Optional remuneration, cash long term incentive plans and bonus deferral

Employment Tax

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The CIOT has received clarification from HMRC that the optional remuneration rules do not apply to bonus deferrals into cash long term incentive plans.

The CIOT has been in correspondence with HMRC regarding the application of the optional remuneration (OPRA) rules to cash long term incentive plans (LTIPs), which involve the deferral of annual bonuses, either where the employer requires part of the bonus to be deferred into the cash LTIP, or where this occurs on a voluntary basis. The OPRA rules are set out at Income Tax (Earnings and Pensions) Act 2003 ss 69A, 69B and 228A.

An LTIP is a generic name for a plan that aims to provide incentives to employers over the long term, via rewards linked to cash, shares or securities. Participation in the plan is often funded by way of sacrifice of all or part of the participant’s annual bonus: employers may defer the payment of bonuses and make eventual payment subject to conditions. Such a deferral may be imposed by the employer or may be entered into voluntarily by the employee. In cash LTIPs, the reward arising from participation in the plan is delivered solely in cash.

HMRC's Employment Income Manual discusses such arrangements at tinyurl.com/353jx3rw (emphasis added):

> 'Employers may defer the payment of bonuses and make eventual payment subject to conditions. For example, the employer awards a bonus of £100,000 referenced to a performance period. £75,000 is paid in cash immediately following the bonus year; £25,000 is to be paid three years later in cash or shares, if the employee has not resigned or been dismissed before the vesting date. Such a deferral may be imposed by the employer, or it may be entered into voluntarily by the employee. **To develop the example, the £25,000 deferral may be required by the employer but the employee has the choice of voluntarily deferring a further £25,000.**'

The question on which CIOT sought HMRC's clarification was whether or not such bonus deferral or cash LTIP arrangements may be caught by the OPRA rules. This said, CIOT commented that in our view the OPRA rules were designed to cover provision of ongoing benefits-in-kind (for example, under flexible benefit arrangements) to employees in lieu of cash earnings, not cases where part of an annual bonus is deferred to be delivered later as earnings under a cash LTIP. In particular, we considered that the employee does not 'give up' the right to receive earnings; rather the quantum/amount of earnings they would have received is varied by virtue of the terms of the LTIP and delivered – as earnings – at a later date. Furthermore, the legislation draws a distinction between 'benefits' and 'earnings' and there is no particular benefit which the employee receives where they participate in a cash LTIP, other than the prospect of later payment of cash earnings.

In response to our request for clarification, HMRC commented that they consider the OPRA rules apply to scenarios where an employee gives up the right to an amount of earnings in favour of a benefit-in-kind, and (subject to exceptions) result in a tax charge on the higher of the value of the benefit-in-kind and the amount of the earnings foregone.

When all or part of a bonus is deferred into a cash LTIP, the employee is not giving up the right to an amount of earnings, so this is not caught by the OPRA rules. Rather the employee is taxable on any earnings paid out of the plan in the tax year they are received.

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