and will retain unvested share awards granted under the performance share plan on a pro-rated basis subject to performance.

Institutional investor guidelines generally set out a preference for termination provisions to not exceed a value of 12 months' salary. A good leaver may also be entitled to a pro-rated bonus for the part of the financial year worked and retain unvested long-term incentive awards subject to pro-rata and performance. The loss of office payment made to Proctor is equivalent to 322 per cent of his received salary for the year and 215 per cent of his salary rate and no further detail was provided regarding the cessation of employment settlement.

Hunting commented on the dissent received on the remuneration report, considering that it reflected concerns relating to the loss of office payment. The company noted that Proctor's service contract was a legacy contract, which the remuneration committee was required to honour and the cessation of employment payment was made in accordance with the remuneration policy approved by shareholders at the 2017 AGM. The company considers that the terms of the service contract of the new CEO Johnson align with UK good practice recommendations.

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COMPANY	EVENT DATE	RESOLUTION TYPE	TURNOUT %	FOR %	ABSTAIN %	AGAINST %	TOTAL DISSENT %	OUTCOME
XP Power	06/04/18	Remuneration Report	62.65%	79.94%	11.72%	8.34%	20.06%	Passed
Dialight	17/04/18	Remuneration Report	81.87%	69.56%	27.62%	2.82%	30.44%	Passed
Hunting	18/04/18	Remuneration Report	83.34%	74.65%	1.40%	23.95%	25.35%	Passed
		Remuneration Policy	83.34%	98.55%	0.38%	1.07%	1.45%	Passed
RELX	19/04/18	Remuneration Report	80.02%	66.77%	20.15%	13.08%	33.23%	Passed
Bank of Ireland Group	20/04/18	Remuneration Report	68.77%	78.70%	20.64%	0.66%	21.30%	Passed
British American Tobacco	25/04/18	Remuneration Report	77.78%	74.37%	1.73%	23.90%	25.63%	Passed
Persimmon	25/04/18	Remuneration Report	67.28%	35.55%	30.94%	33.51%	64.45%	Passed
CRH	26/04/18	Remuneration Report	63.36%	57.66%	4.40%	37.95%	42.34%	Passed
Rotork	27/04/18	Remuneration Report	78.01%	71.65%	0.02%	28.34%	28.35%	Passed
Old Mutual	30/04/18	Remuneration Report	75.14%	70.73%	0.92%	28.35%	29.27%	Passed

Share Schemes Market Practice

Shafiur Choudhury and Chandni Bhagani from PwC report on companies seeking shareholder approval for the introduction of long-term incentive plans presented at general meetings during April 2018.

Of the 89 meetings held, two companies are reported on below, one of which sought approval for its share reward plan. The other one sought approval for amendments to its LTIP.

Weir Group sought approval for its share reward plan at its AGM on 26 April 2018. IVIS awarded this an "amber-top". Under the current LTIP annual awards are capped at 250 per cent of salary for the chief executive officer and 200 per cent of salary for other executives. Vesting of awards depends on three equally weighted performance measures over three years: total shareholder return relative to a peer group comprising global engineering companies, annual growth in earnings per share and return on capital employed. Any vested awards will be subject to an additional two-year holding period.

The remuneration committee is proposing to replace the existing LTIP with restricted share awards under the share reward plan. Maximum awards under this plan have been halved to 125 per cent of salary for the CEO and to 100 per cent of salary for the chief financial officer. Vesting of awards will occur in three tranches: 50 per cent after three years, 25 per cent after four years and the remaining 25 per cent after five years. Each tranche will be subject to an additional two-year post-vesting holding period such that 50 per cent is released to participants after 5 years, 25 per cent after 6 years and the final 25 per cent after 7 years.

It should be noted however that an exception will be made for the first award made under the new policy for 2018, in which the first tranche will vest 25 per cent after two years instead of three years. These transition arrangements are aimed at addressing the one-off transitional risk of migrating from an LTIP to restricted shares.

In addition all awards will be subject to continued employment and an underpin comprising one or more measures, as determined by the board prior to vesting. For 2018, these measures relate to balance sheet health (considering dividends paid and adherence to debt covenants during the vesting period), investor returns (ROCE) and corporate governance (major governance failure). If these thresholds are not met in any year, the committee has discretion to apply any downwards adjustments if considered appropriate. Shareholding requirements have also been doubled from 200 per cent of salary to 400 per cent of salary.

IVIS noted that shareholders will need to feel comfortable that the proposed share reward plan is appropriate given the company's circumstances and strategy. When considering the reduction in quantum by 5o per cent, shareholders should also consider the fact that the LTIP being replaced has not paid out in the last five years. IVIS also noted that Weir Group has adopted the protections expected by shareholders with regard to such restricted share plans.

At the meeting 94 per cent of votes were cast for the proposal with 6 per cent of votes cast against the share reward plan.

Rank Group sought approval for amendments to their LTIP as part of a new remuneration policy at its AGM on 25 April 2018. IVIS awarded the former a "blue-top" and the latter an "amber-top".

Under the 2010 LTIP the committee grants three-year block awards. The quantum of these awards is 600 per cent for the CEO and 400 per cent for other directors. The AGM notice stipulates that the proposed changes to the LTIP will enable the committee to take account of individuals' personal performance when considering the extent to which an award should vest.

The revised policy seeks to continue granting block awards but over a four-year period instead of three. The quantum will remain the same for the CEO (600 per cent of salary) but will be increased to 450 per cent of salary for other executives. While the committee has acknowledged that block awards are not in line with standard UK market practice, the company's majority shareholder considers this structure to be most appropriate for driving transformational growth, so this structure has been retained. No further awards will be made until 2021/22 following the 2017/18 grants.

The 2017/18 awards will vest in three tranches and an additional holding period will apply to the first two tranches, whereby executives will be required to hold the net-of-tax number of vested shares until the fifth anniversary of grant. 70 per cent of the award will be based on financial performance measures (EPS growth, digital net revenue, digital profit, Grosvenor London revenue, Grosvenor London profit) and 30 per cent will be based on a balanced scorecard of measures (value creation, digital division targets and retail division targets). Under the new policy, shareholding requirements have also been increased from 150 per cent for the CEO and 100 per cent for other directors to 200 per cent of salary for all participants.

IVIS noted that shareholders will need to be satisfied with the continued ability to grant block awards under the LTIP, considering 20 per cent of shareholder votes were cast against the current remuneration policy. IVIS also noted that the performance period has been increased to four years and that shareholders will likely welcome the increased share ownership guidelines.

At the meeting 93 per cent of votes were cast in favour of amendments to the LTIP with 7 per cent of votes cast against this resolution. 91 per cent of votes were cast in favour of the remuneration policy with 9 per cent of votes cast against this resolution.

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International Tax and HR Update

Ceri Ross and the team at EY bring us the latest from around the world.

UK - Scottish income tax rates

The Scottish government has now set income tax rates and bands for the 2018/19 tax year that diverge from those for the rest of the UK, with the introduction of two new tax bands to create a "starter rate" and "intermediate rate".

The addition of new bands and rates creates a number of administrative and operational challenges that employers will need to consider as of 6 April 2018. They will also raise some policy questions for employers with assignees moving to or from Scotland, including where employees move between Scotland and other parts of the UK.

The Scottish tax rates apply to those deemed to be a Scottish taxpayer. Scottish taxpayers will broadly be those resident in the UK for tax purposes who meet any of the following three conditions:

- They have a "close connection" to Scotland through either:
  - o A single place of residence in the UK which is based in Scotland, or
  - o More than one "place of residence" in the UK, but their "main place of residence" is in Scotland for at least as much of the tax year as it has been in any one other part of the UK
- No "close connection" to Scotland (or any other part of the UK) but spends at least as many days in Scotland as in any other part of the UK
- A Scottish Parliamentarian

Income tax rates

The 2018/19 tax bands in Scotland, that apply to income in excess of any available personal tax free allowance (the standard personal allowance being £11,850), are: starter rate (19 per cent) - £0-2,000; basic rate (20 per cent) - £2,001-12,150; intermediate rate (21 per cent) - £12,151-31,580; higher rate (41 per cent) - £31,581-150,000; and additional rate (46 per cent) - over £150,000.

The Scottish rates and bands only apply to UK-taxable non-savings and non-dividend income received by a person when they are a Scottish taxpayer. They do not apply to earnings that are sourced to a period when the person was a Scottish taxpayer that are received when the person is no longer a Scottish taxpayer (either because they have moved elsewhere in the UK or because they have become non-UK resident).

It is not possible to be a Scottish taxpayer if non-UK resident, which means the Scottish rates and bands cannot apply to UK source income for non-UK residents.

Administrative and operational consequences for employers

PAYE withholding

HMRC issue PAYE codes with an "S" suffix for individuals believed to be Scottish taxpayers. The additional Scottish bands for 2018/19 mean that some new PAYE codes will be required. It is understood that the codes used to collect tax at a flat rate are to be changed as follows:

- Basic rate 20 per cent code SBR (this code already applies to basic rate taxpayers)
- Intermediate rate: 21 per cent: code SD0 (this code currently applies to higher rate taxpayers)
- Higher rate 21 per cent: code SD1 (this code currently applies to additional rate taxpayers)
- Additional rate 46 per cent: code SD2

There is a potential for confusion here if new codes are not issued to those currently on code SD0 or SD1 as they will see an unexpected reduction to the flat withholding rate if the existing code is simply carried over.

Employers using a modified payroll arrangement for tax-equalised assignees working in the UK must ensure the best estimate of the PAYE due is calculated using the Scottish rates and bands where it is reasonable to assume that the employee will be a Scottish taxpayer for the tax year. For modified payroll it is the employer's responsibility to determine whether the employee is likely to be a Scottish taxpayer because HMRC do not issue codes, so will not issue an 'S' code, for an employee on a modified payroll.

Savings and dividend income

As the Scottish rates and bands apply to non-savings and non-dividend income only, for a Scottish taxpayer who has both earned income, such as employment salary, pension, profits from self-employment or rental profits, and taxable savings (bank interest) or dividend income, it is necessary to consider both the UK rates and bands and the Scottish rates and bands in order to work out a Scottish taxpayer's income tax liability. Inevitably the tax calculation for a Scottish taxpayer with different types of income is going to be even more complicated than it already is.

Pension contributions

As the Scottish basic rate is expected to remain at 20 per cent with a much narrower income band, the main impact for 2018/19 in relation to tax relief for pensions is likely to be a significant increase in Scottish taxpayers needing to submit a claim for excess relief where they have paid 21 per cent or higher.

Relief for Scottish taxpayers under the relief at source method (where pension contributions are made from net pay after tax and the pension scheme claims a basic rate tax credit directly from HMRC) does not appear to be restricted in any way but the new 19 per cent Scottish starter rate, this means individuals contributing to that type of UK registered pension scheme will still get relief at 20 per cent even if the income being relieved is taxed in Scotland at 19 per cent.

Charitable donations

The Scottish tax rates do not affect the rate of tax claimable by charities under the Gift Aid scheme, so that will continue to be at a rate of 20 per cent in all cases. Where a Scottish taxpayer claims excess relief for Gift Aid contributions, that will be based on the difference between the Scottish basic rate and the actual rates of Scottish income tax paid.

Expatriate tax issues

It will make sense for a UK outbound assignee Scottish taxpayer who is tax-equalised to be equalised based on the Scottish tax rates and bands. However, it is clearly for individual mobility programmes to decide as a matter of policy whether to base hypothetical tax on Scottish rates and bands or the rates and bands for the rest of the UK.

Mobility programmes will also need to consider whether, or to what extent, assignments within the UK that involve employees moving to or from Scotland should be subject to tax equalisation. As there are now scenarios where an assignment to Scotland from the rest of the UK could create additional income tax liabilities, it will be important for policies to be clear on the extent to which employers will cover any such costs.

Other issues

There are various tax and benefit rules that apply by reference to whether individuals are higher rate taxpayers. For certain Scottish taxpayers, it will be important to determine whether the rules apply based on the Scottish bands or the UK bands. For example, the level of the savings allowance for a Scottish taxpayer is determined by assuming, for that purpose, that the individual is not a Scottish taxpayer. In contrast, the availability of the transferable marriage allowance for a Scottish taxpayer is determined based on whether they pay income tax at a rate other than the basic rate in Scotland. The UK government has said that the marriage allowance rules will be amended to take account of the Scottish starter and intermediate rates in due course.

Action points

Employers will need to take into account the new Scottish rates and bands and consider the impact of these in respect of assignments to and from Scotland. Mobility policies will need to be updated to take into account the differences between Scottish tax rates and those of the rest of the UK, as they are likely to result in increasing differentials for assignees to and from Scotland.

Employers should also consider ensuring that the PAYE and modified PAYE withholding is applied correctly for anyone expected to be a Scottish taxpayer.

Netherlands - Government announces limitation on inpatriate tax facility without transitional rules

On 20 April 2018 the Dutch Ministry of Finance announced that it will not “grandfather” individuals currently eligible for the 30 per cent facility when the maximum period falls from eight to five years as of 1 January 2019.

If the changes are approved by the Dutch parliament, 2019 will see an immediate impact on the tax affairs of employees who have been claiming the facility for five years. The tax payable on their employment income will rise to 51.75 per cent (maximum) and if they are a Dutch tax resident they will be required to file income tax returns declaring worldwide income and assets.

Background

Qualifying employees relocating to the Netherlands can receive a tax free allowance of 30 per cent of their employment income. This allowance is intended to mitigate the impact of costs associated with working abroad (incurred by employees recruited from outside the Netherlands), by offering a corresponding tax saving for the employer and employee (depending on the circumstances of employment).

This allowance currently applies for a maximum of eight years but this period was due to fall to five years from 1 January 2019.

The Ministry of Finance has announced that it will put forward legislation that ensures that employees currently claiming the 30 per cent facility will also be restricted to a five-year period and not just employees who arrive after 1 January 2019.

Draft legislation and explanations are likely to be published mid-September 2018 as part of the tax plans for 2019. The Dutch parliament has the right to amend the proposal but it is expected that the changes will be confirmed by the end of 2018.

If the 30 per cent tax facility no longer applies after five years, the employment income of affected employees will become subject to the regular tax rates (which are presently proposed to be a maximum of 51.75 per cent for 2019, 50.50 per cent in 2020 and 49.50 per cent in 2021). For employees who are paid a net income by their employer, the gross-up costs for the employer will significantly increase. Employees who are paid gross wages will have a reduced after-tax income.

Any employee who is receiving a tax-free reimbursement for the actual extraterritorial costs (which can be used instead of the 30 per cent tax facility), will also be affected and will be subject to the same reduction to five years.

It should be noted that when the 30 per cent tax facility lapses, Dutch tax residents will become liable to tax on worldwide income from savings and investments (income from bank accounts, shares and real estate - excluding an individual’s primary residence).

In the Netherlands this income from savings and investments is deemed to be a certain percentage of the net value, rather than the actual income. The effective tax rate for savings and investments exceeding a net value of €30,000 for joint filers is 0.6 per cent to 1.61 per cent (above €978,000) of this net value. Foreign real estate also needs to be reported in the Netherlands tax return if the 30 per cent facility is not available but owing to an additional relief the effective Netherlands tax is (very) limited.

Action points

Employers should consider ensuring that employees are aware that the maximum term of the 30 per cent tax facility will be reduced from eight to five years as of 1 January 2019, with possibly no transitional rules for existing cases.

Employers should consider assessing the cost of deployment of key talent, as a result of increased gross employment costs where employers provide net guarantee polices to employees. They should also inform their employees who are paid gross about the decrease in their net income.

Additionally, the attractiveness of the Netherlands as a destination to relocate employees to on a gross paid employment contract will be reduced, impacting employers seeking to recruit such individuals and the employees themselves who accept such offers.

Slovenia - Changes in conditions and taxation of posted workers

New regulations affecting employers who post workers to and from Slovenia entered into force from 1 January 2018. The conditions place the burden on employers to ensure that workers have timely applied for social security certificates of coverage as well as for work registration in Slovenia. Fines of up to €60,000 can be issued for foreign employers who do not comply with the regulations.

The regulations also introduce new tax benefits for workers posted to Slovenia including a deduction of up to €1,000 in taxable pay each month and provisions outlining when reimbursed business expenses are not taxable during short term assignments.

Key points

In February 2017 the National Assembly of Slovenia adopted the new Transactional Provision of Services Act which came into force on 1 January 2018. The Act implements the provisions of Directive 2014/67/EU of the European Parliament and of the Council of 15 May 2014 (governing posted workers) into the Slovene legal system.

The three main objectives of the Act are for:

- Harmonisation of national regulations and practices with EU regulations,
- Prevention of abuse and violation of posted workers' rights, especially:
  - o Prevention of so called "social dumping" where foreign service providers of labour can undercut local service providers owing to lower national labour standards
  - o Prevention of the multiplication of "mail-box" companies that use posting as a way to circumvent employment rules
  - o Setting of measures and control mechanisms to prevent and sanction any abuse and circumvention of the applicable rules.

The Act determines the same basic conditions for foreign employers who wish to post workers in Slovenia as for Slovenian employers who wish to post workers in other EU member states.

- Both foreign employers and Slovenian employers may provide cross-border services if conditions are met and Slovenian employers may perform cross-border services in another EU member state under certain conditions.
- Slovenian employers should obtain an A1 certificate of coverage applicable for EU member states as per EU regulations on Social Security.
- Foreign employers may perform cross-border services in Slovenia for which certain supporting documents should be available, including an A1 certificate of coverage.

Issuance of an A1 certificate in Slovenia

For posting workers from Slovenia abroad, where appropriate, application of an A1 certificate should be completed no more than 30 days before the posting start date (by means of an electronic system, eVem). Slovenian authorities should issue the respective A1 within five working days provided all conditions are met.

Slovenian authorities do not issue retroactive A1 certificates and assignment planning should ensure that an A1 certificate is obtained on time.

Obligations of foreign employers and posted workers to Slovenia

Foreign employers are required to apply for work registration prior to the commencement of any assignment, which will also be considered a posting declaration. The posted worker must have an A1 certificate issued by the competent social security institution in the country of employment, from their first day of work in Slovenia.

During any assignment, the foreign employer must appoint a contact person in Slovenia who will be the main contact for labour inspections and who has access to all supporting documentation related to the posting. The documentation can be requested by the Inspectorate within 24 months after the posting concludes.

Fines and penalties

Non-compliance with obligations in the Act could trigger financial penalties for a foreign employer from €2,000 to €60,000 and for the foreign employer responsible contact from €600 to €2,000.

Changes related to taxation of posted workers

As a consequence of adoption of the Act the government has adopted changes to the Personal Income Tax Act, which came into force on 1 January 2018.

Under certain conditions to the renewed Tax Act, posted workers are entitled to benefit from a reduced taxable base of 20 per cent of monthly income, up to a maximum of €1,000 per month.

This reduced taxable base only applies to income paid out for a posting between 30 days and 60 months (in the last 10 years from the first posting of the worker).

For short term assignments, the Tax Act will allow some reimbursement of employee costs to be considered as non-taxable income. This benefit was adopted following guidance issues by the Minister of Labour, Family, Social Affairs and Equal Opportunities where a business trip for Slovenian tax purposes has been clearly defined for the first time.

Action points

Slovenian and foreign employers should consider reviewing the new obligations arising from the Act and ensure that populations of posted workers are covered by valid A1 certificates for the entire working period and should follow prescribed timeframes and procedures to apply for and obtain A1 certificates.

Employers should be made aware of the tax benefits available for workers posted to Slovenia where conditions for that are met.

India - High Court rules on the tax treatment of lump sum assignment allowances paid without proof of expenditure

The Indian High Court has ruled that allowances paid to employees to meet ordinary daily expenses when working away from their normal place of duty are taxable as benefits where the employer has not obtained proof of actual expenses incurred by employees. It also confirmed that standard cost of living allowances are taxable.

The High Court also ruled that failure to withhold tax by the employer on the allowances paid will attract interest, even where the employer did not deduct tax because of a genuine belief that tax was not due.

This ruling could affect the tax cost of international assignments into and out of India and some organisations may wish to alter their expense reimbursement procedures to retain their exemption from taxation.

Background

The tax treatment of allowances received by employees to meet ordinary daily expenses when working away from their normal place of duty has been a complex issue, specifically for the reason that such allowances can be exempt from tax only to the extent that the expenses are actually incurred by the employee. There have been conflicting rulings on the requirements for an employer to verify that allowances received by employees were actually spent.

This debate also encompassed whether a self-declaration from the employees for the amounts spent was sufficient evidence compared to actually requiring receipts.

In the most recent case the employer paid allowances to its employees who were sent to work in the UK, to cover their expenses towards lodging and boarding. The employer considered that the allowances were not taxable and accordingly did not withhold any tax in India.

The lower level Income Tax Authority subjected the allowance to tax. On appeal, the High Court confirmed that the allowances paid are taxable in the hands of employees as the employer had not verified the actual expenses incurred by the employees. The Court held that the employer is required to withhold tax on such allowances and penal interest for failure to withhold tax should be imposed on the employer, even if the failure was because of a genuine belief that tax was not due.

The observations made by the High Court are set out below:

- In order to claim an exemption, the payment made must be specially granted to meet expenses exclusively incurred in the performance of duties.
- If an allowance is paid to the employee to meet his personal expenses at the place where the duties of his office are ordinarily performed, this is not exempt. Allowances such as a city compensatory or a cost of living allowance, paid to enable the employee to meet the high cost of living in the posting location, and not granted due to the nature of duties, are not exempt from tax.
- The lump sum payments made to employees were to enable them to meet the high cost of accommodation and other personal expenses. It does not come within the remit of expenses incurred in the performance of duties and therefore cannot be treated as exempt.
- The employer was not reimbursing expenditure actually incurred by employees in the UK, but rather was paying a lump sum amount without requiring any evidence or receipts of what was incurred.

Action points

Employers may want to review their policies and processes for verifying expenses incurred by employees and the evidence required for these. This ruling could also have an impact on the employer cost projection when sending individuals for assignments.

While there are rulings to the contrary on this issue, it may be prudent for employers to re-visit their position to avoid any issues with failure to operate withholding tax on such allowances.

Kenya - Government issues new directive for foreign nationals to regularise their immigration work status

On 20 April 2018 the government issued a directive to foreign nationals working in the country to regularise their immigration status within the next 60 days. It was indicated that the government will verify previously issued work permits within the 60 days window in an effort to remove from the country individuals who are illegally working in Kenya. Thereafter electronic work permit cards will be issued to all foreign nationals working in the country. The government will also harmonise identification data into a single card that will carry all personal data. Currently work permits and passes are issued manually.

The government is expected to perform inspections in organisations after the lapse of the 60-day window to ensure that foreign workers are compliant. This is a bid to ensure that all foreign nationals who are working in the country are doing so legally and are in possession of skills and qualifications that are unavailable locally.

Background

All foreign nationals working in Kenya are expected to be in possession of valid work permits. To obtain the work permits these individuals should hold skills that are not locally available; it is the government's policy that work permits be issued only to highly skilled and qualified individuals.

Employers are also expected to have made provisions for training Kenyan nationals to assume the role and responsibility of an expatriate's position after completion of their assignment. However, the government has noted that some expatriates are in contravention of the immigration laws and regulations, with some individuals working in Kenya without the required work documentation and with skills that can be sourced locally.

Action points

Foreign nationals may wish to regularise their work permit status in the country within the next 60 days. Also, employers may wish to ensure that foreign nationals in their organisation are in possession of valid work permits and special passes.

Employers may also consider ensuring that they have proper immigration records for all foreign nationals working for them. The documents should be available on request by the Immigration Department.

Employers and foreign employees should expect queries and impromptu visits from the Immigration Department and may therefore wish to consider their compliance with the Immigration requirements.

Applications for work permits should be submitted early. The qualifications held by the foreign national will be critical and therefore it might be beneficial for employers to ensure that all work permit applications that are submitted going forward clearly demonstrate why the position cannot be filled by a Kenyan national.

Employers should expect delays in the processing of applications for work permits owing to increased scrutiny.

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Executive Compensation Briefing

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