These notes refer to the Finance Act 2010 (c.13) which received Royal Assent on 8 April 2010

FINANCE ACT 2010

EXPLANATORY NOTES

INTRODUCTION

Section 42: Approved Share Incentive Plans

Summary

1. Section 42 counters avoidance arrangements which exploit the corporation tax (CT) reliefs available to approved Share Incentive Plans (SIPs). The avoidance involves companies making corporation tax-deductible payments to SIP trustees, for them to buy shares from existing shareholders for use in the SIP. However, few if any shares with real value are ever issued to employees under the SIP. Transactions by the company altering the share capital or rights attaching to SIP shares have the effect of stripping away the value of shares held in the SIP trust.

2. This section amends the current legislation, so that CT deductions will not be available where a payment to SIP trustees is made as part of tax avoidance arrangements, where the main purpose or one of the main purposes of the company making the payment is to obtain the CT relief.

3. It also closes potential loopholes in the provisions allowing HM Revenue & Customs (HMRC) to withdraw approval of a SIP where there are no participants in the SIP, or where no shares have been awarded under the SIP, at the time when alterations are made to the company's share capital or to rights attaching to its shares, or when differences in the treatment of shares within a class of shares occur.

4. The changes will have effect in relation to payments made, alterations to share capital or rights attaching to shares taking place, and differences in the treatment of shares within a class of shares occurring, on or after 24 March 2010.

Details of the Section

5. Subsection (1) introduces amendments to the provisions for SIPs in Schedule 2 (Approved Share Incentive Plans) to the Income Tax (Earnings and Pensions) Act 2003 (ITEPA).

6. Subsection (2) amends paragraph 84(1) of Schedule 2, which sets out various "disqualifying events" allowing HMRC to withdraw approval of a SIP. It substitutes a revised provision for the current sub-paragraph (d), which is concerned with alterations to the share capital of a company or to the rights attaching to a company's shares that materially affect the value of SIP shares.

7. The key element of the new sub-paragraph (d) is that it applies to alterations materially affecting the value of shares "that are subject to the plan trust". This puts it beyond doubt that the provision is effective even if no shares have been appropriated to participants under the SIP at the time the alterations occur.

8. Subsection (3) amends sub-paragraph (e) of paragraph 84(1), which is concerned with SIP shares receiving different treatment from other shares of that class. The condition that shares "have been awarded to participants" is replaced by "are subject to the plan

trust". This puts it beyond doubt that there is a disqualifying event even if no shares have been awarded to participants under the SIP at the time the difference in treatment occurs.

9. Subsection (4) introduces amendments to section 989 of the Corporation Tax Act 2009 (CTA), which sets out the conditions for companies to receive CT deductions for payments made to SIP trustees to acquire shares for use in the SIP.

10. Subsection (5) inserts a new paragraph (aa) in section 989(1). A further condition for a CT deduction to be allowed is that the payment is not made as part of "tax avoidance arrangements".

11. Subsection (6) inserts new subsections (6A) and (6B) in section 989. These explain the meaning of "tax avoidance arrangements" in the new section 989(1)(aa).

12. New subsections (6A) and (6B) provide that a payment is made as part of "tax avoidance arrangements" if it is made as part of arrangements entered into by the paying company, and the main purpose, or one of the main purposes, of the company in entering into the arrangements was to obtain a deduction or increased deduction for CT. The term "arrangements" is given a wide meaning.

13. Subsections (7) and (8) provide for the amendments made by subsections (1) to (3) of the section have effect in relation to events taking place on or after 24 March 2010, and those made by subsections (4) to (6) to have effect in relation to payments made on or after that date.

Background Note

14. SIPs are tax-advantaged employee share schemes that allow employees to obtain shares in the company they work for (or, in the case of a group scheme, shares in the parent company of their employing company). Subject to limits, employees may receive shares free of charge; they may use their own money to buy shares; or there may be a combination of free and bought shares. If the shares are held in the SIP for five years, there is no income tax or National Insurance contributions liability for employees.

15. Section 989 of CTA allows a CT deduction where (subject to conditions) a company pays money to the trustees who operate the SIP, for them to acquire shares from non-corporate shareholders for use in the plan. HMRC may withdraw the deduction (under section 990 of CTA) if shares are not appropriated to employees under the SIP within certain time limits - 30 per cent of the shares within five years of their acquisition and 100 per cent within 10 years.

16. Some companies are using avoidance arrangements involving a SIP to obtain a CT deduction for money paid to SIP trustees, where it is clear that they have no intention of passing shares with real value to their employees under the SIP.

17. These avoidance arrangements involve companies entering into transactions which alter the share capital or the rights attached to the shares, with the effect of stripping away the value of shares held in the SIP trust.

18. The amendments under this section will allow HMRC to deny the CT deduction if it was the main purpose or one of the main purposes of the company making the payment to obtain the deduction. This will apply in those cases where there is evidence that the company was involved in avoidance arrangements of this type. It will not affect companies (the great majority) that make payments to SIP trustees with the intention of genuinely providing shares to their employees under the SIP.

19. The section also ensures that HMRC can withdraw approval of the SIP where 'value shifting' transactions involving the company's share capital or the rights attaching to the shares materially affect the value of participants' plan shares. This change is a limited one, designed to put it beyond doubt that approval may be withdrawn even where there

are no participants in the SIP, or where no shares have been awarded under it, at the time the transactions take place.