



Income Tax (Earnings and Pensions) Act 2003

2003 CHAPTER 1

PART 7

EMPLOYMENT INCOME: SHARE-RELATED INCOME AND EXEMPTIONS

CHAPTER 9

ENTERPRISE MANAGEMENT INCENTIVES

Introduction

527 Enterprise management incentives: qualifying options

- (1) This Chapter provides—
 - (a) for share options notified to the Inland Revenue to be qualifying options for the purposes of the EMI code, and
 - (b) for exemptions and reliefs from income tax in connection with qualifying options.
- (2) Schedule 5 contains the requirements that have to be met for a share option to be a qualifying option, together with the notification procedure.
- (3) The provisions of—
 - (a) this and the following sections of this Chapter,
 - (b) Schedule 5, and
 - (c) Part 4 of Schedule 7D to TCGA 1992 (enterprise management incentives: capital gains tax consequences of exercise of qualifying option),together constitute “the EMI code”.
- (4) In the EMI code—

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“qualifying option” means a share option—

- (a) in relation to which the requirements of Schedule 5 are met at the time when the option is granted, and
- (b) which is notified to the Inland Revenue in accordance with Part 7 of that Schedule;

“replacement option” means an option within paragraph 41(4) of that Schedule (grant of replacement option in connection with company reorganisations);

“share option” means a right to acquire shares in a company;

and any reference to the requirements of Schedule 5 is to the requirements set out in paragraph 1(3) of that Schedule.

- (5) Other expressions used in the EMI code and contained in the index at the end of Schedule 5 have the meaning indicated by the index.

Tax advantages: receipt of option

528 No charge on receipt of qualifying option

No liability to income tax arises in respect of the receipt of a qualifying option.

Tax advantages: exercise of option

529 Scope of tax advantages: option must be exercised within 10 years

- (1) Sections 530 to 540 apply in connection with the exercise of a qualifying option.
- (2) But those sections only apply in cases where the option is exercised on or before the tenth anniversary of—
 - (a) the date of the grant of the option, or
 - (b) if it is a replacement option, the date of the grant of the original option.
- (3) In the EMI code “the original option” means—
 - (a) where there has been one replacement option, the option that that option replaced, or
 - (b) where there have been two or more replacement options, the option that the first of them replaced.

530 No charge on exercise of option to acquire shares at market value

- (1) This section applies if the option is to acquire shares at not less than their market value—
 - (a) at the time when the option is granted, or
 - (b) if it is a replacement option, at the time when the original option was granted.
- (2) If this section applies, no liability to income tax arises by virtue of section 476 (charge on exercise etc. of option by employee) in respect of the exercise of the option.
- (3) This section has effect subject to section 532 (modified tax consequences following disqualifying events).

531 Limitation of charge on exercise of option to acquire shares below market value

- (1) This section applies if the option is to acquire shares at less than their market value—
- (a) at the time when the option is granted, or
 - (b) if it is a replacement option, at the time when the original option was granted, or at nil cost.

- (2) If this section applies, the section 476 gain is—

$$\text{CMV} - (\text{ACO} + \text{ACS})$$

where—

CMV is the chargeable market value,
ACO is the amount or value of the consideration given for the grant of the option,
and
ACS is the amount, if any, for which the shares are acquired.

- (3) “The chargeable market value” means—
- (a) the market value of the shares—
 - (i) at the time when the option was granted, or
 - (ii) if it is a replacement option, at the time when the original option was granted, or
 - (b) the market value of the shares at the time when the option is exercised,
whichever is lower.
- (4) In this section “the section 476 gain” means the amount which is to be regarded for the purposes of section 476 (charge on exercise etc. of option by employee) as the amount of the gain realised by exercising the option.
- (5) This section has effect subject to section 532 (modified tax consequences following disqualifying events).

Tax advantages where disqualifying events

532 Modified tax consequences following disqualifying events

- (1) This section applies where—
- (a) a disqualifying event (see section 533) occurs in relation to a qualifying option before the option is exercised, and
 - (b) the option is exercised later than 40 days after the day on which the event occurred.

- (2) If the option is within section 530(1) (option to acquire shares at market value), the section 476 gain is—

$$\text{PEG} - \text{ACO}$$

(see subsection (4)).

- (3) If the option is within section 531(1) (option to acquire shares at less than market value), the section 476 gain is—

$$(\text{CMV} + \text{PEG}) - (\text{ACO} + \text{ACS})$$

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(see subsection (4)).

(4) For the purposes of subsections (2) and (3)—

ACO is the amount or value of the consideration given for the grant of the option,
 ACS is the amount, if any, for which the shares are acquired,
 CMV is the chargeable market value (as defined by section 531(3)), and
 PEG is the post-event gain, that is the amount (if any) by which the market value of the shares at the time when the option is exercised exceeds their market value immediately before the disqualifying event.

(5) In those subsections “the section 476 gain” means the amount which is to be regarded for the purposes of section 476 (charge on exercise etc. of option by employee) as the amount of the gain realised by exercising the option.

(6) Nothing in the following provisions—

- (a) subsections (2) and (3) above, or
- (b) sections 530 and 531,

applies if the amount that counts as employment income by virtue of section 476 in respect of the exercise of the option would, in the absence of those provisions, be less than the amount that counts as such income as a result of those provisions.

533 Disqualifying events

(1) The following provisions deal with the events that are (or are to be treated as) disqualifying events in relation to a qualifying option—

- (a) section 534 (events relating to the relevant company),
- (b) section 535 (events relating to the employee), and
- (c) section 536 (other disqualifying events), read with sections 537 to 539 (which contain supplementary provisions).

(2) In the provisions mentioned in subsection (1) “the employee” means the person holding the qualifying option and “the relevant company” means the company whose shares are the subject of the option (see paragraph 1(3) of Schedule 5).

534 Disqualifying events relating to relevant company

(1) The following events relating to the relevant company are disqualifying events in relation to a qualifying option—

- (a) when the relevant company becomes a 51% subsidiary of another company;
- (b) when the relevant company comes under the control of—
 - (i) another company, or
 - (ii) another company and any other person connected with that other company,
 without becoming a 51% subsidiary of that other company;
- (c) when the relevant company ceases to meet the trading activities requirement (see paragraphs 13 to 23 of Schedule 5).

(2) But where a replacement option has been granted, an event within subsection (1)(a) or (b) is not a disqualifying event in relation to the old option (see paragraph 41(2) of Schedule 5) if the event occurs at any time during the period—

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- (a) beginning at the same time as the period within which the replacement option had to be granted (see paragraph 42 of Schedule 5), and
 - (b) ending with the release of the rights under the old option.
- (3) A disqualifying event is to be treated as occurring in relation to a qualifying option if the circumstances mentioned in subsection (4) arise.
- (4) The circumstances are that—
 - (a) the relevant company was a qualifying company at the time when the option was granted as a result only of preparations to carry on a qualifying trade; and
 - (b) either—
 - (i) the preparations cease to be carried on, or
 - (ii) the initial period comes to an end,without the relevant company (or, if it is a parent company, any member of the group) beginning to carry on that qualifying trade.
- (5) “The initial period” means the period of two years after the date when the option was granted.
- (6) Paragraph 41(5)(b) of Schedule 5 has the effect that a replacement option is to be treated as granted on the date when the original option was granted.

535 Disqualifying events relating to employee

- (1) The following events relating to the employee are disqualifying events in relation to a qualifying option—
 - (a) when the employee ceases to be an eligible employee in relation to the relevant company as a result of ceasing to meet the requirement in paragraph 25 of Schedule 5 (the employment requirement);
 - (b) when the employee ceases to be such an employee as a result of ceasing to meet the requirement in paragraph 26 of that Schedule (the requirement as to commitment of working time).
- (2) In addition, a disqualifying event is to be treated as occurring in relation to a qualifying option at the end of any tax year if, during that year, the average amount per week of the employee’s reckonable time in relevant employment was less than the statutory threshold.
- (3) An employee’s “reckonable time in relevant employment” means the time which the employee in fact spent, as an employee in relevant employment—
 - (a) on the business of the relevant company, or
 - (b) if that company is a parent company, on the business of the group,together with any time which the employee would, as such an employee, have spent on that business but for any of the reasons set out in paragraph 26(3)(a) to (d) of Schedule 5 (requirement as to commitment of working time).
- (4) The “statutory threshold” means—
 - (a) 25 hours, or
 - (b) if less, 75% of the employee’s working time.
- (5) For the purpose of applying subsection (2) to the tax year in which the option was granted, any part of that year which preceded the date on which it was granted is to be disregarded in calculating the average amount mentioned in that subsection.

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(6) In this section—

- (a) “relevant employment” means employment—
 - (i) by the relevant company, or
 - (ii) if that company is a parent company, by any member of the group;
- (b) “working time” has the meaning given by paragraph 27 of Schedule 5 (meaning of “working time”).

536 Other disqualifying events

(1) The following are also disqualifying events in relation to a qualifying option—

- (a) any variation of the terms of the option whose effect is either—
 - (i) to increase the market value of the shares that are the subject of the option, or
 - (ii) that the requirements of Schedule 5 would no longer be met in relation to the option;
- (b) any alteration to the share capital of the relevant company—
 - (i) to which subsection (2) (share values affected by alteration of rights or restrictions) of section 537 applies, and
 - (ii) whose effect is that the requirements of Schedule 5 would no longer be met in relation to the option;
- (c) any alteration to the share capital of the relevant company to which—
 - (i) subsection (2) (share values affected by alteration of rights or restrictions), and
 - (ii) subsection (3) (alteration designed to increase share values),
 of section 537 apply;
- (d) a conversion of any of the shares to which the option relates into shares of a different class, except in a case within section 538(2); and
- (e) the grant to the employee of a relevant CSOP option, if immediately after it is granted the employee holds unexercised employee options in respect of shares with a total value of more than £100,000.

(2) In subsection (1)(e)—

“relevant CSOP option”, and
 “employee option”,

have the meaning given by section 539 (CSOP and other options relevant for purposes of this section); and sub-paragraphs (6) to (8) of paragraph 5 of Schedule 5 (determination of value of shares) apply for the purposes of subsection (1)(e) as they apply for the purposes of paragraph 5.

537 Alterations of share capital for purposes of section 536

- (1) This section has effect for the purposes of section 536(1)(b) and (c) (other disqualifying events: alterations of share capital of relevant company).
- (2) This subsection applies to an alteration of the share capital of the relevant company if—
 - (a) the alteration affects (or but for the occurrence of some other event would affect) the value of the shares to which the option relates; and
 - (b) it consists of or includes—

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- (i) the creation, variation or removal of a right relating to any shares in the relevant company,
 - (ii) the imposition of a restriction relating to any such shares, or
 - (iii) the variation or removal of a restriction to which any such shares are subject.
- (3) This subsection applies to an alteration of the share capital of the relevant company if the effect of the alteration is to increase the market value of the shares to which the option relates and either—
 - (a) it is not made by the relevant company for commercial reasons, or
 - (b) the main purpose (or one of the main purposes) for making it is to increase the market value of those shares.
- (4) In this section any reference to—
 - (a) a restriction relating to shares or to which shares are subject, or
 - (b) a right relating to shares,is a reference to such a restriction imposed or right conferred by any contract or arrangement or in any other way.

538 Share conversions excluded for purposes of section 536

- (1) This section has effect for the purposes of section 536(1)(d) (other disqualifying events: share conversions).
- (2) A conversion of shares is not a disqualifying event if—
 - (a) it is a conversion of shares of one class only (“the original class”) into shares of one other class only (“the new class”);
 - (b) all the shares of the original class are converted into shares of the new class; and
 - (c) one of the conditions in subsection (3) is met.
- (3) The conditions are—
 - (a) that immediately before the conversion the majority of the relevant company’s shares of the original class are held otherwise than by or for the benefit of—
 - (i) directors or employees of the relevant company,
 - (ii) an associated company of the relevant company, or
 - (iii) directors or employees of such an associated company;
 - (b) that immediately before the conversion the relevant company is employee-controlled as a result of holdings of shares of the original class.
- (4) In this section “associated company”, “director”, “employee” and “employee-controlled” have the same meaning as in section 440 (exception from tax charge where conversion of entire class of shares).

539 CSOP and other options relevant for purposes of section 536

- (1) This section has effect for the purposes of section 536(1)(e) (other disqualifying events: grant of CSOP option).
- (2) A “relevant CSOP option” means a CSOP option granted to the employee by reason of the employee’s employment—
 - (a) with the employer company, or

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- (b) if it is a member of a group of companies, with any member of that group.
- (3) A share option is an “employee option” if it is—
- (a) the qualifying option mentioned in section 536(1), or
 - (b) another qualifying option granted to the employee by reason of the employee’s employment as mentioned in subsection (2)(a) or (b) above, or
 - (c) a relevant CSOP option.
- (4) In this section a “CSOP option” means an option to acquire shares under a scheme approved under Schedule 4 (CSOP schemes).

Tax advantages: taxable benefits

540 No charge on acquisition of shares as taxable benefit

- (1) In its application in relation to a UK resident employee, Chapter 8 of Part 3 (taxable benefits: notional loans in respect of acquisitions of shares) does not apply in relation to the acquisition of shares by the exercise of a qualifying option.
- (2) An employee is a “UK resident employee” if—
- (a) at the time when the option is granted, or
 - (b) at the time when it is exercised,
- the earnings from the employment are (or would be if there were any) general earnings to which section 15 or 21 applies (earnings for year when employee resident and ordinarily resident in the United Kingdom).

Other income tax consequences

541 Effects on other income tax charges

- (1) Nothing in the EMI code affects—
- (a) any liability to income tax arising by virtue of section 199 (charge on disposal of employment-related shares for more than market value) in respect of shares acquired under a qualifying option;
 - (b) any liability to income tax arising by virtue of section 476 (charge on exercise etc. of option by employee) in respect of the release of rights conferred by a qualifying option;
 - (c) any liability to income tax arising by virtue of section 449, 453 or 457 (charge on post-acquisition benefits relating to shares) in respect of shares acquired under a qualifying option; or
 - (d) subject to subsection (2), any liability to income tax arising by virtue of—
 - (i) section 427 (charge on interest in shares ceasing to be only conditional), or
 - (ii) section 438 (charge on conversion of shares),
 in respect of shares acquired under a qualifying option.
- (2) If section 427 or 438 applies in respect of shares acquired under a qualifying option, the amount of relief on the exercise of the option is to be regarded as a deductible amount for the purposes of section 428(1) or 439(1) (amount of charge), as appropriate.
- (3) “The amount of relief on the exercise of the option” means the difference between—

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- (a) the amount that would have counted as employment income by virtue of section 476 in respect of the exercise of the option apart from the EMI code, and
- (b) the amount (if any) that in fact counts as such income in accordance with the EMI code.