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March 2013

Share Based Payments - IFRS 2 Recharges in Groups

The original Share Based Payments Standard (IFRS2) generally assumed a single company granting equity based awards to its own employees. The resulting accounting entries in that company were a debit (expense) to employment costs, and a credit to reserves or shareholders funds. The accounting became more complex if there was a group structure and there were employees in a subsidiary who in a group scheme received awards over the parent company's shares.

In this case the IFRS2 expense for employment costs is recognised in the subsidiary's accounts and the credit is treated as a notional capital contribution to the subsidiary by the parent. In the parent company's accounts there is a credit to shareholders funds or reserves, and the corresponding debit is regarded as an investment in the subsidiary by the parent company. If the share based payment expenses were £100,000, the accounts with IFRS2 recharges might be summarised as follows:

Subsidiary's accounts

Dr Employment Costs £100k — Cr Capital contributions £100k

Parent company's accounts

Dr Investment in subsidiary £100k — Cr Shareholders Funds £100k

Consolidated Group accounts

Dr Employment Costs £100k — Cr Shareholders Funds £100k

Given this somewhat unusual and complex accounting, many companies initially preferred to keep the accounting simple and not recharge the share based payment expenses to subsidiaries at all. However, increasingly groups have been recharging subsidiaries to ensure that subsidiaries are accountable for all the related employment costs of their employees.

In international groups recharging share based payments can also create opportunities to claim corporation tax relief in foreign subsidiaries, without any corresponding taxable income arising in the UK parent. This is because of a special rule by HMRC for share scheme transfer pricing. Under this rule, providing the recharges are in accordance with IFRS2, they should not generate any taxable income in the UK parent.

Whether there is corporation tax relief in the foreign subsidiary depends on the tax rules in each jurisdiction. The UK and the USA have specific statutory provisions giving relief but this is unusual. In most countries relief, if it is available, will be claimed by reference to cash payments by the subsidiary to the parent company rather than the IFRS2 recharge. Effectively there is CT relief if some or all of the notional capital contribution is paid back to the parent company by the subsidiary. If the cash payment exceeds the capital contributions then the excess is a distribution.

Care is needed in some jurisdictions because recharges can have adverse consequences (eg creating social security charges on awards that otherwise would be exempt from social security charges). However sometimes the corporate tax relief arising from IFRS2 recharges can be substantial and more than outweigh the other costs.

The dilemma companies can face is how accurately should they make their recharges. IFRS2 includes complicated rules about reversing ("truing up") charges if certain assumptions made when the expenses were calculated are not met. How should this "truing up" be reflected in the recharges? The employees who participate in share schemes are often internationally mobile and move between group companies, so how should recharges for these employees be reflected in subsidiary accounts?

Potentially, one might try to attribute the share based payment expense to each individual and then allocate the recharges on an individual basis to the companies where that person works, but that can involve maintaining very complex and detailed integrated accounting and HR records. Across a large multinational company, the costs of maintaining that information might outweigh the benefits from accurate recharging. For smaller companies that have participating employees overseas, more pragmatic solutions may be required if valuable tax relief is not to be lost.

For further guidance and assistance in relation to the recharges please contact us.

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