

*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**

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## **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**

#### **PAYE implications**

#### *Chapter 10: Priority share allocations*

#### **Overview**

2189. This Chapter derives from section 68 of FA 1988 which applies to offers made on or after 23 September 1987. That section exempts the benefit derived by directors and employees from a priority allocation of shares.
2190. Section 68 of FA 1988 starts by granting a complete exemption from the charge as emoluments in respect of any benefit derived from an entitlement to a priority allocation of shares. Then, in some circumstances, the legislation brings back into charge any discount enjoyed by employees. It does so by excluding the relevant amount from the initial exemption. The rules for calculating this amount are different from the normal rules for calculating emoluments.
2191. When section 68 of FA 1988 was enacted, it only dealt with relatively straightforward offers where there was a single public offer under which both members of the public and directors and other employees applied for shares including any priority shares.
2192. Successive amendments catered for more complex share offers. These included offers where, because of legal and other technical issues, the priority shares for directors and employees were subject to a separate employee offer. Each new tranche of legislation was “bolted on” to what had gone before. This was done by imposing the fiction that the separate public and employee offers were in fact a single offer – “the offer”.
2193. This led to some rather dense and convoluted legislation – particularly in the rules for the limits on the number of priority shares and the “similar terms” condition. In order to try to make the provisions easier to understand, that fiction has been abandoned and the Act instead uses the following structure: sections 542 and 543 deal with single share offers; sections 544 and 545 deal with share offers with separate public and employee offers; and sections 546 to 548 deal with supplementary material that is common to both.
2194. It should be noted that section 68(4) of FA 1988 (dealing with the capital gains aspects) does not appear in this Chapter. Instead, paragraph 212 of Schedule 6 to this Act inserts

a new section 149C in TCGA 1992. In addition, section 68(6) of FA 1988, the original commencement provision, is omitted on the grounds that it is spent.

***Section 542: Exemption: offer made to public and employees***

2195. This section is concerned with offers which are open to both the public and employees. *Subsection (1)* derives from section 68(1) of FA 1988 and introduces the basic conditions for the exemption. The exemption itself is found in *subsection (2)* and is from liability to income tax as earnings. It follows that the exemption does not apply to a benefit received in connection with a change or termination within Chapter 3 of Part 6 of this Act which derives from section 148 of ICTA.
2196. *Subsections (3) to (6)* derive from sections 68(2), (2A) and (2B) of FA 1988 and give the detailed conditions which must be satisfied in order for the exemption to apply. In contrast to the source legislation, dealing with the conditions one by one should be clearer.
2197. *Subsection (7)* introduces section 543 which excludes certain discounts from the exemption in this section.

***Section 543: Discount not covered by exemption in section 542***

2198. This section derives from section 68(1A) of FA 1988 and excludes from the exemption in section 542 the benefit of certain discounts enjoyed by a director or employee in acquiring the priority shares. The discount therefore remains taxable as earnings. In calculating the taxable discount the amount of any registrant discount (see section 547) is disregarded.

***Section 544: Exemption: different offers made to public and employees***

2199. This section is concerned with cases where there are separate offers to the public and employees. *Subsection (1)* derives mainly from section 68(1ZA) of FA 1988 and introduces the basic conditions for the exemption. The exemption itself is found in *subsection (2)* and is from liability to income tax as earnings. It follows that the exemption does not apply to a benefit received in connection with a change or termination within Chapter 3 of Part 6 of this Act which derives from section 148 of ICTA.
2200. *Subsections (3) to (6)* derive from sections 68(1ZB), (2), (2A), (2B) and (2C) of FA 1988 and give the detailed conditions which must be satisfied for the exemption to apply. *Subsection (3)* requires the case of each company whose shares are subject to the employee offer to be considered. In the FA 1988 provisions, the fiction that the public offer and the employee offer are a single offer means that, reading *subsections 68(2) (a) and 68(2C)* together, a company whose shares are *only* subject to the public offer also has to be considered. In such a case, the limit on the number of shares allocated to employees, imposed by section 68(2)(a), will never be exceeded. These companies are not therefore mentioned. See *Note 52* in Annex 2.
2201. *Subsection (7)* introduces section 545 which excludes certain discounts from the exemption in this section.

***Section 545: Discount not covered by exemption in section 544***

2202. This section derives from section 68(1) of FA 1988 and excludes from the exemption in section 544 the benefit of any discount (disregarding the registrant discount) enjoyed by a director or employee in acquiring the priority shares. The discount therefore remains taxable as earnings.
2203. *Subsections (3) to (6)* derive from the rather complex provisions in section 68(5B) and (5C) of FA 1988 which determine the “appropriate notional price” of the shares in the offer. Generally this is the notional price, but in some circumstances it is a proportion of

the notional price. A formula has been introduced to make the basis of the calculation clearer.

***Section 546: Meaning of being entitled “on similar terms”***

2204. This section derives from sections 68(3) and (3A) of FA 1988 and explains the condition that entitlement to a priority allocation of shares must be on “similar terms”.
2205. *Subsections (3) to (6)* only apply where the allocation of shares in a company for directors and employees of the company is different from the allocations for directors and employees of other companies.

***Section 547: Meaning and amount or value of “registrant discount”***

2206. This section derives from section 68(5A) of FA 1988 which defines “registrant discount”. Section 68(5A)(b) requires at least 40% of shares which are allocated to members of the public *other than employees and directors* to be allocated to individuals entitled to the discount. It is not made explicit what this phrase means. *Subsection (4)* has been drafted to make clear that the intention is to exclude employees and directors who are entitled to a priority allocation. This change in approach is explained in detail in *Note 53* in Annex 2.
2207. In this section the label “subscribing employee” has been used to describe those directors and employees who subscribe for shares under the offers and who comply with the same registration requirements as members of the public.

***Section 548: Minor definitions***

2208. This section contains the definitions used in this Chapter and mainly derives from section 68(5) of FA 1988. That legislation does not define “director” (except to include prospective and former directors) or “shares”. The definitions introduced here are discussed in *Change 132* in Annex 1.