



# Finance Act 1988

## 1988 CHAPTER 39

### PART III

#### INCOME TAX, CORPORATION TAX AND CAPITAL GAINS TAX

### CHAPTER II

#### UNAPPROVED EMPLOYEE SHARE SCHEMES

##### *Preliminary*

#### **77**     **Scope of Chapter**

- (1) Subject to subsections (2) and (3) below, this Chapter shall apply where, on or after 26th October 1987, a person acquires shares or an interest in shares in a company in pursuance of a right conferred on him or an opportunity offered to him by reason of his office as a director of, or his employment by, that or any other company.
- (2) This Chapter shall not apply in relation to an acquisition by a person who is not chargeable to tax under Case I of Schedule E in respect of the office or employment in question.
- (3) This Chapter shall not apply where the acquisition is made in pursuance of an offer to the public.

##### *Charges to tax*

#### **78**     **Charge where restrictions removed etc**

- (1) The person acquiring the shares or interest in shares shall be chargeable to tax if—
  - (a) a chargeable event occurs in relation to the shares at a time when he has not ceased to have a beneficial interest in them, and

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- (b) the shares are shares in a company which was not a dependent subsidiary at the time of the acquisition and is not a dependent subsidiary at the time of the chargeable event.
- (2) Subject to subsections (4) and (5) below, any of the following events is a chargeable event in relation to shares in a company for the purposes of this section if it increases, or but for the occurrence of some other event would increase, the value of the shares —
- (a) the removal or variation of a restriction to which the shares are subject;
  - (b) the creation or variation of a right relating to the shares;
  - (c) the imposition of a restriction on other shares in the company or the variation of a restriction to which such other shares are subject;
  - (d) the removal or variation of a right relating to other shares in the company.
- (3) A charge by virtue of this section shall be a charge under Schedule E, for the year of assessment in which the chargeable event occurs, on the amount by which the value of the shares is increased by the chargeable event or the amount by which it would be increased but for the occurrence of some other event (or, if the interest of the person chargeable is less than full beneficial ownership, on an appropriate part of that amount).
- (4) An event is not a chargeable event in relation to shares in a company for the purposes of this section unless the person who acquired the shares or interest has been a director or employee of —
- (a) that company, or
  - (b) (if it is different) the company as a director or employee of which he acquired the shares or interest, or
  - (c) an associated company of a company within paragraph (a) or (b) above,
- at some time during the period of seven years ending with the date on which the event occurs.
- (5) An event is not a chargeable event for the purposes of this section if it consists of—
- (a) the removal of a restriction to which all shares of a class are subject from all those shares,
  - (b) the variation of such a restriction in the case of all those shares,
  - (c) the creation of a right relating to all shares of a class,
  - (d) the variation of such a right in the case of all those shares,
  - (e) the imposition of a restriction on all shares of a class, or
  - (f) the removal of a right relating to all shares of a class from all those shares,
- and any of the conditions in subsection (6) below is satisfied.
- (6) The conditions referred to in subsection (5) above are—
- (a) that at the time of the event the majority of the company's shares of the same class as those which, or an interest in which, the person acquired are held otherwise than by or for the benefit of—
    - (i) directors or employees of the company,
    - (ii) an associated company of the company, or
    - (iii) directors or employees of any such associated company;
  - (b) that at the time of the event the company is employee-controlled by virtue of holdings of shares of that class;
  - (c) that at the time of the event the company is a subsidiary which is not a dependent subsidiary and its shares are of a single class.

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- (7) References in this section to restrictions to which shares are subject, or to rights relating to shares, include references to restrictions imposed or rights conferred by any contract or arrangement or in any other way.

## **79 Charge for shares in dependent subsidiaries**

- (1) The person acquiring the shares or interest in shares shall be chargeable to tax if the shares are shares in a company which—
- (a) was a dependent subsidiary at the time of the acquisition, or
  - (b) was not a dependent subsidiary at that time but becomes a dependent subsidiary before the person making the acquisition ceases to have any beneficial interest in the shares,
- and there is a chargeable increase in the value of the shares.
- (2) There is a chargeable increase in the value of shares in a case within subsection (1)(a) above if the value of the shares at the earlier of—
- (a) the expiration of seven years from the time of the acquisition, and
  - (b) the time when the person making the acquisition ceases to have any beneficial interest in the shares,
- exceeds their value at the time of the acquisition.
- (3) Subject to subsection (7) below, there is a chargeable increase in the value of shares in a case within subsection (1)(b) above if the value of the shares at the earlier or earliest of—
- (a) the expiration of seven years from the time when the company becomes a dependent subsidiary, and
  - (b) the time when the person making the acquisition ceases to have any beneficial interest in the shares, and
  - (c) if the company ceases to be a dependent subsidiary, the time when it does so, exceeds their value at the time when the company becomes a dependent subsidiary.
- (4) A charge by virtue of this section shall be a charge under Schedule E, for the year of assessment which includes the end of the period for which the chargeable increase is determined, on an amount equal to that increase (or, if the interest of the person chargeable is less than full beneficial ownership, on an appropriate part of that amount).
- (5) Where, in accordance with the terms on which the acquisition was made, the consideration for the acquisition is subsequently increased, the amount chargeable to tax by virtue of this section shall be reduced by an amount equal to the increase in the consideration.
- (6) Where, in accordance with those terms, the person making the acquisition subsequently ceases to have a beneficial interest in the shares by a disposal made for a consideration which is less than the value of the shares or his interest in them at the time of the disposal, the amount on which tax is chargeable by virtue of this section shall be reduced so as to be equal to the excess of that consideration over the value of the shares or interest at the time of the acquisition.
- (7) In a case within subsection (1)(b) above there is no chargeable increase in the value of shares in a company unless the person who acquired the shares or interest has been a director or employee of—

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- (a) that company, or
  - (b) (if it is different) the company as a director or employee of which he acquired the shares or interest, or
  - (c) an associated company of a company within paragraph (a) or (b) above,
- at some time during the period of seven years ending with the time when the company becomes a dependent subsidiary.

## **80 Charge on special benefits**

- (1) Subject to subsections (5) and (6) below, the person acquiring the shares or interest in shares shall be chargeable to tax if he receives a special benefit by virtue of his ownership of or interest in the shares.
- (2) A benefit is a “special benefit” for the purposes of subsection (1) above unless—
  - (a) it is received in respect of all shares of the same class as those which, or an interest in which, the person acquired, and
  - (b) any of the conditions in subsection (3) below is satisfied.
- (3) The conditions referred to in subsection (2) above are—
  - (a) that when the benefit is received the majority of the company’s shares of the class concerned are held otherwise than by or for the benefit of—
    - (i) directors or employees of the company,
    - (ii) an associated company of the company, or
    - (iii) directors or employees of any such associated company;
  - (b) that when the benefit is received the company is employee-controlled by virtue of holdings of shares of the class concerned;
  - (c) that when the benefit is received the company is a subsidiary which is not a dependent subsidiary and its shares are of a single class.
- (4) A charge by virtue of this section shall be a charge under Schedule E, for the year of assessment in which the benefit is received, on an amount equal to the value of the benefit.
- (5) Subsection (1) above shall apply only if the person receiving the benefit has been a director or employee of—
  - (a) the company referred to in that subsection, or
  - (b) (if it is different) the company as a director or employee of which he acquired the shares or interest, or
  - (c) an associated company of a company within paragraph (a) or (b) above,

at some time during the period of seven years ending with the date on which the benefit is received.
- (6) A benefit shall not be chargeable by virtue of this section if it is chargeable to income tax apart from this section.

### *Miscellaneous*

#### **81 Changes in interest**

Where a person's interest in shares is increased or reduced he shall be treated for the purposes of this Chapter as acquiring or disposing of a separate interest proportionate to the increase or reduction.

#### **82 Company reorganisations etc**

(1) Subsection (2) below applies where—

- (a) a person has acquired shares or an interest in shares as mentioned in section 77 above (those shares being referred to in subsection (2) below as “the originally-acquired shares”); and
- (b) by virtue of his holding of those shares or the interest in them he acquires (whether or not for consideration) additional shares or an interest in additional shares (those shares being referred to in subsection (2) below as “the additional shares”).

(2) Where this subsection applies—

- (a) the additional shares or the interest in them shall be treated for the purposes of this Chapter as having been acquired as mentioned in section 77 above and as having been acquired at the same time as the originally-acquired shares or the interest in them;
- (b) for the purposes of section 79 above, the additional shares and the originally-acquired shares shall be treated as one holding of shares and the value of the shares comprised in that holding at any time shall be determined accordingly (the value of the originally-acquired shares at the time of acquisition being attributed proportionately to all the shares in the holding); and
- (c) for the purposes of that section, any consideration given for the acquisition of the additional shares or the interest in them shall be taken to be an increase falling within subsection (5) of that section in the consideration for the original acquisition.

(3) If, on a person ceasing to have a beneficial interest in any shares, he acquires other shares or an interest in other shares and the circumstances are such that, for the purposes of sections 78 to 81 of the Capital Gains Tax Act 1979 (reorganisations etc.) the shares in which he ceases to have a beneficial interest constitute “original shares” and the other shares constitute a “new holding”—

- (a) section 78 of that Act (which equates the original shares and the new holding) shall apply for the purposes of this Chapter; and
- (b) if any such consideration is given for the new holding as is mentioned in section 79(1) of that Act, it shall be treated for the purposes of this Chapter as an increase falling within section 79(5) above in the consideration for the shares; and
- (c) if any such consideration is received for the disposal of the original shares as is mentioned in section 79(2) of that Act, the consideration shall be apportioned among the shares comprised in the new holding and the amount which, apart from this paragraph, would at any subsequent time be the value of any of those shares shall be taken to be increased by the amount of the consideration apportioned to them.

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### **83 Connected persons etc**

- (1) For the purposes of this Chapter, where a person acquires shares or an interest in shares in a company in pursuance of a right conferred on him or opportunity offered to him as a person connected with a director or employee of that or any other company, the shares or interest shall be deemed to be acquired by the director or employee.
- (2) For the purposes of this Chapter, where a person who acquires shares or an interest in shares disposes of the shares or interest otherwise than by a bargain at arm's length with a person who is not connected with him, he shall be deemed to continue to have a beneficial interest in the shares until there is a disposal of the shares or interest by such a bargain.
- (3) Subsection (2) above shall not apply where shares, or an interest in shares, in a company are disposed of to the company in accordance with the terms on which the acquisition was made.
- (4) Where a person who has made an acquisition as mentioned in subsection (1) above receives a benefit in the circumstances described in section 80 above, the benefit shall be treated for the purposes of that section as received by the person deemed by that subsection to have made the acquisition; and where at a time when a person is deemed by subsection (2) above to continue to have a beneficial interest in shares another person receives a benefit in such circumstances, the benefit shall be treated for those purposes as received by him.

### **84 Capital gains tax**

Where an amount is chargeable to tax under this Chapter on a person who acquires shares or an interest in shares, then on the first disposal of the shares (whether by him or another person) after his acquisition, section 32(1)(a) of the Capital Gains Tax Act 1979 (expenditure allowable in computation of chargeable gains) shall apply as if a sum equal to the amount chargeable had formed part of the consideration given by the person making the disposal for his acquisition of the shares; and this section shall apply with the appropriate modifications in a case to which section 83 above applies.

### **85 Information**

- (1) Where in any year of assessment a person acquires shares, or an interest in shares, in a company in the circumstances described in section 77(1) above, that company and (if it is different) the company as a director or employee of which he acquires the shares or interest shall give written particulars of the acquisition to the inspector within 30 days of the end of the year.
- (2) Where—
  - (a) there occurs in relation to shares in a company an event which is a chargeable event for the purposes of section 78 above, or
  - (b) a person receives a special benefit (within the meaning given for the purposes of section 80(1) above) in respect of shares, or an interest in shares, in a company,the company, and (if it is different) the company as a director or employee of which the person who acquired the shares or an interest in the shares made the acquisition, shall within 60 days give to the inspector written particulars of the event or benefit and of the shares concerned.

- (3) In the second column in the Table in section 98 of the Taxes Management Act 1970 (penalty for failure to furnish information, etc.) there shall be added at the end—

“Section 85(1) and (2) of the Finance Act 1988”.

### *Supplementary*

## **86 Meaning of “dependent subsidiary”**

- (1) For the purposes of this Chapter a company which is a subsidiary is a dependent subsidiary throughout a period of account of the company unless—

- (a) the whole or substantially the whole of the company’s business during the period of account (taken as a whole) is business carried on with persons who are not members of the same group as the company,
- (b) during the period of account either there is no increase in the value of the company as a result of intra-group transactions, or any such increase in value does not exceed 5 per cent. of the value of the company at the beginning of the period (or a proportionately greater or smaller percentage in the case of a period which is longer or shorter than a year),
- (c) the directors of the principal company of the group give to the inspector, not later than two years after the end of the period of account, a certificate that in their opinion the conditions mentioned in paragraphs (a) and (b) above are satisfied in relation to the period of account, and
- (d) there is attached to the certificate a report addressed to those directors by the auditors of the subsidiary that the auditors—
  - (i) have enquired into the state of affairs of the company with particular reference to the conditions mentioned in paragraphs (a) and (b) above, and
  - (ii) are not aware of anything to indicate that the opinion expressed by the directors in their certificate is unreasonable in all the circumstances.

- (2) For the purposes of subsection (1)(a) above business carried on with any subsidiary of the company concerned shall be treated as carried on with a person who is not a member of the same group as the company unless the whole or substantially the whole of the business of that or any other subsidiary of the company during the company’s period of account (taken as a whole) is carried on with members of the group other than the company and its subsidiaries.

- (3) In this section—

“group” means a principal company and all its subsidiaries;

“intra-group transactions” means transactions between companies which are members of the same group on terms which are not such as might be expected to be agreed between persons acting at arm’s length (other than any payment for group relief, within the meaning given in section 402(6) of the Taxes Act 1988);

“period of account”, in relation to a company, means the period for which it makes up its accounts;

“principal company” means a company of which another company is a subsidiary and which is not itself a subsidiary of another company.

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## 87 Other interpretation provisions

- (1) In this Chapter, except where the context otherwise requires,—
- “associated company” has the same meaning as, by virtue of section 416 of the Taxes Act 1988, it has for the purposes of Part XI of that Act;
  - “director” includes a person who is to be, or who has ceased to be, a director;
  - “employee” includes a person who is to be, or who has ceased to be, an employee;
  - “shares” includes stock and also includes securities as defined in section 254(1) of the Taxes Act 1988;
  - “subsidiary” means 51 per cent. subsidiary;
  - “value”, in relation to shares or a benefit, means the amount which the person holding the shares or receiving the benefit might reasonably expect to obtain from a sale in the open market;
- and references to an interest in any shares include references to an interest in the proceeds of sale of part of the shares.
- (2) For the purposes of this Chapter a company is “employee-controlled” by virtue of shares of a class if—
- (a) the majority of the company’s shares of that class (other than any held by or for the benefit of an associated company) are held by or for the benefit of employees or directors of the company or a company controlled by the company, and
  - (b) those directors and employees are together able as holders of the shares to control the company.
- (3) Sections 839 (connected persons) and 840 (control) of the Taxes Act 1988 shall apply for the purposes of this Chapter.
- (4) Where a right to acquire shares or an interest in shares in a company is assigned to a person and the right was conferred on some other person by reason of the assignee’s office as a director of, or his employment by, that or any other company, the assignee shall be treated for the purposes of this Chapter as acquiring the shares or interest in pursuance of a right conferred on him by reason of that office or employment.

## 88 Transitional provisions

- (1) Section 138 of the Taxes Act 1988 and section 79 of the Finance Act 1972 shall not apply to an acquisition of shares, or of an interest in shares, made on or after 26th October 1987.
- (2) Where—
- (a) tax is chargeable by virtue of section 138(1)(a) of the Taxes Act 1988 or section 79(4) of the Finance Act 1972 by reference to the market value, after 26th October 1987, of shares in a company which is not a dependent subsidiary on that date, and (b) that market value is greater than the market value of the shares on 26th October 1987,
- the amount on which tax is chargeable (and the question whether any tax is chargeable) shall be determined by reference to the market value on 26th October 1987 (and for this purpose “market value” has the same meaning as in section 138 of the Taxes Act 1988).



- (3) Subject to subsection (4) below, this Chapter, with the omission of sections 79 and 80, shall have effect where shares, or an interest in shares, in a company which is not a dependent subsidiary on 26th October 1987 have been acquired before that date as it has effect (apart from this section) where shares or an interest in shares are acquired on or after that date.
- (4) In relation to shares which were, or an interest in which was, acquired before 26th October 1987 the removal or variation of a restriction to which the shares are subject shall not be a chargeable event for the purposes of section 78 above if, because of paragraph 7 of Schedule 8 to the Finance Act 1973, the restriction would not have been regarded as one to which the shares were subject for the purposes of section 79(2)(c) of the Finance Act 1972.

## 89 Consequential amendments

In relation to acquisitions of shares or interests in shares on or after 26th October 1987—

- (a) for the words from “section 138(1)(a)” to “value of the shares” in section 185(3)(a) (approved share option schemes) and section 186(2)(b) (approved profit sharing schemes) of the Taxes Act 1988, and
- (b) for the words from “section 79(4)” to “value of the shares” in—
- (i) section 53(3)(b) of the Finance Act 1978 (approved profit sharing schemes),
  - (ii) section 47(1)(b) of the Finance Act 1980 (savings-related share option schemes), and
  - (iii) section 38(3)(a) of the Finance Act 1984 (approved share option schemes),

there shall be substituted the words “section 78 or 79 of the Finance Act 1988 in respect of the shares”.