

INCOME TAX (EARNINGS AND PENSIONS) ACT 2003

EXPLANATORY NOTES

COMMENTARY ON SECTIONS

Omitted material

Schedule 5: Enterprise Management Incentives

Overview

Part 6: Company reorganisations

Paragraph 39: Company reorganisations: introduction

3533. This paragraph introduces the provisions in the rest of this Part of this Schedule and explains the term “company reorganisation”. In this context a “company reorganisation” is broadly where a company acquires control of another company whose shares are subject to an unexercised qualifying share option. This paragraph derives from paragraph 59 of Schedule 14 to FA 2000.

Paragraph 40: Meaning of “qualifying exchange of shares”

3534. Among the ways listed in paragraph 39 of this Schedule for a company to acquire control of another company is by a “qualifying exchange of shares”. Paragraph 40 sets out that a “qualifying exchange of shares” is an arrangement under which the new company issues shares in itself in exchange for acquiring all the shares in the old company, subject to certain conditions laid down in this paragraph. This paragraph derives from paragraph 60 of Schedule 14 to FA 2000.

Paragraph 41: Grant of replacement option

3535. Paragraph 41 derives from paragraph 61 of Schedule 14 to FA 2000. It sets out how, if a company reorganisation meets the required criteria set out in the preceding paragraph, a qualifying share option in the old company (“the old option”) is exchanged for an equivalent share option in the new company, “the new option”, to form a “replacement option”. The replacement option must meet certain conditions and must be granted within the time limit outlined in paragraph 42 of this Schedule.

3536. The new *sub-paragraph (6)* makes it clear that when valuing the shares that are subject to the replacement option, for the purpose of the tests in paragraphs 5 to 7 of this Schedule, the value of the shares in the *acquired* company, at the time when the old option was granted, is the measure of the valuation of the shares subject to the new option. See *Change 177* in Annex 1.

Paragraph 42: Period within which replacement option must be granted

3537. This paragraph outlines the time limit on granting the replacement option mentioned in the preceding paragraph. That time limit depends on the circumstances under which the new company acquires control of the old company. The various possibilities are covered in *sub-paragraphs (2) to (4)*.
3538. In *sub-paragraphs (2) and (3)* there is a six-month period time limit. The wording in the source legislation does not make it clear whether or not the six months start running on the day that the change in control occurs, or on the day after. *Sub-paragraphs (2) and (3)* clarify this by referring to “6 months after the date on which...”. So if, for example, the new company acquires control of the old company at 2pm on 1 January 2004, the replacement option must be granted *before 2 July 2004*.
3539. This paragraph derives from paragraph 62 of Schedule 14 to FA 2000.

Paragraph 43: Further requirements to be met as to replacement option

3540. This paragraph sets out various other conditions that must be met if the new option is to qualify as a replacement option for the purposes of EMI. This paragraph derives from paragraph 63 of Schedule 14 to FA 2000.
3541. As noted above, in relation to paragraphs 5 and 41 of this Schedule, the test in *sub-paragraph (3)(b)* (the maximum value of options under paragraph 7) should be applied to the new option and the acquiring company but the shares to be valued are those in the acquired company at the date of the grant of the old option. This is made clear in *sub-paragraph (4)*. See *Change 177* in Annex 1.