

*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 8: Approved CSOP schemes*

#### **Overview**

- 2113. This Chapter tells an employee receiving or exercising a share option whether or not the option is within a CSOP scheme and what the tax consequences are. A CSOP scheme is defined in section 521. The acronym CSOP stands for a company share option plan. This label has not been used in the statute up to now but it is commonly used in practice.
- 2114. The label CSOP denotes a CSOP scheme in these notes.
- 2115. Unlike in sections 185 and 187 of and Schedule 9 to ICTA, in this Act CSOP has been separated from the SAYE schemes in an attempt to make these rules easier to read and understand.
- 2116. The rules for APS scheme (profit sharing schemes approved under Schedule 9 to ICTA) are not being rewritten in this Act. These rules will therefore still be found in sections 186 and 187 of and Schedules 9 and 10 to ICTA. There is reference to this in section 418(2) and in Part 8 of Schedule 7 to this Act.
- 2117. The redrafting of the CSOP and SAYE schemes has been influenced by the way the newer schemes, Enterprise Management Incentives (“EMI”) and Share Incentive Plans (“SIP”), were written in FA 2000. This is a matter of style and also part of an attempt to achieve consistency across the share schemes where possible. Codes have been introduced for each scheme or plan as explained in the notes to the introduction to this Part.
- 2118. Each section of this Chapter and each paragraph of Schedule 4 has a heading to help explain its contents and there are several examples of both sections and paragraphs containing introductory material.
- 2119. The requirements for the initial and continuing approval of the scheme are now contained in paragraphs 28 to 32 of Schedule 4. There are transitional provisions in Schedule 7 to ensure that a scheme approved under Schedule 9 to ICTA is treated as a CSOP scheme approved under this Act.

***Section 521: Approved CSOP Schemes***

2120. This section sets out what is contained in this Chapter and in Schedule 4 to this Act. It sets the scene: CSOP is a scheme which requires prior approval by the Inland Revenue and which enables the option-holder to benefit from income tax relief. There is also provision here for amounts to count as employment income in certain circumstances.
2121. There are references in the CSOP code in several places to the Inland Revenue, where the relevant provisions in ICTA referred to the Board. This reflects practice and is in line with the approach in FA 2000 to EMI and SIP codes. The Inland Revenue is defined in section 720 as “any officer of the Board of Inland Revenue”. See *Change 158* in Annex 1.
2122. In *subsection (3)(c)* there is a cross-reference to Part 3 of Schedule 7D to TCGA 1992 which covers the capital gains tax angle (see Schedule 6 to this Act).
2123. Share options are described as being granted rather than obtained in most contexts and especially where the timing of the grant is significant. This ties in with the terminology in EMI and perhaps gives a clearer indication of the exact date of the occasion.
2124. The definitions derive from section 187 of ICTA. There are minor definitions and a new index of defined expressions, at the end of Schedule 4 to this Act. This is based on the approach in the tax-relieved share schemes, introduced by FA 2000. The definition of “share option” matches the one used for EMI in FA 2000 (and in the EMI code). There is for the first time a definition of the CSOP scheme in section 521.

***Section 522: Share options to which this Chapter applies***

2125. This is an introductory section, which derives from section 185(1) of ICTA. This Chapter applies to an individual who obtains an option in accordance with the provisions of an approved scheme by reason of his or her employment. This phrase in section 185(1) matches the expression in the benefits code. The rules in paragraph 8 of Schedule 4 to this Act govern the particular employment.
2126. The reference to a commencement date in section 185(1) of ICTA is spent and is not being rewritten. This is also the case with section 185(9) of ICTA, which is specific to CSOP.

***Section 523: No charge in respect of receipt of option***

2127. *Subsection (1)* derives from section 185(2) of ICTA. Here as elsewhere the phrase “no liability to income tax arises” expresses this type of exemption.
2128. *Subsection (2)* also derives from section 185(2) of ICTA.

***Section 524: No charge in respect of exercise of option***

2129. This and the following section bring together section 185(3) and (5) of ICTA and incorporate paragraph 27(3) of Schedule 9 to ICTA, which was formerly referred to in section 185(3).
2130. These two sections explain the conditions for relief from income tax on the exercise of an option and on post-acquisition benefits. As with the SAYE provisions, this section makes the circumstances of relief and the exceptions more straightforward, expressing them in a positive form.
2131. No liability to income tax arises in the circumstances set out in the condition in *subsection (2)*. The option has to be exercised between three years and ten years after receipt and three years after a previous exempt exercise, as defined in *subsection (3)*.
2132. There are therefore three dates crucial to this relief. The three year period in *subsection (2)(a)(i)* begins with the day on which the option is granted. There is a minor

change in relation to the exercise on the tenth anniversary of the grant in *subsection (2)(a)(ii)*. See *Change 129* in Annex 1.

2133. In *subsection (2)(b)* the rule makes it clear that the period is inclusive of the exercise of the current option. (In section 185(5)(b) of ICTA the period looks back to the date of an earlier exercise.) The effect is that if there is an exempt exercise of an option on 1 January 2002, an employee can be confident that a further exercise on the same date three years later will qualify for income tax relief.
2134. There are similar clarifications in the SAYE code and there are references to time limits elsewhere in the explanatory notes on the approved schemes. These are instances where it might be open to doubt whether or not the trigger date, from which a period is measured, is to be included in the period. As the law ignores fractions of a day when computing periods of this nature, this section identifies the start date for the various periods.
2135. The Inland Revenue practice under which the charge on the exercise, assignment and release of unapproved share options after the death of an option holder is lifted has now been given statutory effect in section 477(4). There is a new cross-reference to this section in *subsection (4)*. Also, to make it clear that the operation of section 477 acts in conjunction with the approved share scheme rules, which concern the time when a share option lapses after death, there is a signpost to paragraph 25 of Schedule 4 in *subsection (5)*.

***Section 525: No charge in respect of post-acquisition benefits***

2136. This section mirrors the previous section and also derives from section 185(3) and (5) of ICTA. It gives relief in the same circumstances from income tax on specified charges (post-acquisition charges under section 449 and section 453) on an increase in the value of shares acquired by way of a tax-relieved exercise. The exercise has to meet the condition set out in section 524. See *Note 50* in Annex 2.

***Section 526: Charge where option granted at a discount***

2137. This section derives from section 185(6) and (8) of ICTA. Section 185(7) of ICTA which covers the capital gains tax consequences (relief against a double charge) is now in Part 3 of Schedule 7D to TCGA 1992 (see Schedule 7 to this Act).
2138. The section imposes a charge in the rare case that the total of any consideration given for the grant of the option and the amount payable on exercising the option is less than the market value of the shares at the time the option is granted. The option has to be granted at a price which is not manifestly less than the market value at that date (which is the rule in paragraph 22 of Schedule 4, formerly paragraph 29 of Schedule 9 to ICTA). Therefore this charge can only occur where there has been an agreement to fix the value earlier than the date of the grant or a mistake is made on the valuation.
2139. The language of *subsections (2)* and *(4)* reflects the new approach to expressing “charge”.
2140. In response to a suggestion made in the consultation process leading up to this Act, “the price” in *subsection (1)(b)* has been changed to “the amount payable” since price implies an amount payable per share. A further clarification has also been introduced. This is the reference to “the maximum number of shares” that can be acquired under the option, which specifies the number of shares in the frame in order to make the comparison required.
2141. The reference to the discount being earned income has been dropped, as this has no continuing effect.

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2142. Under *subsection (4)*, “knock-on” relief is given against further income tax charges on the same shares. This is a signpost only now; the way the relief is given is included in sections 194, 479 and 480.