

*These notes refer to the Income Tax (Earnings and Pensions)
Act 2003 (c.1) which received Royal Assent on 6th March 2003*

INCOME TAX (EARNINGS AND PENSIONS) ACT 2003

EXPLANATORY NOTES

COMMENTARY ON SECTIONS

Example 3

Ne = £5,000; Da = 183; De = 183; Smg = 0

Part 7: Employment income: share-related income and exemptions

Arrangement of material for share schemes

1815. This Act provides for a “code” for each of SIPs, SAYE schemes, CSOPs and EMIs. That “code” includes all the legislation relating to the particular scheme or plan, covering the tax advantages and any consequential tax charges together with all the rules relating to the qualification criteria and administration of the scheme or plan in question. The material in each “code” has been divided into two principal categories. The material dealing with the tax advantages and consequential tax charges has been placed in the main run of sections in this Part of this Act; but the administrative provisions have been placed in the supporting Schedules 2 to 5 to this Act.
1816. This approach is intended to highlight the legislation relating to the actual tax advantages offered, and any consequential tax charges, so that all the information with a direct impact on an employee’s tax liability appears in one place in the body of this Act.
1817. The provisions relating to the qualification criteria for each code are likely to be relevant to different sets of people (e.g. the company setting up the scheme and its advisers). It therefore seems logical to separate these out and to place them in a Schedule separate from the main run of sections concerning the taxation of employment income.

Chapter 1: Introduction

Overview

1818. This short introductory Chapter consists of five sections:
- Section 417 is concerned with the scope of this Part of the Act;
 - Section 418 is concerned with other provisions relating to share related income;
 - Section 419 introduces the provisions that impose duties to provide information to the Inland Revenue;
 - Section 420 deals with a computational matter of general application;
 - Section 421 deals with the application of this Part to office-holders.

Section 417: Scope of Part 7

1819. This section, which is a drafting addition, introduces the provisions of this Part of this Act. Those provisions contain special rules relating to employees or directors who acquire shares in companies, or options relating to such shares, in connection with their office or employment (see *subsection (1)*).
1820. *Subsection (2)* then lists nearly all the chapters in this Part that follow this introductory Chapter. Of these, it may be said that Chapters 2 to 5 are primarily concerned with charges to income tax that may arise in certain circumstances. Chapters 6 to 9 then deal with the plans and schemes under which employees and directors may be offered shares or options on advantageous terms. And, finally, Chapter 10 deals with a particular income tax exemption that arises when employees or directors benefit from a priority allocation of shares.
1821. *Subsection (3)* lists the chapters in this Part that provide for amounts to count as employment income; and *subsection (4)* lists the chapters in this Part that provide for exemptions and reliefs from income tax. *Subsection (5)* records that there is also a supplementary chapter (Chapter 11) which contains provisions about employee benefit trusts.

Section 418: Other provisions about share-related income and exemptions

1822. This section, which is another drafting addition, sets out where other provisions dealing with share related income and exemptions may be found.
1823. *Subsections (1) and (2)* list other provisions of this Act that deal with share-related income and exemptions.
1824. *Subsection (3)* deals with approved profit sharing schemes (“APS schemes”). This subsection explains that, in view of the phasing out of these schemes, the legislation relating to APS schemes has not been rewritten in this Act. That legislation will accordingly continue to apply while APS schemes continue.
1825. *Subsection (4)* preserves the effect of sections 138 to 140 of ICTA where shares or interests in shares were acquired before 26 October 1987.

Section 419: Duties to provide information

1826. This section lists the provisions in this Part that impose duties to provide information to the Inland Revenue.
1827. This section is also a drafting addition, as, once again, it provides signposts to the various sections that are relevant in this context. As these sections are all placed near the end of the chapters in which they appear, they might otherwise be given insufficient attention.

Section 420: Negative amounts treated as nil

1828. The charges to income tax for which this Part of this Act provides constitute “specific employment income” (see sections 6(1) and 7(4) of this Act). Under ICTA this income is charged to income tax under paragraph 5 of section 19(1) of that Act.
1829. In this Part of this Act, where deductions from a chargeable amount are permitted, the relevant provision signals this fact by using a formula.
1830. This section, which is new, gives effect to the general proposition that it is not possible for an allowable loss to arise under paragraph 5 of section 19(1) of ICTA. Deductions might reduce a chargeable amount to nil; but, beyond this point, they could not be used to create a negative amount and (accordingly) an allowable loss. See *Note 43* in Annex 2.

Section 421: Application of Part 7 to office-holders

1831. The general rule is that the provisions of the employment income Parts apply equally to offices, unless the contrary is stated (see section 5(1)). But, with one exception, the legislation rewritten in this Part does not apply to office-holders. This section deals with these propositions for the whole of this Part of this Act.

Chapter 2: Conditional interests in shares

Overview

1832. Where shares are awarded to employees by reason of their employment, their value (less anything paid for them) will generally be taxable as an emolument. If the shares have restrictions attached to them so that they are subject to risk of forfeiture (typically in the event of performance criteria not being met), the Inland Revenue view until 1998 was that there was not an emolument at the time of award and that liability only arose when the risk of forfeiture was lifted. Legal advice in 1998 showed that this view was wrong. Liability arose in the normal way at the time of the award on the value of the shares taking into account the risk of forfeiture. No liability as an emolument arose at the time that the risk was lifted. Nor would the legislation in sections 77 to 88 of FA 1988 generally bite as there was no event giving rise to an immediate increase in value.

1833. The legislation introduced by sections 140A to 140C of ICTA (together with supplementary provisions in sections 140G and 140H) is intended broadly to restore the position as it existed under the earlier practice. It applies to shares acquired on or after 17 March 1998. In essence the normal income tax emoluments charge on award is removed by section 140A unless the shares can still be subject to forfeiture more than five years after acquisition. The same section then imposes a charge (whether or not there is an emoluments charge) when the employee's interest ceases to be "only conditional", a term which is defined by section 140C. A number of situations are specifically excluded from counting as "only conditional" so that in those circumstances the normal rules of a charge on acquisition apply.

1834. Sections 140G and 140H of ICTA contain supplementary provisions some of which apply solely to the provisions concerning conditional shares (sections 140A to 140C of ICTA), some of which apply solely to the provisions concerning convertible shares (sections 140D to 140F of ICTA) which were introduced at the same time and some which apply to both. In this Act the provisions on convertible shares appear in Chapter 3. This does mean that those supplementary provisions which apply to both types of share have been duplicated, but the overall result is intended to be much easier to follow.

Section 422: Application of this Chapter

1835. *Subsection (1)* of this introductory section derives from section 140A of ICTA and gives the two basic conditions for the provisions to apply. First, the shares must be acquired "as a director or employee" and that term is defined in section 423. The second condition is that the employee's interest in the shares is "only conditional" as defined in section 424. The fact that these provisions only apply to shares acquired on or after 17 March 1998 is made clear in Part 7 of Schedule 7 to this Act, to which there is also a signpost in section 418(1).

1836. *Subsection (2)* is new and sets out a number of useful labels which make for less cumbersome drafting. The fact that this Chapter applies to prospective and former directors and employees is made clear by the reference to the extended definition in section 434(1).

Section 423: Interests in shares acquired "as a director or employee"

1837. *Subsection (1)* explains the circumstances in which shares are regarded as being acquired by a person ("E") "as a director or employee". They are broadly equivalent

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to the circumstances in which a normal earnings charge would arise. The provision derives from section 140H(1) of ICTA. *Subsection (1)(c)* no longer says an assignment “to him” because if the assignment was to anyone else the shares would not have been acquired by E.

- 1838. *Subsection (2)* qualifies subsection (1) and derives from section 140H(2) of ICTA with only minor modifications.
- 1839. *Subsections (3) and (4)* are based on section 140H(4) of ICTA and explain the treatment when one conditional or convertible interest is exchanged for another.
- 1840. *Subsection (5)* derives from the opening words of section 140H(4) of ICTA.
- 1841. *Subsection (6)* contains the definition of “convertible shares”.

Section 424: Meaning of interest being “only conditional”

- 1842. *Subsection (1)*, which derives mainly from section 140C(1) of ICTA, defines when an interest in shares is “only conditional”. While section 140C of ICTA says “for the purposes of sections 140A and 140B”, the definition is applied more widely by section 140H(5) of ICTA. Hence the definition is now applied “for the purposes of this Chapter”.
- 1843. *Subsection (2)* summarises the exceptions from subsection (1) which prevent the interest being only conditional so that the normal charge as earnings applies on acquisition. The exceptions derive from section 140C (1A), (2), (3), (3A) and (4) of ICTA.
- 1844. *Subsection (3)* derives from section 140C(5) of ICTA and expands on the circumstances falling within subsection (1)(a). They are not regarded as including cases where the terms on which the employee is entitled to the interest allow the employee to require a person to acquire the interest at undervalue.
- 1845. *Subsection (4)* relates back to subsection (1)(b) and derives from the closing words of section 140C(1) of ICTA.
- 1846. *Subsection (5)* is new and reflects the latest legal advice that the term “articles of association” includes foreign equivalents, thus widening the circumstances in which an interest is not “only conditional”. See *Note 44* in Annex 2.
- 1847. *Subsection (6)* is supplementary to subsections (2)(b) and (c) and derives from parts of section 140C(3) and 140C(3A) of ICTA.
- 1848. *Subsection (7)* derives from section 140(6) of ICTA.

Section 425: Cases where this Chapter does not apply

- 1849. The two rules in this section derive from section 140H(3) of ICTA.
- 1850. The source legislation specifies that these provisions only apply to Case I employments. *Subsection (1)* rewrites this rule by applying the equivalent test that the earnings must be within section 15 or 21.
- 1851. *Subsection (2)* explains that the test in subsection (1) is to be applied to the final year of employment in cases where the right or opportunity to acquire the shares is conferred or offered after the employment has ceased.

Section 426: No charge in respect of acquisition of employee’s interest in certain circumstances

- 1852. This section concerns the five year rule and derives from section 140A(3) of ICTA. In the typical case the conditions apply for less than five years at which point the employee has an indefeasible interest in the shares. In those circumstances no charge

as an emolument arises on acquisition but this does not affect any charges that may arise under section 135 of ICTA (where the shares are acquired by exercising an option) or section 162 of ICTA (where the shares are acquired at undervalue). In this Act those provisions are in section 476 and Chapter 8 of Part 3 respectively.

Section 427: Charge on interest in shares ceasing to be only conditional or on disposal

1853. *Subsections (1) to (3)* derive from section 140A(4) of ICTA which imposes a tax charge when the risk of forfeiture is lifted or on the earlier disposal of the shares.
1854. *Subsection (4)* is new and acts as a signpost to a provision removing the charge for shares awarded under an approved SIP.

Section 428: Amount of charge

1855. This section concerns the calculation of the taxable charge under section 427. It derives from section 140(5), (7), and (9) of ICTA. A formula has been introduced in *subsection (1)* to make the provisions more user-friendly.
1856. The deductible amount provided by section 140A(7)(b) of ICTA is any amount chargeable in respect of the acquisition of the interest. It is not immediately clear what is meant by that phrase and the approach adopted here is to specify what is allowable. The three charges that are relevant are detailed in paragraphs (b), (c) and (d) of *subsection (2)*. See *Note 45* in Annex 2.
1857. *Subsection (3)* provides that charges under sections 449 and 453 are deductible. It derives from section 140A(7)(c) of ICTA. The opportunity has been taken to make it clear that a charge taken under these provisions is not a deductible amount if it is generated by the same event which gives rise to the charge under this Chapter. This is because the FA 1988 provisions, from which sections 449 and 453 derive, are subject to section 140A of ICTA so that the latter takes priority.

Section 429: Amount or value of consideration given for employee's interest

1858. This section derives from section 140B(1) to (6) of ICTA. Section 140B(7) has been taken to a separate section. This section determines, for the purposes of section 428, the amount allowable as the cost of the shares.

Section 430: Amount or value of consideration given for right to acquire shares

1859. This section derives from section 140B(7) of ICTA which is concerned with calculating the allowable cost where an original option has been exchanged for a replacement option. Section 140B(7) simply refers to the workings of section 136 of ICTA which are not easy to follow. This section spells out what the allowable cost is and the wording follows section 485 which derives from section 136. See *Change 125* in Annex 1.

Section 431: Application of this Chapter where employee dies

1860. This section derives from section 140A(8) of ICTA which gives rules which apply when the employee dies holding the conditional shares. There is a deemed disposal immediately before death and a special market value rule applies.

Section 432: Duty to notify provision of conditional interests in shares

1861. This section derives from those parts of section 140G of ICTA concerning information requirements on the initial award of the conditional shares. Section 140G(1)(b)(i) has been omitted as unnecessary because the original award of the shares cannot itself result in any charge under section 140A of ICTA. Accordingly this section simply focuses on the possibility of there being subsequent events that may result in a charge.

1862. The time limits for providing information throughout Chapters 2 to 5 of Part 7 have been standardised at 92 days after the end of the year in which the matter arose or after the event concerned. In the source legislation for this section the time limit was 30 days after the end of the tax year in which the interest is provided. In addition where a time limit runs from the end of the tax year it is now expressed as “before 7th July” to give greater clarity. See *Change 111* in Annex 1.

Section 433: Duty to notify events resulting in charges under section 427

1863. This section derives from those parts of section 140G of ICTA concerning information requirements on the occurrence of any of the three events (death, disposal of shares, lifting of restrictions) which may result in a charge under section 140A of ICTA. The time limit for providing information has been extended from 30 to 92 days after the end of the tax year in which the event occurred and expressed differently. See *Change 111* in Annex 1.

Section 434: Minor definitions

1864. This section brings together the definitions in section 140H of ICTA and elsewhere in the provisions and adds some new labels for terms used in section 422. In the definition of “terms” the word “include” in section 140H(6) of ICTA has been replaced by “means” to make better sense of the additional words “or in any other way”.
1865. The definition of shares (which comes from section 136(5)(d) of ICTA, as applied with modifications by section 140H(8) of ICTA) includes stock “in so far as the context permits”. This rider has been omitted as unnecessary since there does not appear to be anywhere in this Chapter where the context would not so permit.

Chapter 3: Convertible shares

Overview

1866. Sections 140D to 140F of ICTA (together with supplementary provisions in sections 140G and 140H) were introduced by FA 1998 and apply to shares acquired on or after 17 March 1998. The provisions are concerned with countering possible avoidance in the award of convertible shares by reason of employment. Such shares could be issued having a low value but be later converted to shares of a different class with a higher value. The emoluments charge on award of the shares would be measured by reference to the initial low value and without these provisions the uplift in value on conversion would escape taxation.
1867. The legislation imposes a charge to tax on the market value of the shares immediately after conversion as reduced by sums paid on acquisition or conversion and by any amounts already charged to tax in respect of those shares. No charge arises if all the shares of one class are converted to shares of a new single class and immediately before conversion the company was either controlled by outside shareholders or was employee-controlled.
1868. Sections 140G and 140H of ICTA contain supplementary provisions some of which apply solely to the provisions concerning convertible shares (sections 140D to 140F of ICTA), some of which apply solely to the provisions concerning conditional shares (sections 140A to 140C of ICTA) which were introduced at the same time and some which apply to both. In this Act the provisions on conditional shares appear in Chapter 2. This does mean that those supplementary provisions which apply to both types of share have been duplicated, but the overall result should be much easier to follow.

Section 435: Application of this Chapter

1869. *Subsection (1)* derives from section 140D(1) of ICTA and gives the basic condition that the shares must be acquired “as a director or employee” and that term is defined in

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section 436. The reference to interests in shares as well as shares themselves throughout the Chapter derives from section 140F(6) of ICTA. The fact that these provisions only apply to shares acquired on or after 17 March 1998 is made clear in Part 7 of Schedule 7, to which there is also a signpost in section 418(1).

1870. *Subsection (2)* is mainly derived from section 140D(2) of ICTA (but also parts of section 140G(6) and section 140H(5) of ICTA) and defines the meaning of “convertible”.
1871. *Subsection (3)* derives from section 140F(2) of ICTA.
1872. *Subsection (4)* is new and sets out a number of useful labels which make for less cumbersome drafting. The fact that this Chapter applies to prospective and former directors and employees is made clear by the reference to the extended definition in section 446(1).

Section 436: Shares acquired “as a director or employee”

1873. This section derives from subsections (1), (2), (4) and (7) of section 140H of ICTA. It expands on what is meant by shares (or an interest in shares) acquired by a person “as a director or employee”.

Section 437: Cases where this Chapter does not apply

1874. This derives from section 140H(3) of ICTA. It limits the application of this Chapter to cases where the earnings from the employment are within section 15 or 21 and reproduces the restriction in the source legislation to Case I employments.

Section 438: Charge on conversion of shares

1875. This is the charging provision for this Chapter. It derives from section 140D(3) and (4) of ICTA and imposes a charge when the shares are converted to shares of a different class.

Section 439: Amount of charge

1876. This section concerns the calculation of the taxable charge under section 438. It derives from section 140D(5) and (6) of ICTA. A formula has been introduced to make the provisions more user-friendly. As with section 428 the approach now adopted is to specify precisely what deductions are allowable in respect of amounts chargeable in respect of the acquisition of the interest. The three charges that are relevant are detailed in paragraphs (c), (d) and (e) of *subsection (2)*. See *Note 45* in Annex 2.
1877. *Subsection (3)* provides that charges under the provisions derived from sections 78 and 79 of FA 1988 are deductible. It derives from section 140D(6)(d) of ICTA. In contrast to section 428, there is no need to refer to “a different event” here since the conversion itself does not give rise to a charge under the FA 1988 provisions.
1878. *Subsection (5)* gives the meaning of “market value”, the definition of which is not found in ICTA until section 140F(3).
1879. *Subsection (6)* derives from the definition of “taxable conversion” in section 140D(7) of ICTA.
1880. *Subsection (7)* is new. It meets the point that there should be no reason why a charge arising at the end of the seven-year period in section 79 of FA 1988 should not be a deductible amount. This is a minor change to the law. See *Change 112* in Annex 1.

Section 440: Case outside charge under section 438: conversion of entire class

1881. In ICTA the main exemption from the charge on conversion is tucked away in subsections (8) and (9) of section 140D with related definitions in section 140F. The exemption is now in a separate section and the definitions are in *subsections (4) and (5)*.

Section 441: Case outside charge under section 438: acquisition of conditional interest

1882. This section provides that no charge arises under this Chapter if the new shares are within the scope of Chapter 2. This ensures that where a conditional interest in shares is acquired on the conversion of other shares and under section 426 of the Act there is no charge in respect of the acquisition of the interest, there will not be a charge under this Chapter in respect of the conversion of the other shares. The section derives from section 140D(10) of ICTA.

Section 442: Amount or value of consideration given for shares or conversion

1883. This section derives from section 140E(1) to (6) of ICTA. Section 140E(7) has been taken to a separate section. It determines, for the purposes of section 439, the amount allowable as the cost of the shares or the cost of conversion.

Section 443: Amount or value of consideration given for right to acquire shares

1884. This section derives from section 140E(7) of ICTA which is concerned with calculating the allowable cost where an original option has been exchanged for a replacement option. That section simply refers to the workings of section 136 of ICTA which are not easy to follow. In order to assist readers, this section sets out what the allowable cost is and the wording follows section 485 which derives from section 136 of ICTA. See *Change 125* in Annex 1.

Section 444: Conversion in consequence of employee's death

1885. This section derives from section 140F(1) of ICTA which deems certain conversions within 12 months of death to have occurred immediately before death.

Section 445: Duty to notify conversions of shares

1886. This section derives from those parts of section 140G of ICTA concerning the information requirements when shares are converted and may result in a charge under this Chapter. The time limit for providing information has been extended from 30 to 92 days after the tax year in which the conversion takes place and expressed differently. See *Change 111* in Annex 1.

Section 446: Minor definitions

1887. This section brings together the definitions in section 140H of ICTA and elsewhere in the source legislation and adds some new labels for expressions used in section 435. In the definition of "terms" the word "include" in section 140H(6) of ICTA has been replaced by "means" to make better sense of the additional words "or in any other way".

1888. The definition of shares (which comes from section 136(5)(d) of ICTA, as applied with modifications by section 140H(8) of ICTA) includes stock "in so far as the context permits". This rider has been omitted as unnecessary since there does not appear to be anywhere in this Chapter where the context would not so permit.

Chapter 4 – Post-acquisition benefits from shares

Overview

1889. This Chapter is concerned with the income tax charges which may arise in respect of shares (or an interest in shares) which have been awarded by reason of an individual's office or employment.
1890. The initial award of the shares may have given rise to a Schedule E charge as an emolument or benefit or taxed as general earnings under this Act. This Chapter is not concerned with that initial charge. Instead it provides for a charge to tax in certain circumstances on the increase in value of those shares and in respect of any special benefits which are received by virtue of ownership of those shares. The increase in value charges do not apply where the shares have been issued under one of the share schemes approved by the Inland Revenue, but the special benefits charge may still apply.
1891. The provisions in this Chapter derive from sections 77 to 88 of FA 1988. They apply to shares acquired on or after 26 October 1987 and replace legislation in sections 138 and 139 of ICTA which had a similar, though rather more wide-ranging, effect. Sections 138 and 139 of ICTA, together with the interpretation provisions in section 140 of ICTA still apply to shares acquired before 26 October 1987 and that legislation remains on the statute book although it has not been rewritten. Paragraphs 55 to 57 in Part 7 of Schedule 7 to this Act contain the appropriate savings and also rewrite the transitional provisions in section 88 of FA 1988 that are still relevant.
1892. Section 84 of FA 1988 is a capital gains tax provision and is duplicated in section 120(1) of TCGA 1992. As it is not intended to include the provision in this Act, the section has not been rewritten. Amendments to section 120 of TCGA 1992 are made by paragraph 210 of Schedule 6 to this Act.
1893. The 1988 anti-avoidance legislation contains three distinct charges in sections 78, 79 and 80 of FA 1988. That ordering of the charges has been followed in this Act with the corresponding charges now in sections 449, 453 and 457. Other than that, however, much of the material has been moved to present it in a logical and more helpful order. One broad intention is that in respect of each charge the legislation sets out in the following order
- The scope of the charge
 - The calculation of the charge
 - The exceptions from the charge

Section 447: Application of this Chapter

1894. This section sets out the scope of the Chapter. *Subsection (1)* derives from the rule at the end of section 77 of FA 1988 that the provisions are concerned with acquisitions of shares in a company by a director or employee of that or any other company. The fact that these provisions only apply to shares issued on or after 26 October 1987 is made clear in Part 7 of Schedule 7 to which there is also a signpost in section 418(1).
1895. *Subsections (2) and (3)* are new. They spell out what subsequent references to “the acquisition” and “the shares” are references to. The fact that this Chapter applies to prospective and former employees is made clear by the reference to the extended definition in section 470. The definition of “the employer company” is designed to avoid some rather tortuous references to it elsewhere in this Chapter.
1896. *Subsection (4)* derives from the rules in section 77(1) and in section 87(4) of FA 1988 which explain that the Chapter is concerned both with shares acquired by the employee directly and with shares first issued to another person and then assigned to the employee.

1897. *Subsection (5)* derives from section 83(1) of FA 1988. That provision ensures that where the shares are issued to a connected person because the opportunity was offered to that person rather than the employee himself, the acquisition is treated as having been made by the employee. The charges in the Chapter generally operate by reference to beneficial interests and it is not expressly provided in section 83(1) of FA 1988 that the deeming provision applies to beneficial ownership although that is the way the subsection has always been interpreted. This section clarifies the general understanding that the opening words “For the purposes of this Chapter” imply that the shares are deemed to have been acquired by the employee as a director or employee. This clarification is explained in detail in *Note 46* in Annex 2.

Section 448: Cases where this Chapter does not apply

1898. *Subsection (1)* derives from section 77(2) of FA 1988. It limits the scope of the Chapter to cases where the earnings from the employment are within section 15 or 21 reproducing the restriction in the source legislation to Case I employments. See *Note 47* in Annex 2.
1899. *Subsection (2)* derives from section 77(3) of FA 1988 and is an exemption for public offers.
1900. *Subsections (3) and (4)* derive from section 77(4) of FA 1988 and extend the public offer exemption to certain other offers which are made to employees separate from a public offer.

Section 449: Charge on occurrence of chargeable event

1901. This is the first of the charging provisions and derives from parts of section 78(1) and (3) of FA 1988. The meaning of chargeable event, the calculation of the charge and the exceptions appear in separate sections. *Subsection (5)* acts as a signpost to the provisions which remove the charge under various approved schemes.

Section 450: Chargeable events

1902. This section defines what is and is not a chargeable event and derives from section 78(2), (5), (6) and (7) of FA 1988. It will be noted that a new label “outside shareholders” is used as shorthand for the persons within section 78(6)(a) of FA 1988 and the term is defined in section 469.
1903. The words in section 78(6)(c) of FA 1988 “which is not a dependent subsidiary” have been omitted in new subsection (4)(c) on the grounds that they are unnecessary. It is already clear from section 78(1)(b) of FA 1988 that no charge arises if the company is a dependent subsidiary.
1904. *Subsection (6)* derives from section 78(7) of FA 1988. The term “are references to such” has been used instead of “include” to make better sense of the additional words “or in any other way”.

Section 451: Amount of charge

1905. This section, which derives from section 78(3) of FA 1988, specifies the amount of the charge under section 449. The FA 1988 subsection is rather complex and so this section separates out the various ideas to make the provision easier to grasp.

Section 452: Cases outside charge under section 449

1906. This section brings together the various exceptions in sections 77 and 78 of FA 1988.
1907. *Subsection (2)* ensures that if a charge is taken under section 427 in respect of an event then no charge is taken under this section. It derives from the opening words of

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section 77(1) of FA 1988 which give priority to the charge on conditional shares in section 140A of ICTA (rewritten in Chapter 2 of this Part).

1908. *Subsection (3)* derives from section 78(4) of FA 1988 which contains the let-out if the employee has not been a director or employee of the company or an associated company within the seven years ending with the chargeable event. The source legislation uses the term “the person who acquired the shares” rather than the “employee”. However, since shares acquired by connected persons are treated as acquired by the employee, the effect is the same.
1909. *Subsection (4)* derives from section 78(1)(b) of FA 1988. Shares in dependent subsidiaries are excluded from the charge under section 449 because they are instead subject to a charge under section 453. For the sake of clarity this section replaces the word “at” in the phrase “at the time of the chargeable event” with “immediately before”. See *Note 48* in Annex 2.

Section 453: Charge on increase in value of shares of dependent subsidiary

1910. This is the second of the charging provisions and derives from section 79(1) and (4) of FA 1988. Again, matters concerning what is chargeable, the calculation of the amount and the exceptions have been taken to separate sections.
1911. *Subsection (3)* derives from section 79(4) of FA 1988 and specifies the year of charge.
1912. *Subsections (4)* and *(5)* are new. *Subsection (5)* acts as a signpost to the provisions which remove the charge under various approved schemes.

Section 454: Chargeable increases

1913. This section derives from section 79(2) and (3) of FA 1988 and determines the period over which any rise in the value of the shares is measured in order to be an increase subject to charge.

Section 455: Amount of charge

1914. This section brings together all those parts of section 79 of FA 1988 which concern the calculation of the charge and in particular it makes clear what deductions should be made from the rise in value of the shareholding.
1915. *Subsection (1)* introduces a formula and *subsection (2)* specifies the items that are allowable deductions. *Subsection (3)* derives from section 79(6) of FA 1988 and is concerned with certain cases where the employee receives less than market value for the shares. The aim is to ensure that the employee is only charged on the difference between base value and the actual proceeds. That provision produces the right result where the chargeable increase is calculated by reference to the value of the shares at acquisition, but not where it is calculated by reference to the value of the shares at the later time that the company becomes a dependent subsidiary. The section produces the right result in both situations. It is a minor change to the law. See *Change 113* in Annex 1.
1916. *Subsection (4)* derives from the final two lines in section 79(4) of FA 1988.

Section 456: Cases outside charge under section 453

1917. *Subsection (2)* reflects the opening words of section 77(1) of FA 1988 “subject to section 140A of the Taxes Act 1988”. It ensures that if a charge is taken under section 427 (conditional interests in shares) then no charge is taken under section 453. This is because if a disposal potentially gives rise to a charge under section 453 (which is more general in its application) and under section 427 then the latter charge has priority.
1918. *Subsection (3)* derives from section 79(7) of FA 1988 and provides a let-out if the employee has not been a director or employee of the company or an associated company

in the seven years before the time that the company becomes a dependent subsidiary. As with section 452, the phrasing has been changed to produce a true exception and the reference is to “the employee” rather than “the person who acquired the shares”.

Section 457: Charge on other chargeable benefits from shares

1919. This is the third of the charging provisions and derives from section 80 of FA 1988. The term “chargeable benefit” in *subsection (1)* has replaced “special benefit” in order to be consistent with “chargeable event” and “chargeable increase” in the other charging provisions in this Chapter.
1920. An amount in respect of benefits attaching to shares may be charged on the employee, not only when the shares are owned by the employee (section 80(1) of FA 1988), but also when owned by other persons (section 83(1) and (4) of FA 1988). *Subsection (2)* brings together and clarifies how these rules are considered to operate and remedies the deficiencies in the wording of the source legislation. See *Change 114* in Annex 1.

Section 458: Chargeable benefits

1921. This section derives from the rather complex rules in section 80 of FA 1988 giving further conditions as to when a benefit is a chargeable benefit.
1922. *Subsection (2)* introduces the following three subsections. The approach adopted is to define what are chargeable benefits, replacing the approach in FA 1988 of saying that all benefits are chargeable benefits unless paragraphs (a) and (b) of section 80 apply. This makes the rules easier to understand.
1923. *Subsection (3)* derives from section 80(2)(a) of FA 1988.
1924. *Subsection (4)* derives from section 80(1A) of FA 1988.
1925. *Subsection (5)* introduces the conditions in *subsection (6)* which derive from section 80(3) of FA 1988. *Subsection (6)(a)* uses the new term “outside shareholders” which was first introduced in section 450.
1926. *Subsection (7)* contains two definitions which apply solely for the purposes of this section. The definition of “the company” is new and clarifies which company is being referred to in subsections (4) and (6). The other definition derives from section 87(1) of FA 1988.

Section 459: Amount of charge

1927. This section specifies the amount of the chargeable benefit. It derives from section 80(4) of FA 1988 and the definition of “value” in section 87(1) of FA 1988.

Section 460: Cases outside charge under section 457

1928. This section derives from section 80(5) of FA 1988 which contains the let-out where the employee has not been a director or employee of the company or an associated company in the seven years before the benefit is received. There are two points to note. Section 80(5)(a) of FA 1988 refers to the company in *subsection (1)* when that subsection contains no reference to a company. It clearly means the company whose shares are mentioned in *subsection (1)*. See *Change 115* in Annex 1. Also, in section 80(5) of FA 1988 the test is expressed to apply to the person receiving the benefit. But by virtue of the connected persons rules in section 83(4) of FA 1988 the test effectively applies to the employee himself. Accordingly, the test is applied directly to the employee in this section.

Section 461: Related acquisitions of additional shares

1929. This section derives from section 82 (1) and (2) of FA 1988 and concerns the treatment of additional shares received by the employee in respect of an original holding which had been acquired by virtue of the employment. The effect is to treat the new shares as within the Chapter and as having been acquired at the same time as the original shares.
1930. An award of additional shares may give rise to a chargeable benefit within section 457. This section makes it clear that the timing rule in section 82(2)(b) of FA 1988 does not affect the date on which the charge under section 457 is taken. See *Change 116* in Annex 1.

Section 462: Company reorganisations etc.

1931. This section derives from section 82(3) of FA 1988 and concerns exchanges of shares under company reorganisations. The main effect is to adopt the capital gains tax rule under which new holdings are treated as acquired as the original shares were.
1932. *Subsections (3) and (4)* derive from section 82(3)(b) and (c) of FA 1988. Subsection (3) (b) reflects what is meant by the rather obscure phrase “as is mentioned in section 128(1) and (2)” in section 82(3)(b).

Section 463: Disposals of shares to connected persons etc. ignored

1933. This section derives from section 83(2) and (3) of FA 1988. It is reasonably plain what section 83(2) of FA 1988 is trying to do, namely to ignore disposals which are not at arm’s length or are to a connected party so that the employee is deemed to retain the beneficial interest. However it is not clear whether the wording of that subsection achieves that result where the shares were originally issued to a connected party and so have already been subject to the deeming provision in section 83(1) of FA 1988. This has been made clear in this section by specifying that the employee retains the interest. It is a minor change to the law. See *Change 114* in Annex 1.

Section 464: Application to interests in shares

1934. This section derives from section 81 of FA 1988 (which applies for the purposes of charges under sections 79 and 80 of FA 1988). It sets out the supplementary rule that where a person’s interest in shares is increased or reduced it is treated as the acquisition or disposal of a separate interest proportionate to the increase or reduction.

Section 465: Duty to notify acquisitions of shares or interests in shares

1935. This section derives from section 85 of FA 1988 which is the information requirements provision.
1936. The section makes explicit what is implicit in section 85 that the time limit runs by reference to the year in which the additional shares are acquired. This is a minor change to the law. See *Change 116* in Annex 1.
1937. *Subsection (3)* provides that the particulars must be given to the Inland Revenue instead of to the inspector. See *Change 158* in Annex 1.
1938. *Subsection (4)* rewrites the 92-day time limit by requiring the information to be provided before 7 July. This is in line with the new practice in Chapters 2 to 5 of this Part.
1939. *Subsection (5)* is new and ensures that notification of an acquisition need be made only once. This is a minor change to the law. See *Change 116* in Annex 1.

Section 466: Duty to notify chargeable events and chargeable benefits

1940. This section also derives from section 85 of FA 1988 and contains the information requirements where certain charges arise.

1941. *Subsection (2)* provides that the particulars must be given to the Inland Revenue instead of to the inspector. See *Change 158* in Annex 1.
1942. The time limit of 60 days has been extended to 92 days. See *Change 111* in Annex 1.

Section 467: Meaning of “dependent subsidiary”

1943. This section derives mainly from section 86 of FA 1988. For ease of use *subsection (1)* is now introductory and the various conditions have been placed into four separate subsections. In *subsection (4)* the directors’ certificate is now to be given to the Inland Revenue rather than the inspector. See *Change 158* in Annex 1.
1944. The definition of “period of account” in *subsection (8)* derives from section 86(3) of FA 1988. That definition was repealed by FA 2002 and a new definition was inserted into section 832(1) of ICTA. In relation to a company the definitions are effectively the same.

Section 468: Meaning of “employee-controlled”

1945. This section derives from section 87(2) of FA 1988. The definitions of “connected persons” and “control” in ICTA are applied by sections 718 and 719 respectively.

Section 469: Shares “held by outside shareholders”

1946. This section explains the new shorthand term which is used in sections 450 and 458. The definition derives from sections 78(6)(a) and 80(3)(a) of FA 1988.

Section 470: Minor definitions

1947. This section picks up the remainder of the definitions in section 87(1) of FA 1988 which are not included elsewhere. The meaning of “interest in shares” has been expanded to make it clear that it excludes a right to acquire shares eg options. See *Change 117* in Annex 1.

Chapter 5: Share options

Overview

1948. This Chapter is concerned with the income tax charges which may arise in respect of a share option granted to any person by reason of an individual’s office or employment.
1949. The case of *Abbott v Philbin* (1960) 39 TC 82 (HL), [1960] 2 All ER 763, established that under general Schedule E rules, the only occasion of charge is on the grant (or assignment) of the option. The source of any gain arising on the later exercise of the option is the option itself, not the employment.
1950. The effect of this decision was largely reversed by legislation introduced in 1966 and now in sections 135 to 140 of ICTA. The underlying purpose of that legislation is to replace the charge on grant with one on exercise. Indeed that was what the original legislation achieved. However in 1972 the charge on grant was reintroduced for longer-term options to prevent liabilities being pushed too far into the future. At the same time the value of the grant was defined and provision made for any tax paid on grant to be deducted from the tax payable on exercise.
1951. The charging provision, section 135 of ICTA, does three main things.
- It provides that the gain on exercise (or on assignment, release or otherwise turning to account) is chargeable to tax under Schedule E provided the employee is in an employment within Case I of Schedule E.
 - If any gain on exercise would be chargeable then it removes the charge on grant, except where the option can be exercised more than ten years after grant.

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- It provides rules regarding the computation of charges that arise on grant and on exercise.
1952. The charges on grant and on exercise are removed where the options are issued under one of the schemes approved by the Inland Revenue. The legislation regarding these schemes has been rewritten in Chapters 7, 8 and 9 of this Part. Those provisions do impose charges to tax in certain circumstances.
1953. The rewritten legislation sets out the scope of the Chapter in the opening sections. It then adopts a logical order by first considering the taxation issues that arise in respect of the receipt and then the issues that arise on exercise, assignment or release. The rules in section 187A of ICTA and in section 4 of the Social Security Contributions (Share Options) Act 2001 which give a deduction to the employee when under an agreement or election he meets some or all of the employer's secondary or special national insurance contribution have been incorporated.
1954. Two provisions in the source legislation have not been rewritten.
- Section 136(4) of ICTA excludes from the charge that part of any gain that arises before 3 May 1966. It only applies to options granted before that date. The provision is regarded as spent and it is not being preserved.
 - Section 137 of ICTA allows for payment of tax under section 135 by instalments. It only applies to options granted before 6 April 1984. The provision is regarded as spent and it is not being preserved.

Section 471: Share options to which this Chapter applies

1955. This section sets out which share options come within the scope of the Chapter. It introduces the term "share option" in place of the cumbersome "right to acquire shares". In fact, although the title of section 135 of ICTA includes the words "share options", that term is not used at all in the source legislation.
1956. *Subsection (1)* makes it clear at the outset that the options concerned are those granted by reason of a person's office or employment. It derives from parts of section 135(1) and (6) and section 140(1) of ICTA.
1957. *Subsection (2)* makes it clear that the shares over which the option is granted can be shares in any body corporate. The normal case, of course, will be the grant of options over shares in the employing company, but the legislation can apply even if the body corporate is totally unconnected with the employment.
1958. *Subsection (3)* makes it clear that the option may be granted to someone other than the director or employee. It derives from section 140(1) of ICTA.
1959. *Subsection (4)* sets out two definitions which help to make the legislation easier to read. For example, the term "the employee" is used instead of "the director or employee of the company". Also, the fact that this Chapter applies to prospective and former employees is made clear by the reference to the extended definition in section 487(1).

Section 472: Introduction to taxation of share options

1960. This is a new introductory section. *Subsection (1)* derives from the *Abbott v Philbin* decision. It makes clear that unless a charge is imposed by this Chapter on exercise, then the only possible charge is when the option is received. If there is a charge on grant or assignment then it arises by virtue of Chapter 1 of Part 3 as earnings or under Chapter 10 of Part 3 as a taxable benefit.
1961. *Subsection (2)* acts as a signpost to the major exemption from the charge in respect of receipt, ie where the options expire within ten years of being obtained.

1962. *Subsections (3) and (4)* draw attention to charges that may arise when the option is exercised, assigned or released and *subsection (5)* to the different rules that apply for options received under an approved scheme or under the EMI code.

Section 473: Share options to which this Chapter does not apply

1963. This section explains which offices and employments come within the scope of these provisions. *Subsection (1)* brings to the fore the idea that the Chapter is only concerned with options granted in respect of an office or employment the earnings from which fall within sections 15 or 21. This is derived from the restriction in section 140(1) of ICTA, that the legislation only applies to Case I offices and employments, although the exact scope of that restriction was not clear. Clarifying the scope of the restriction is a minor change to the law. See *Change 118* in Annex 1.
1964. *Subsection (2)* derives from section 140(1) of ICTA and makes it clear that the legislation applies to options granted after the employment has ceased if the employment is within sections 15 or 21 in the last tax year in which the employment was held. This section makes it clear that a charge can arise where an option is granted to another person after the employment has ceased. See *Note 49* in Annex 2.

Section 474: No charge in respect of receipt of shorter-term option

1965. This section derives from section 135(2) of ICTA which gives an exemption in respect of receipt of options which expire within ten years provided that any gain on exercise of the option would be chargeable. The proviso is not expressly stated in this section. It follows from the fact the reference to “share option” imports the conditions in sections 471 and 473 and therefore limits the scope of the exemption to options within the Chapter and potentially chargeable on exercise.
1966. *Subsection (2)* also highlights the point, referred to rather obliquely by the opening words of section 135(2) of ICTA, that charges can arise on grant under an approved CSOP scheme in certain circumstances. Other than this instance, it follows that a charge in respect of the receipt can only arise where:
- the award is of a longer-term option; or
 - the circumstances are such that a charge could not arise on exercise. Examples of this would be that the employment (considered at the time of grant) is not within sections 15 or 21, or the holder of the option is an office-holder who is not a director or employee.

Section 475: Value of longer-term option for purposes of liability to tax in respect of receipt

1967. This section derives from the rule in section 135(5)(b) of ICTA regarding the valuation of a longer-term option for the purposes of a charge to tax in respect of the receipt of the option. Section 135(5)(b) says that the value of the option is not less than the current market value of the option shares reduced by whatever the employee has to pay for the shares. In practice, a higher value is never used. Accordingly, the “not less than” part of the rule has been left out. This is a minor change to the law. See *Change 119* in Annex 1.
1968. *Subsection (2)* derives from section 135(5)(b) of ICTA and resolves an ambiguity if the option shares carry conversion rights. It is not clear in the source legislation in such a case whether the value of the option shares or the value of the shares obtained on their conversion should be the basis of the charge. This section resolves the ambiguity by taking the higher value. This is a minor change in the law. See *Change 120* in Annex 1.
1969. The definition of “market value” in *subsection (3)* derives from section 140(3) of ICTA. It is reasonably plain from the wording of section 140(3) that the intention is to have the same rules about market values as apply in TCGA 1992 although only section 272 is mentioned. The new definition refers to Part 8 of TCGA 1992 rather than

just section 272 and is now the same as in Schedules 2, 3, 4 and 5 to this Act. This change in approach is explained in more detail in *Note 23* in Annex 2.

Section 476: Charge on exercise, assignment or release of option by employee

1970. In ICTA, the rules that apply in situations where another person (rather than the employee) realises the gain are in the middle of section 135 surrounded by other material dealing with the more common case in which the gain is realised by the employee personally. In this Act the rules have been separated, this section being concerned with gains realised by the employee and section 477 with gains realised by other persons.
1971. *Subsection (2)* provides that an amount is to count as employment income of the employee. It derives from section 135(1) of ICTA. Such an amount is specific employment income (see section 7(4) of this Act) which replaces the free-standing Schedule E charge. It does not depend on the residence status of the employee at the time of exercise. The charge applies whether the option was originally granted to the employee or to another person and then assigned to the employee; see section 471(3) of this Act. The amount that is to count as employment income (the taxable amount) is determined under section 478.
1972. *Subsection (3)* is new and simply specifies the year for which the taxable amount counts as employment income. It is Inland Revenue practice to apply section 135 of ICTA to charge the gain in the year of exercise etc. See *Note 3* in Annex 2.
1973. *Subsection (4)* refers to the exceptions that apply if the options were granted under an approved scheme or under the EMI code.

Section 477: Charge on employee where option exercised, assigned or released by another person

1974. This section derives from section 135(6) and (7) of ICTA which imposes a charge on the employee where the gain is realised by another person. *Subsection (1)* sets out clearly the three circumstances where an amount is to count as employment income of the employee. The amount that is to count as employment income (the taxable amount) is calculated under section 478.
1975. *Subsection (3)* is new and specifies the year for which the taxable amount counts as employment income. See *Note 3* in Annex 2.
1976. *Subsection (4)* is new. It legislates the present practice of not charging the personal representatives or beneficiaries when the option is exercised following the death of the person to whom the option was granted. See *Change 121* in Annex 1.
1977. *Subsection (5)* derives from section 135(7) of ICTA and contains an exemption where the employee was divested of the share option by operation of law. The reference in section 135(7) of ICTA to “on his bankruptcy or otherwise” has been left out as it adds nothing.
1978. *Subsection (6)* provides that where subsection (5) applies, the gain is chargeable under Schedule D, Case VI. The subsection also removes ambiguity by making it clear that any person charged under Case VI is entitled to the reduction derived from the closing words of section 135(6) of ICTA. This is a minor change to the law. See *Change 122* in Annex 1.

Section 478: Amount of charges

1979. This section identifies those deductions which are made from the amount of the gain (calculated under section 479 or 480) in arriving at the taxable amount.

1980. *Subsection (2)(a) and (b)* reflects the amendments made to section 135 of ICTA by paragraph 1 of Schedule 6 to FA 2002. That changed the rule about giving relief where there had been an earlier charge in respect of the receipt of the option. The amount that is charged to tax in respect of the receipt is now deducted in calculating the taxable amount instead of giving relief in terms of tax. In strictness, a deduction is only due where the option is exercised, assigned or released by the employee. However, in practice it is appropriate to give the deduction where the option is exercised by another person, so long as the same amount is not deducted twice. The section makes any amount charged to tax in respect of the receipt of an option a deductible amount in calculating the taxable amount for the purposes of section 477 (charge where option exercised by another person), but *subsection (3)* prevents double deductions. This is a minor change to the law. See *Change 123* in Annex 1.
1981. *Subsection (2)(c)* allows a deduction in calculating the taxable amount for the amount of any allowable national insurance contributions met by the employee. It derives from section 187A(4) of ICTA.

Section 479: Amount of gain realised by exercising option

1982. This section brings together the parts of section 135(3) and (6) of ICTA which provide the rules regarding the computation of the gain on exercise and a further rule in section 185(8) of ICTA. That rule allows a deduction in calculating the amount of the gain for any charge to tax under section 185(6) of ICTA in respect of the grant at a discount of a share option under an approved CSOP scheme. Those parts of section 135(3) of ICTA which relate solely to the gain on an assignment or release appear in a separate section. The method adopted leads to some repetition between this section and section 480, in order to assist the reader.
1983. *Subsection (1)* introduces a formula for calculating the gain.
1984. *Subsection (2)* specifies the items which are deductible costs in calculating the gain.
1985. *Subsection (3)* derives from the closing words of section 135(4) of ICTA and ensures that the amount paid for the option is deducted only once. It should be noted that section 135(9) of ICTA replicates the effect of section 135(4) of ICTA and has not been separately rewritten. This removes unnecessary material.
1986. *Subsection (4)* provides a signpost to the EMI provisions which modify the calculation of the amount of the gain.

Section 480: Amount of gain realised by assigning or releasing option

1987. This section mirrors section 479 and sets out the rules which apply to the computation of the gain when the option is assigned or released. As the EMI provisions do not apply when an option is assigned or released no signpost is required here.

Section 481: Deductible amount in respect of secondary Class 1 contributions met by employee

1988. Section 187A of ICTA, introduced by section 56(1) of FA 2000, provides relief against a gain chargeable under section 135 of ICTA for amounts of employer's Class 1 National Insurance contributions payable in respect of the gain and met by the employee under arrangements set out in social security legislation. The relief has now been written as a deduction in calculating the taxable amount and does not affect the amount of the gain. It is the amount of the gain (rather than the taxable amount) that is relevant for the purposes of section 120(4) of TCGA 1992 and national insurance provisions. It is therefore not necessary to reproduce the rule in section 187A(5) of ICTA which prevented relief under section 187A from being taken into account for those purposes.

1989. *Subsection (4)* derives from section 4(3) of the Social Security Contributions (Share Options) Act 2001. Its effect is that one cannot get a deduction under both this section and under section 482 (special contributions).

Section 482: Deductible amount in respect of special contribution met by employee

1990. This section derives from section 4 of the Social Security Contributions (Share Options) Act 2001. That Act enabled the employer or employee as appropriate to cap exposure to employer's Class 1 National Insurance contributions by instead paying a special contribution calculated by reference to any increase in value of the shares subject to the option on 7 November 2000. Although any special contributions had to be paid by 11 August 2001 the relief is due when the gain is realised which may not be for several years.
1991. For the same reasons as explained above in the notes on section 481, the provisions of section 187A(5) of ICTA have not been reproduced in this section. It is not necessary to prohibit a deduction made in calculating the taxable amount and not in calculating the amount of the gain.

Section 483: Extended meaning of "assign" and "release"

1992. This section brings together the two rules regarding the extended meaning of "assign" and "release" to include other situations where options are turned to account. It derives from section 135(8) and section 136(5)(a) of ICTA.

Section 484: Amount or value of consideration given for grant of share option

1993. This section contains supplementary rules for determining the amount allowable as a deduction in respect of the cost of the option in calculating the amount of the gain.
1994. *Subsection (2)* derives from the rule at the end of section 135(3) of ICTA regarding the apportionment of a single sum paid for both the share option and something else. The wording in that subsection is a "just" apportionment. This has been amended to "just and reasonable" to align the wording with that used in sections 429 and 442. This is a minor change to the law. See *Change 124* in Annex 1.
1995. *Subsection (3)* derives from section 135(4) and provides that no account is taken of the value of the duties of the employment performed by the employee. As mentioned in the explanatory note to section 479, section 135(9) of ICTA has not been rewritten as it replicates the effect of the rule in the final part of section 135(4), that the cost of the option can only be deducted once. That rule is rewritten in sections 479(3) and 480(3).

Section 485: Application of this Chapter where share option exchanged for another

1996. This section derives from what is probably the most complex part of the source legislation. Section 136(1) to (3) of ICTA are concerned with creating a form of rollover treatment which applies when a right to acquire shares is effectively swapped for another such right. The effect is to ignore the swap for section 135 purposes and apply the Chapter to the replacement option. Any consideration received which is not represented by the new option is taken into account in calculating the gain in the normal way.
1997. The prevention of the early crystallisation of the charge in the case of a straightforward exchange also has an anti-avoidance effect. In the absence of the provision it could be arranged that a valuable option is exchanged for an option with an apparently lower value (thus generating an immediate, but low tax charge), and there would be no charge on exercise because the new option would not have been issued by reason of employment, but to the employee as option-holder.
1998. Section 136(1) of ICTA is not easy to follow partly because it says that the cost of the new option excludes some things, but includes others; and partly because those

rules are in the same long sentence detailing other rules not concerned with working out the allowable cost of the new option. These ideas have been separated and in order to make the provision easier to use *subsection (4)* specifies what is in fact the consideration for the grant of the new option. *Subsections (5)* and *(6)* extend the rollover treatment to cases where the swap is achieved indirectly under arrangements described in section 136(2) and (3) of ICTA.

1999. It may be noted that section 136(2)(b) of ICTA refers to tax “chargeable under this section”. This makes no sense because tax is not chargeable under section 136, but under section 135 of ICTA. The problem stems from consolidation. Previously section 136(2) was part of the same section as section 135. When that section (section 186 of ICTA 1970) was split in two on consolidation the relevant amendment to section 136(2) (b) was missed. This error has been corrected in section 485(5)(b). See *Change 125* in Annex 1.

Section 486: Duty to notify matters relating to share options

2000. This section derives from section 136(6) to (8) of ICTA. The time limit of 92 days after the end of the year of assessment has been rewritten as “before 7th July” in line with the new practice in Chapters 2 to 5 of this Part. The particulars are now to be given to the Inland Revenue rather than to the inspector. See *Change 158* in Annex 1.

Section 487: Minor definitions

2001. This section brings together minor definitions from section 136(5) of ICTA and others from section 187A of ICTA in connection with the deductions for National Insurance contributions.
2002. The definition of shares in section 136(5)(d) of ICTA includes stock “in so far as the context permits”. This rider has been omitted as unnecessary since there does not appear to be anywhere in this Chapter where the context would not so permit.

Chapter 6: Approved share incentive plans

Background

2003. This Chapter, together with Schedule 2, derives from the legislation relating to share incentive plans (or “SIPs” for short). SIPs were previously known as employee share ownership plans (or “ESOPs” for short). The SIPs legislation is the result of a policy designed to bring share ownership in a company to the whole of that company’s workforce.
2004. Nearly all the SIPs legislation is contained in Schedule 8 to FA 2000 (introduced by section 47 of that Act). Schedule 8 to FA 2000 was amended, to a certain extent, by Schedule 13 to FA 2001 (introduced by section 61 of that Act), and also by section 95 of that Act. Further amendments to Schedule 8 of FA 2000 were made by section 39 of FA 2002 and also by the Employee Share Schemes Act 2002.
2005. The new legislation relating to SIPs, the majority of which is contained in this Chapter and Schedule 2, is called “the SIP code”: a term introduced in section 488.
2006. The core of the SIP code is that a company establishing a share incentive plan must offer either “free shares” or “partnership shares” (or both) to its employees. Two other types of shares - “matching shares” and “dividend shares” - are dealt with in the SIP code; and either or both of these may also be offered to employees - although this is not essential. And if a SIP is to be “approved” for the purposes of the legislation (and thus obtain the tax advantages available to an approved SIP), there are general requirements to be met, and also further requirements relating to the eligibility of individuals, to the types of shares that may be awarded, and to the trustees.
2007. The SIP code, accordingly, has a number of distinguishable components:

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- it specifies requirements that a SIP must meet before it may be “approved” for the purposes of the SIP code;
 - it deals with the procedural aspects relating to the approval of plans and the withdrawal of approval;
 - it specifies the tax advantages that an approved SIP possesses;
 - it specifies the tax charges that may arise in certain circumstances (for example, when shares cease to be subject to the plan); and
 - it deals with supplementary matters (including interpretation).
2008. Of the components listed in the last paragraph, this Chapter deals with the tax advantages that an approved SIP possesses, and with the tax charges that may arise.
2009. [Schedule 2](#) deals with the other components listed in that paragraph. After the introduction (in Part 1), that Schedule deals with the requirements that a SIP must meet before it may be “approved” for the purposes of the SIP code (in Parts 2 to 9); with the approval of plans and the withdrawal of approval (in Part 10); and with supplementary matters (in Part 11).
2010. [Schedule 8](#) to FA 2000 also contained other provisions relating to corporation tax, capital gains tax and stamp duty. These other provisions are dealt with in [Schedule 6](#) to this Act (consequential amendments). [Schedule 7](#) to this Act includes provisions designed to avoid any transitional problems arising from the replacement of [Schedule 8](#) by the provisions contained in this Act.