

# FINANCE ACT 2014

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## EXPLANATORY NOTES

### INTRODUCTION

#### *Section 290 & Schedule 37: Companies Owned by Employee-Ownership Trusts*

#### Summary

1. This section and Schedule introduce a relief from capital gains tax and an exemption from income tax relevant to the creation and operation of legal structures in which a trading company is owned by a particular sort of trust for the benefit of employees.
2. Part 1 of the Schedule introduces a relief from capital gains tax on disposals of shares in a trading company or in the parent company of a trading group. The disposals must be made to a trust with specified characteristics, and the trustees must hold a defined controlling interest in the company at the end of the tax year for which the relief is claimed. The trustees must apply the trust's property for the benefit of all the eligible employees of the company (or, as the case may be, the group headed by the company).
3. Part 2 of this Schedule introduces an exemption from income tax for up to £3,600 per employment on a qualifying bonus payment in any tax year. The qualifying bonus payment must be one made to its employees (and any qualifying former employees) by a company which is owned directly or indirectly by a trust of the type specified in Part 1 at the time of the payment and which meets the qualifying conditions. A qualifying bonus payment will be an award other than regular salary or wages that is paid to all employees of the company (or the group of which it is a member) on equal terms, although bonus amounts can be set by reference to a percentage of salary or length of service or hours worked.
4. Part 3 of this Schedule makes amendments to inheritance tax provisions to support the creation and operation of the trust. It ensures that transfers to the trust and the trust itself are exempt from inheritance tax charges in cases where the conditions for the existing exemptions which apply to employee benefit trusts are not met.
5. Part 4 of this Schedule makes miscellaneous amendments consequent upon Parts 1-3.

#### Details of the Schedule

##### **Part 1: capital gains tax relief**

6. Part 1 of the Schedule makes changes to the Taxation of Chargeable Gains Act 1992 (TCGA 1992) to introduce a relief from capital gains tax on disposals of shares in a trading company or in the parent company of a trading group. The disposals must be made to a trust with specified characteristics, and the trustees must hold a defined controlling interest in the company at the end of the tax year for which the relief is claimed. The trustees must apply the trust's property for the benefit of all the eligible employees of the company (or, as the case may be, the group headed by the company).
7. Paragraph 1 inserts new sections 236H to 236U into TCGA 1992.

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8. Subsection (1) of new section 236H summarises the circumstances in which the section applies and relief is due. It refers to the relief requirements which are described more fully in subsection (4).
9. Subsections (2) and (3) of new section 236H override the 'market value rule' which would normally apply, and instead require that the consideration received by the person disposing of the shares and given by the trust acquiring the shares be taken to be an amount which results in no gain and no loss arising on the disposal.
10. Subsection (4) of new section 236H introduces five 'relief requirements' all of which must be met in order for the capital gains tax relief to be due. Four of these requirements are described in detail in other new sections of the TCGA:
  - The trading requirement must be met by the company whose shares are acquired by the trustees at the time of the disposal and until the end of the tax year in which that disposal is made: see new section 236I, paragraph 15 below.
  - The all-employee benefit requirement must be met by settlement the trustees of which acquire the shares, see new sections 236J, 236K and 236L, paragraphs 19, 26 and 29 below.
  - The controlling interest requirement must also be met by that settlement, see new section 236M, paragraph 34 below.
  - The limited participation requirement is an anti-avoidance provision, referring to the shareholders and other participators in the company, see new section 236N, paragraph 36 below.
11. Subsections (4)(e) and (6) of new section 236H contain the fifth relief requirement. This is that neither the claimant nor anyone connected with him has received relief under section 236H in an earlier year on a disposal of either shares in the same company or shares in a company which was at that time a member of the same group as the company whose shares are the subject of the present claim.
12. Subsection (5) of new section 236H explains how the alternative mechanism alternative mechanism at section 236L, by which a settlement may be treated as meeting the all-employee benefit requirement, works for the purposes of the relief requirements in section 236H(4). A settlement which ceases to meet the conditions of the all-employee benefit requirement cannot rely on section 236L (ie on the behaviour of its trustees and other factors) to ensure that it is treated as continuing to meet that requirement, and hence meet the relevant relief requirement. Likewise, a settlement which was treated as meeting the all-employee benefit requirement by virtue of section 236L but later came to actually meet it by virtue of satisfying the conditions of section 236K cannot revert to relying on section 236L in order to meet it and hence meet the relevant relief requirement.
13. Subsection (7) of new section 236H requires the claimant to supply certain information to HMRC with any claim, to allow HMRC to check the validity of the claim.
14. Subsection (8) of new section 236H directs the reader to new section 236O where there are further conditions relevant to making a claim to relief under section 236H, and provisions for relief given to be withdrawn in certain circumstances.
15. New section 236I provides details of the trading requirement which must be met by the company ('C') whose shares are acquired by the trust. If C is not in a group then it must be a trading company. Otherwise C must be the parent company of a trading group.
16. Subsection (2) of new section 236I defines a trading company: C may be a trading company even if it carries on some non-trading activities, providing those activities are not substantial in relation to all its activities taken together.

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17. Subsection (3) of new section 236I defines a trading group: at least one member of the group must carry on a trade and the activities of all the members taken together must not include to a substantial extent activities which are either non-trading or unrelated to the trade of another group member.
18. Subsection (5) of new section 236I provides for all the activities of the members of a group to be treated as one business and for businesses carried on by a company in its capacity as a member of a partnership not to be treated as trading activities or related to the trade of another group member. The latter is to ensure that control of the company by the trustees carries with it control of the company's business: if the company is in a partnership it is not generally possible to say that it controls the partnership's business. In this context, 'partnership' takes its meaning from the Partnership Act 1890 and the Limited Partnerships Act 1907. Members of limited liability partnerships may also be treated as partners for the purposes of the TCGA 1992.
19. New section 236J provides details of the all-employee benefit requirement which must be met by the settlement whose trustees acquire the shares in company 'C'. Subsection (1) says that the settlement meets the requirement if the trusts
  - Only permit the settled property to be used for the benefit of all 'eligible employees' on the same terms (this is the equality requirement - see section 236K).
  - Do not permit the trustees to create any sub trusts, to transfer property to the trustees of any other settlement (except by means of an 'authorised transfer', defined at subsection (7), which is effectively a transfer to a trust which itself will be an EOT immediately after the transfer).
  - Do not permit the trustees to make loans to beneficiaries of the trust.
  - Do not permit the trustees or anyone else to amend the trusts so that any of these restrictions are removed.

If a settlement does not satisfy these conditions, it will nonetheless be treated as meeting the all-employee benefit requirement if it, the trusts and the trustees satisfy the alternative conditions at section 236L (see paragraph 29 below).
20. Subsections (3) and (4) of new section 236J define the 'eligible employees' who must be beneficiaries of the trust. Subject to the exceptions described in subsection (5), every employee of C and (where C is the parent company of a group) every employee of every member of the group headed by C is an eligible employee. The parent company of a group is a member of that group. If the trusts permit office-holders as well as employees to be beneficiaries then all the office-holders who may be beneficiaries are treated as eligible employees for the purposes of this section.
21. Subsection (4) of new section 236J provides a special definition of eligible employee in cases where C has ceased to meet the trading requirement (see section 236I) or where the trustees no longer hold any shares in C: in order to permit equitable distribution of the trust's property in these circumstances, 'eligible employees' will include individuals who were eligible employees at any time in the two years immediately preceding either the disposal of C's shares or C ceasing to meet the trading requirement (whichever is the earlier).
22. Subsection (5) of new section 236J lists individuals who are 'excluded participators', and as such cannot be eligible employees for the purposes of subsections (3) and (4). These individuals may therefore not be beneficiaries of the settlement, though they may be eligible to receive qualifying bonus payments (see paragraph 68 below). An individual is an excluded participator if he or she:
  - Is a participator in C or in any company which is a member of the group of which C is the parent (the parent company of a group is a member of that group).

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- Is a participator in a close company which has transferred property to the trustees of the settlement and that transfer would have given rise to an inheritance tax charge but for the exemption in section 13 or new section 13A of the Inheritance Tax Act 1984 (see paragraph 99 below).
- Has been a participator in any of those companies during the ten years before either the creation of the settlement or 10 December 2013, whichever is the later, or
- is connected with any participator identified under the preceding rules in this subsection. (In this context, ‘connected with’ takes its meaning from section 286 TCGA 1992, and is extended to include uncles, aunts, nephews and nieces. See section 236U(3), paragraph 54 below).

For these purposes, ‘participator’ has a restricted meaning - see subsection (6) at paragraph 23 below.

23. Subsection (6) of new section 236J applies a special definition of ‘participator’ for the purposes of deciding whether a person is an excluded participator. A person who does not own, or is not entitled to acquire, 5% or more of any class of share in a company and who would not be entitled to 5% or more of the company’s assets available for distribution to members on its winding-up is not treated as a participator and therefore cannot be an excluded participator.
24. Subsection (7) of new section 236J defines terms used in this section such as ‘authorised transfer’, ‘relevant group company’, ‘close company’ and ‘relevant group company’.
25. Subsection (8) of new section 236J ensures that the restrictions on how the settled property of the trust may be applied refer also to income arising from that property.
26. New section 236K explains the ‘equality requirement’ which is introduced as an element of the all-employee benefit requirement by section 236J(1). This ensures that, with a few specific exceptions, every eligible employee benefits from the trust’s income and property, though they need not benefit by exactly the same amounts.
27. Subsections (1) and (2) of new section 236K list five things the trustees may be permitted or prevented by the trusts from doing, without jeopardising the equality requirement’s being met. The trusts may:
  - Permit the trustees to apply settled property for the benefit of a surviving spouse, civil partner or dependant of an eligible employee who has died for up to 12 months after the death (or such shorter period as the trusts may provide), as if the recipient were that eligible employee.
  - Permit the trustees to comply with a written request from an individual not to receive the benefit of the settled property.
  - Permit the trustees to apply settled property for charitable purposes as well as for the benefit of eligible employees.
  - Prevent the trustees from applying settled property for the benefit of individuals who have not been continuously employed by the company or by the group for a minimum period (not exceeding 12 months) preceding the payment.
  - Prevent the trustees from applying settled property for the benefit of individuals who only qualify as eligible employees because they are office-holders in the company.

For these purposes, ‘eligible employee’ has the same meaning as in section 236J and ‘settled property’ includes the income arising from such property.

28. Subsections (3) (4) (5) and (6) of new section 236K permit differing amounts to be paid to eligible employees on certain specific grounds, notwithstanding the equality

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requirement, but not so that some employees receive nothing at all. An individual's benefit from the trust may be computed by reference to his or her remuneration, length of service, or hours worked, but entitlement on account of each factor must be computed separately and the total payment must be sum of such relevant components. These specific grounds are separate from and in addition to the freedoms which may be permitted the trustees under subsections (1) and (2).

29. New section 236L provides an alternative mechanism by which some existing settlements created before 10 December 2013 (when the draft legislation was published) may meet the all-employee benefit requirement at section 236J. This alternative mechanism can only apply where the trust cannot meet the all-employee benefit requirement on the terms of section 236J.

30. Subsection (1) of new section 236L states the conditions which must be met for this alternative mechanism to apply and for the settlement to be deemed to meet the all-employee benefit requirement. The principal conditions are that on 10 December 2013:

- The trusts of the settlement must be of a description specified in section 86 Inheritance Tax Act 1984 (trusts for the benefit of employees), and
- the trustees held a significant interest in the company which they would later control: see subsection (2) and paragraph 34 below.

In addition, the trustees of the settlement must act throughout the 12 months preceding the disposal of shares to the trustees of that settlement in respect of which CGT relief is claimed under section 236H as though the trusts of their settlement met the terms of the all-employee benefit requirement at section 236J(1)(c) (this is the 'the behaviour requirement').

31. Subsection (2) of new section 236L gives more detail about the 'significant interest' which the trustees must hold at 10 December 2013 in order for section 236L to apply. The definition is based closely on the 'controlling interest requirement' at section 236M - see paragraph 34 below - but requires the trustees to have a shareholding of 10% or more in the company which the trustees directly control. There are special rules at new section 236T (paragraph 65 below) to prevent trustees failing these conditions as a result of certain common commercial provisions.

32. Subsections (3) to (9) of new section 236L support the behaviour requirement by applying relevant definitions from new section 236J (the all-employee benefit requirement) and defining what is and is not compliant behaviour in terms consistent with section 236K (the equality requirement) (see paragraphs 26-28 above).

33. Subsection (4) contains provisions corresponding to those in subsection (1) of section 236K. Subject to the terms of the trusts of the settlement, the trustees may do the following without infringing the behaviour requirement:

- Apply settled property for the benefit of a surviving spouse, civil partner or dependant of an eligible employee who has died for up to 12 months after the death (or such shorter period as the trusts may provide), as if the recipient were that eligible employee.
- Comply with a written request from an individual not to receive the benefit of the settled property.
- Apply settled property for charitable purposes as well as for the benefit of eligible employees.
- Apply settled property only for the benefit of individuals who have been continuously employed by the company or by the group for a minimum period (not exceeding 12 months) preceding the payment.

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- Not apply settled property for the benefit of individuals who only qualify as eligible employees because they are office-holders in the company, provided this is because the trustees are prevented by the trusts from doing so.

For these purposes, 'eligible employee' has the same meaning as in section 236J and 'settled property' includes the income arising from such property.

34. New section 236M provides details of the controlling interest requirement which must be met by the settlement, trustees of which acquire the shares in company 'C', at the end of the tax year in which the relevant disposal is made and which may not cease to be met once it has begun to be met. The requirement has three conditions, each of which must be satisfied, plus a fourth general condition which ensures the continuation of the controlling interest. There are special rules at new section 236T (paragraph 65 below) to prevent trustees failing these conditions as a result either of certain common commercial provisions, or provisions which are often found in trust deeds. For the purposes of the controlling interest requirement, Chapter 6 of Part 5 of the Corporation Tax Act 2010 applies to give the meaning of terms such as 'equity holder' (see new section 236T).

35. Subsection (1) of new section 236M requires the trustees:

- To hold a majority of the ordinary share capital of C and that they also have voting powers which represent a majority of votes on questions affecting C as a whole.
- to be entitled to a majority of the profits available for distribution to equity holders of C, and
- to be entitled to a majority of C's assets available for distribution to equity holders in the event of C's winding-up.

Even if the three conditions above are met, subsection (1)(d) provides that the controlling interest requirement will not be met if there are any provisions in any agreement or document affecting C's constitution or management or its shares or securities, for any of the conditions to cease to be met without the consent of the trustees. New section 236T (paragraph 65 below) ensures that trustees do not fail to meet these conditions as a result either of certain common commercial provisions, or provisions which are often found in trust deeds.

36. Subsection (1) of new section 236N explains the limited participation requirement. It will be met if there was no time during the year ending immediately after the disposal when the claimant was a participator in the company C and at that time the 'participator fraction' exceeded  $\frac{2}{5}$  (see subsection (5)). In this context 'participator' has a special meaning given at subsection (6).

37. Subsection (4) of new section 236N permits a 'grace period' of up to six months during which the participator fraction may exceed  $\frac{2}{5}$  without the limited participation requirement being failed on that account. In order for this treatment to apply, the fraction must exceed  $\frac{2}{5}$  as a result of events beyond the reasonable control of the trustees, such as sudden changes in commercial circumstances.

38. Subsection (5) of new section 236N defines the 'participator fraction'. The numerator NP is the total of (i) the number of persons who are both participators in C and either employees of, or office-holders in, C and (ii) the number of persons who are both employees of, or office-holders in C (or, as the case may be, of any member of the group headed by C) and connected with anyone included in (i). The denominator NE is the total number of persons who are employed by C (or as the case may be, the group headed by C) immediately after the disposal. In this context 'participator' has a special meaning given at subsection (3). For these purposes, the meaning of 'connected' is given by section 236U, see paragraph 70 below.

39. Subsections (6) and (7) of new section 236N define 'participator' for the purposes of the limited participation requirement. The meaning is as given by section 454 of the

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Corporation Tax Act 2010, but it does not include any person who does not hold, or is not entitled to acquire, five percent or more of any class of C's share capital and who is also not entitled to five percent or more of C's assets available for distribution to its members on a winding-up. Where the word is used in connection with a company which is not a close company, 'participator' includes a person who would be a participator in the company if it were a close company.

40. New section 236O withdraws relief already given and prevents further claims to relief when specified events occur before the end of the tax year following the tax year in which the disposal is made.
41. Subsection (1) of new section 236O states that the section applies when a disposal has been made on which relief under section 236H is available, whether or not a claim to relief has in fact been made, and when subsequent to such a disposal a 'disqualifying event' occurs in the tax year following the year in which the disposal occurs.
42. Subsection (2) of new section 236O defines 'disqualifying events' for the purposes of subsection (1).
43. Subsection (3) of new section 236O states that where the section applies no claim for relief may be made on or after the day of the disqualifying event in respect of the disposal.
44. Subsection (4) of new section 236O states that any claim for relief which has been made before the disqualifying event is revoked, and the gains or losses of any person for any period are computed as though that claim had never been made.
45. Subsection (6) of new section 236O explains how the alternative mechanism at section 236L, by which a settlement may be treated as meeting the all-employee benefit requirement, works for the purposes of the disqualifying events rules. Section 236H(5) applies in this context as it does for section 236H(4)(b): section 236L (which provides for the all-employee benefit requirement to be treated as met in certain circumstances) cannot be relied upon to prevent there being a disqualifying event where the all-employee benefit requirement has previously actually been met.
46. Subsection (7) of new section 236O explains how the disqualifying event concerning the participator fraction works. The rule at section 236N(2) applies in this context. There is normally a disqualifying event if the fraction exceeds 2/5. However, there is a 'grace period' of up to six months during which the fraction may exceed 2/5 without there being a disqualifying event on that account. In order for this treatment to apply, the fraction must exceed 2/5 as a result of events beyond the reasonable control of the trustees, such as sudden changes in commercial circumstances
47. New section 236P makes provisions for gains or losses to accrue to the trustees on the occurrence of a 'disqualifying event' after the end of the tax year following that in which the relieved disposal took place. Disqualifying events largely correspond to the relief requirements in 236H ceasing to be met at a time after a disposal to the trust in respect of which relief has been given on a disposal to the trust.
48. Subsection (2) of new section 236P lists the disqualifying events. These are that:
  - The company C ceases to meet the trading requirement, or
  - the settlement ceases to meet the all-employee benefit requirement,
  - the settlement ceases to meet the controlling interest requirement; or
  - the participation fraction exceeds 2/5 (subject to a six month grace period, as for the limited participation requirement in section 236N),
  - the trustees act in a way contrary to what is permitted by the all-employee benefit requirement.

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49. Subsection (3) of new section 236P directs that when a disqualifying event occurs, the trustees are treated as disposing of the shares they hold in C immediately before that event and reacquiring the same shares for their then market value. This deemed disposal and reacquisition applies only to shares acquired in circumstances where CGT relief was given under section 236H, and to which this section has not applied before. Gains and losses latent in the shares concerned will accrue and may be taxed or relieved subject to the relevant provisions of the Taxes Acts.
50. Subsection (4) of new section 236P provides special rules for deciding whether a settlement has ceased to meet the all-employee benefit requirement. A settlement which ceases to meet the conditions of section 236K cannot rely on section 236L (i.e. on the behaviour of its trustees and other factors) to ensure that it continues to meet the all-employee benefit requirement. Likewise, a settlement which originally met the requirement by virtue of section 236L but later came to meet it by virtue of meeting the conditions of section 236K cannot revert to relying on section 236L without triggering a disqualifying event.
51. Subsection (5) of new section 236P ensures that the limited participation requirement at section 236N works properly for the purposes of identifying disqualifying events under section 236P.
52. New section 236Q contains special provisions which apply when trustees of a settlement (the acquiring settlement) become entitled to shares in a company which is settled property against the trustee of that property in another settlement (the transferring settlement). Section 71 of TCGA 1992 provides for a disposal and reacquisition to be deemed to occur on that event by the trustees of the transferring settlement, and section 236Q ensures that the trustee of the transferring settlement may claim relief on the deemed disposal, subject to the same conditions as apply on actual disposals of shares to a trust.
53. Subsections (2) and (3) of new section 236Q allow the relief in the same way as section 236H where section 236Q applies.
54. Subsection (4) of new section 236Q ensures that the provisions of section 236P (concerning the consequences of disqualifying events) apply to the acquiring settlement where section 236Q applies, by treating the acquisition as one made in circumstances where section 236H applies.
55. Subsection (5) of new section 236Q ensures that the terms of sections 236H to 236T are applicable to the acquiring settlement.
56. Subsection (6) of new section 236Q requires the claimant to supply certain information to HMRC with any claim, to allow HMRC to check the validity of the claim. This requirement corresponds to section 236H(7).
57. Subsection (7) of new section 236Q directs the reader to new section 236R where there are further conditions relevant to making a claim to relief under section 236Q, and provisions for relief given to be withdrawn in certain circumstances.
58. New section 236R withdraws relief already given under section 236Q and prevents further claims to relief when specified events occur before the end of the tax year following the tax year in which the deemed disposal under section 71 is treated as made. It is a counterpart to new section 236O.
59. Subsection (1) of new section 236R states that the new section applies when a deemed disposal has arisen on which relief under section 236Q is available, whether or not a claim to relief has in fact been made, and when subsequent to such a disposal a 'disqualifying event' occurs in the tax year following the tax year in which the deemed disposal is treated as made.



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60. Subsection (2) of new section 236R states that where the section applies no claim for relief may be made on or after the day of the disqualifying event in respect of the disposal.
61. Subsection (3) of new section 236R states that any claim for relief which has been made before the disqualifying event is revoked, and the gains or losses of any person for any period are computed as though that claim had never been made.
62. Subsection (4) of new section 236R ensures that HMRC may make any and all adjustments necessary to give effect to a revocation of a claim under subsection (3).
63. Subsection (5) of new section 236R explains what is meant by a 'disqualifying event' for the purposes of section 236R. The definition in section 236O is used, with minor modifications necessary to make it applicable to the circumstances in which section 236Q has applied.
64. New section 236S applies where trustees hold both shares in respect of which the CGT relief applied on acquisition (known as EOT exempt shares) and other shares which would be treated as of the same class but for section 104(4A) (see paragraph 125 below). In these cases, when they make a disposal, the trustees may determine what proportion of the shares disposed of are EOT exempt shares (subject to their holding sufficient EOT exempt shares prior to the disposal). This prevents the trustees' gain or loss being distorted by the acquisition cost deemed to apply to the EOT exempt shares. However, the trustees may not use this provision to mitigate the effect of a disposal deemed to take place on a disqualifying event under section 236P.
65. New section 236T provides further rules which apply when deciding whether trustees have the necessary interest in a company for the purposes of the controlling interest requirement at section 236M or for the behaviour requirement at section 236L(2).
66. Subsection (2) of new section 236T applies the relevant part of the Corporation Tax Act 2010 for the purposes of identifying equity holders, ordinary shares etc.
67. Subsection (3) of new section 236T says that when ascertaining the trustees' interest they are to be treated as entitled to dividends on shares which they hold even if they are required or permitted to waive the dividends on those shares.
68. Subsections (4) and (5) of new section 236T allow trustees to use their shares in company C as security for borrowing from third parties. Without this provision, the mere possibility that the trustees could involuntarily lose control of their shares (in the event of a default) could prevent the controlling interest requirement in section 236M or the significant condition in section 236L being met the behaviour requirement from applying. However in the event that the trustees do actually lose control of the shares under such an arrangement, the controlling interest requirement will cease to be met.
69. Subsection (5) of new section 236T defines the terms 'close company' and 'participator' for the purposes of the section. It also gives a special definition of 'third party' which excludes persons who are or have in the preceding 12 months been a participator in the employee-owned company controlled by the trustees, and persons connected with them.
70. New section 236U defines 'company', 'ordinary share capital' and 'trade' as they are used in sections 236H to 236T. It also provides for references to a group, to membership of a group and to the principal company of a group to be read in a manner consistent with their definitions in section 170 TCGA 1992. References to a group are to be construed with any necessary modifications where applied to a company which is not incorporated in the UK. This section also applies section 286 TCGA for the purposes of deciding whether one person is 'connected with' another, subject to the definition of a relative used in that section being extended to include uncle, aunt, nephew and niece.
71. Paragraph 2 of Part 1 of the Schedule provides for the relief to have effect in relation to disposals made in tax year 2014-15 or later years, subject to paragraph 3.

72. Paragraph 3 of Part 1 of the Schedule ensures that disposals which took place on or after 6 April and before 26 June 2014 are not subject to the rules for the withdrawal of relief on the occurrence of a disqualifying event, but are instead subject to special rules. In summary, in these cases a disqualifying event causes a gain or loss to accrue to the trustees of the settlement, based on a deemed disposal and reacquisition of shares at their market value immediately after the event.
73. Paragraph 3 of Part 1 of the Schedule creates special rules which apply to disposals made on or after 6 April and before 26 June 2014. The effect is that these disposals are subject to the rules as originally published in the Finance Bill in March 2014. Specifically, claims to relief in respect of such disposals will not be revoked if there is a disqualifying event:
- The relief requirements in section 236H are modified in relation to these disposals.
  - The limited participation requirement at section 236N is also modified.
  - Section 236O and section 236R, which revoke or prevents a claim to relief when there has been a disqualifying event in the tax year following the tax year in which the disposal is made, will not apply.
  - Section 236P, which deems a gain or loss to accrue to the trustees when a disqualifying event occurs, applies, subject to the event taking place at a specified time.
74. Paragraph 4 of Part 1 of the Schedule refers to the means by which a settlement may be deemed to meet the all-employee behavioural requirement through new section 236L(1) (c) (paragraph 29 above). It provides for the trustees' actions before 10 December 2013 to be disregarded when deciding whether the all-employee behavioural requirement may be deemed to be met for the purpose of determining whether the CGT relief is available (but not for determining whether the income tax exemption is available as mentioned in Part 2).

## **Part 2: employment income exemption**

75. Paragraph 5 of Part 1 of the Schedule inserts new Chapter 10A to Part 4 of the Income Tax (Earnings and Pensions) Act 2003, which contains the following provisions.

### **New Section 312A**

76. New subsection (1) provides that the income tax exemption applies to qualifying bonus payments made in a tax year to employees or former employees of a company.
77. New subsection (2) sets the maximum amount of the qualifying bonus payment that is exempt from income tax (the "exempt amount") at £3,600.
78. New subsection (3) provides that, where an employee receives a qualifying bonus from more than one employer in a tax year, the exempt amount in subsection (2) applies separately to the total payments made by each employer.
79. New subsection (4) provides an exception to subsection (3). Where an employee or former employee receives a bonus from two or more employers who first make a bonus payment when they are part of the same group, the exempt amount applies to the total amount of the bonuses received from all employers in the group, instead of applying separately in relation to each employer.
80. New subsection (5) provides that where an employee has received a qualifying bonus from a company which was a member of a group of companies at the time it first made a payment for the year, that employer will be treated as remaining a member of the group until the end of that tax year even if it subsequently leaves the group. This is relevant in determining if the aggregate of qualifying bonus payments received in a tax year from the group exceeds the exempt amount (see subsection (4) above).

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81. New subsection (6) sets out how the exempt amount should be applied when more than one qualifying bonus is received in the same tax year by an employee. It provides that the exempt amount should be applied to each bonus in the order they were made to determine if and when the exempt amount has been exceeded.
82. New subsection (7) explains how the exempt amount should be applied when two (or more) qualifying bonuses are made on the same day. It provides that the exempt amount (or the unused amount of the exempt amount) should be shared equally between each of the payments received on the same day.
83. New subsection (8) provides that where a qualifying bonus is paid by different employers (who are not members of the same group) ordering rules in subsections (6) and (7) apply separately.
84. New subsection (9) provides an Order-making power enabling the Treasury to increase or reduce the exempt amount. However, where the amount is to be reduced, new subsection (10) specifies that the draft statutory instrument must be laid before and approved by the House of Commons.
85. New subsection (11) defines the term “chargeable amount” as being the amount of the bonus payments that would have been taxable if not for the exemption. This term is referred to in subsection (2).

### **New Section 312B**

86. New subsection (1) introduces all the conditions which must be met for a payment to be a qualifying bonus payment, and, where necessary, cross-references the sections in which detail of how those conditions apply is provided for.
87. New subsection (2) provides that the qualifying period is the 12 months ending with the day on which the payment is made. However, new subsection (3) specifies two situations where the qualifying period may not be the full 12 months. Paragraph (a) provides that the qualifying period does not include any days before the settlement first met the all-employee benefit requirement as defined in section 236J of TCGA 1992. Paragraph (b) provides that the qualifying period does not include any days prior to the date when the settlement first met the controlling interest requirement provided for in section 236M of TCGA 1992.
88. The ‘office holder’ condition set out in subsection (1)(e) specifies that the condition must be met for “a requisite number of days”, which recognises that in some cases, for reasons beyond the employer’s control, the condition might not be met. New subsection (4) defines this term as the number of days in the qualifying period less 90 days. Where the qualifying period is shorter than 12 months by virtue of new subsection (3) the requisite number of days is the number of days in the qualifying period, less the corresponding fraction of 90 days.

### **New Section 312C**

89. New subsection (1) provides the detail of the participation and equality requirements which form one of the conditions set out in section 312B(1). For a bonus scheme to meet the participation requirement all persons in relevant employment must be eligible to be awarded a bonus under the scheme. Paragraph (b) provides that to meet the equality requirement every employee who is awarded a bonus under the scheme must do so on the same terms. That does not mean they must necessarily be awarded the same amount.
90. New subsection (2) defines when a person is in “relevant employment”. This is when the person is employed by the company paying the bonus or where the company paying the bonus is a member of a group, the person is employed by any company which is a member of the group.

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91. New subsection (3) sets out an exception to the participation requirement. It permits employers to exclude employees from the bonus award if those employees have less than a specified minimum period of continuous service at the time of the award which can be no longer than 12 months.
92. New subsection (4) provides for further exceptions to the participation requirement in respect of employees subject to a finding of gross misconduct or summary dismissal. Paragraph (a) provides that where a finding of gross misconduct has been made in the period 12 months immediately before the bonus is determined, the employee can be excluded from participating in the award. Paragraph (b) allows the award of a bonus to be conditional if at the time it is determined the employee is subject to disciplinary proceedings, depending on the outcome. Finally, paragraph (c) provides that if disciplinary proceedings initiated after determination of the award lead to a finding of gross misconduct before payment is made, or if the employee is summarily dismissed before payment is made, the employee is treated as if they were never eligible to participate.
93. New subsection (5) provides that only those factors set out in subsection (6) can be used to determine the amount of the award. New subsection (6) provides that if these refer to the employee's remuneration, length of service, or hours worked, the equality requirement will not be infringed.
94. New subsection (7) provides that the equality requirement is infringed if some of the participating employees receive nothing.
95. New subsection (8) provides that where the amount of a participating employee's share of an award under the scheme is determined by reference to more than one of the factors mentioned in subsection (6) the equality requirement will not be satisfied unless each of those factors gives rise to a separate bonus amount and the employee's total bonus is the sum of those separate amounts. This means that the entitlements cannot be multiplied together or used in any other kind of mathematical formula.
96. New subsection (9) prevents the equality requirement from being met if any feature of the scheme has or is likely to have the effect of disproportionately rewarding directors or former directors, higher paid employees, employees from specific parts of the business, or employees carrying out specific types of activity. This has to be read in conjunction with subsection (6), but is intended to prevent an employer from paying an extra amount of bonus in addition to whatever is determined through use of the allowable factors.
97. New subsection (10) provides that any references to an employee in subsections 1(b), (5), (6), (7) and (9) include a former employee and similarly references to remuneration and other factors in the case of former employees are to be read as relating to the former employment.

### **New Section 312D**

98. New subsections (1) to (5) provide for the definition of 'trading requirement' and related terms, as referred to in section 312B(1). This requirement must be met throughout the qualifying period (see 312B(1)).

### **New Section 312E**

99. New subsection (1) provides that a company meets the indirect employee ownership requirement referred to in section 312B(1) if, throughout the qualifying period, the settlement meets the controlling interest requirement and the all-employee benefit requirement.
100. New subsection (2) provides the meaning of the controlling interest requirement and all-employee benefit requirement by reference to sections 236M, and 236J - 236K respectively. These are both subject to the modification in subsection (3).

101. New subsection (3) provides that if a settlement does not meet the all-employee benefit requirement throughout the qualifying period, it is treated as meeting that requirement if the behaviour requirement section 236L of TCGA 1992 applies. However, if the settlement has previously met the all-employee benefit requirement at any time since 10 December 2013, the settlement will not meet the behaviour requirement in section 236L. This means that once a settlement has met the all-employee benefit requirement it must continue to do so in order for the income tax exemption for the bonus to apply.
102. New subsection (4) clarifies the context in which sections 236I to 236M TCGA 1992 are to be read for purposes of subsections (2) and (3). This provides that for the purposes of applying section 236L, it does not matter, if, because of another provision (section 312B(3)), the qualifying period is less than 12 months.

### **New Section 312F**

103. New subsection (1) provides that a company meets the office holder requirement referred to in section 312B(1) if the appropriate fraction does not exceed two fifths. New subsection (2) defines the appropriate fraction as the number of persons who are one or both of a director or office holder of the company or an employee of the company connected with a director or office holder, divided by the total number of employees of the company.

### **New Section 312G**

104. One of the conditions of section 312B(1) for the exemption to apply is that the company must not be a service company. New subsection (1) provides definitions of a 'service company' as either being a managed service company within section 61B or a company which meets Conditions A and B.
105. Conditions A and B are provided for in new subsections (2) and (3) respectively. The company will be a service company if most of the business carried on by the company is the provision of the services of its employees and it meets the definition of a person (or persons) described in subsection (4) who is not a member of the same group as the company paying the bonus.
106. New subsection (4) specifies that the persons or companies referred to in subsection (3) are those who have previously had control over the company, have employed all or most of the employees of the company or the company's group in the past, or a subsidiary of a company which has done so previously.
107. New subsection (5) provides that subsection (4) should be applied in a similar way in relation to partnerships.
108. New subsection (6) lists the three legislative provisions that apply for the purposes of interpreting specified terms used within this section.

### **New Section 312H**

109. New subsections (1) and (2) provide that payments will be excluded if they are made in return for the employee (or former employee) giving up an amount of general earnings, specific employment income or other description of employment income.

### **New Section 312I**

110. New subsections (1) and (2) define the words and phrases used in Chapter 10A by cross reference to other tax legislation.
111. New subsection (3) defines when a payment is made.

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112. New subsection (4) provides that in the case where an employee has died, his or her personal representatives are still able to benefit from the exemption to the same extent (if at all) as if the employee had not died, as long as the payment is made within 12 months of the death.
113. New subsection (5) provides that the order-making power for Treasury to increase or reduce the exempt amount is not subject to annulment in pursuance of a resolution of the House of Commons.
114. New subsection (6) inserts the updated reference to ‘company (in Chapter 10A of Part 4)’, ‘ordinary share capital (in Chapter 10A of Part 4)’ and ‘trade (in Chapter 10A of Part 4)’ in Part 2 of Schedule 1.
115. New subsection (7) provides the date from which the amendments made to ITEPA apply and the date from which qualifying bonus payments are eligible for the income tax exemption.

### **Part 3: minor amendments**

#### **Inheritance Tax Act 1984**

116. Paragraph 9 makes amendments to Inheritance Tax Act 1984 (IHTA).
117. Paragraph 10(1) inserts new section 13A into IHTA which provides for an exemption for transfers (dispositions) of cash or other assets by a close company (“C”) to the trust. This provides for an alternative exemption where the condition in section 13(1) that the trust property must be applied for the benefit of ‘all or most’ employees is not met because of the application of the provisions in section 236K(1) TCGA.
118. New section 13A(1) provides that a transfer to the trust by C is not a transfer of value, and hence is not subject to inheritance tax, if C meets the trading requirement, the trust meets the all-employee benefit requirement, and the trust meets the controlling interest requirement at the end of the tax year in which the transfer occurs.
119. New sections 13A(2) and (3) specify the provisions which apply to determine whether the requirements in section 13A(1) are met and explain the meaning of “close company” and “tax year”.
120. Paragraph 10(2) provides that this amendment takes effect for transfers made on or after 6 April 2014.
121. Paragraph 11(1) inserts new section 28A into IHTA which provides for an exemption for transfers of shares in a company (“C”) by an individual to the trust. This provides for an alternative exemption where the condition in section 28(1)(b) that the trust property must be applied for the benefit of ‘all or most’ employees is not met because of the application of the provisions in section 236K(1) TCGA.
122. New section 28A(1) provides that a transfer by the individual is exempt if C meets the trading requirement, the trust meets the all-employee benefit requirement, and the trust meets the controlling interest requirement at the end of the tax year in which the transfer occurs.
123. New sections 28A(2) and (3) specify the provisions which apply to determine whether the requirements in section 28A(1) are met and explain the meaning of “tax year”.
124. Paragraph 11(2) provides that this amendment has effect for transfers made on or after 6 April 2014.
125. Paragraph 12(1) makes consequential amendments to section 29A(6) to bring the new provisions within the scope of section 29A. Section 29A applies where the estate on death is attributable wholly or in part to an exempt gift, including a transfer of shares to an employee benefit trust exempt under section 28, and the beneficiary of that gift

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settles a claim against the estate out of their own resources. The transfer is chargeable to the extent that the beneficiary's estate is less through settling the claim. This paragraph extends the treatment to a transfer of shares which is exempt under new section 28A.

126. Paragraph 12(2) provides that this amendment takes effect for transfers made on or after 6 April 2014.
127. Paragraph 13(1) makes amendments to section 72 of IHTA, which applies where settled property ceases to be subject to trusts to which section 86 applies.
128. Paragraph 13(3) inserts new section 72(3A) which provides for an exemption from the charge under section 72(2)(a) which would otherwise apply when settled property continues to be held on trust, but in such a way that it ceases to be exempt under section 86. This ensures that there is no charge if the trust ceases to be exempt under new section 86(3)(d) because the trading requirement or controlling interest requirement (or both requirements) are no longer met.
129. Paragraph 13(4) provides that this amendment is treated as coming into force on or after 6 April 2014.
130. Paragraph 14(1) inserts new section 75A into IHTA.
131. New section 75A(1) provides an exemption from the charge under section 65 when shares in a company ("C") which are already held in a trust become held in a trust to which section 86(1) applies if certain conditions are met.
132. New section 75A(2) sets out the conditions that have to be met, which are that C meets the trading requirement, the trusts of the settlement meet the all-employee benefit requirement, and the settlement meets the controlling interest requirement at the end of the tax year in which the transfer occurs.
133. New section 75A(3) and (4) specify the provisions which apply to determine whether the requirements in section 75A(2) are met and explain the meaning of "tax year".
134. Paragraph 14(2) provides that this amendment is treated as coming into force on 6 April 2014.
135. Paragraph 15(1) makes amendments to section 86 of IHTA.
136. Paragraph 15(2) inserts new section 86(3)(d) so that the trust qualifies for the same exemption from inheritance tax which applies to employee benefit trusts providing that it holds shares in a company which meets the trading requirement, and the trust meets the controlling interest requirement and the all-employee benefit requirement.
137. Paragraph 15(3) inserts new section 86(3A) which specifies the provisions that apply to determine whether the trading requirement, all-employee benefit requirement and controlling interest requirement are met, and defines ordinary share capital.
138. Paragraph 15(4) provides that these amendments are treated as coming into force on 6 April 2014.
139. Paragraph 16(1) makes consequential amendments to section 144 to include new section 75A.
140. Paragraph 16(2) provides that this amendment is treated as coming into force on 6 April 2014.

#### **Part 4. Miscellaneous amendments**

##### **Finance Act 1986**

141. Paragraph 17(1) amends the provisions in section 102(5) Finance Act 1986 so that the reservation of benefit provisions does not apply to a gift which is exempt from tax under section 28A.
142. Paragraph 17(2) provides that this amendment has effect for disposals on or after 6 April 2014.

##### **Taxation of Chargeable Gains Act 1992**

143. Paragraph 18 amends the share pooling and identification rules so that shares which were most recently acquired on a disposal to which section 236H applied are treated as being of a different class from other shares of the same company held by the trustees (if they would otherwise be treated as being of the same class). This means that EOT exempt shares (see paragraph 46 on new section 236S TCGA above) are pooled separately from other shares and the other share identification rules which apply on disposals are applied separately to EOT exempt shares. The new rules apply to any disposal on or after 6 April 2014.

##### **Income Tax (Earnings and Pensions) Act 2003**

144. Paragraphs 19 to 21 amend rules concerning the type of shares that can be awarded under three of the Government's tax-advantaged employee share schemes: Share Incentive Plan (SIP), Save As You Earn Option Scheme (SAYE) and Company Share Option Plan Scheme (CSOP). They provide that shares in a company that is subject to an employee-ownership trust may be awarded under these schemes, and also provide that a company that is subject to an employee-ownership trust is not a close company for the purposes of certain eligibility conditions in relation to shares. "Subject to an employee-ownership trust" is defined at paragraph 19, sub-paragraph (3) by reference to conditions provided elsewhere in this Schedule. These changes apply with effect from 1 October 2014.
145. Following these changes, shares in a company ("C") will be "eligible shares" for the purposes of SIP, SAYE and CSOP where:
  - C is subject to an employee-ownership trust; or
  - in the case of SIP and SAYE, C is controlled by a listed company which is itself subject to an employee ownership trust.
146. Paragraph 22 amends the independence requirement for the Enterprise Management Incentives (EMI) tax advantaged employee share scheme to accommodate companies that are subject to an employee-ownership trust. The change to EMI will be commenced by order.

##### **Corporation Tax Act 2009 ("CTA2009")**

147. Paragraph 23 ensures that a company which would otherwise be entitled to a corporation tax deduction in respect of a qualifying bonus payment is not prevented by section 1290 of the CTA 2009 (Employee benefit contributions) from claiming such deduction by virtue of all or part of such payment being exempt from income tax. It does this by amending section 1292 CTA 2009 (provision of qualifying benefits) so as to provide that if, and to the extent that the qualifying bonus payment is exempt from income tax under new Section 312A of ITEPA, it will be treated as a qualifying benefit.



## **Background Note**

148. The Government announced in Autumn Statement 2013 that it would provide £70 million annually from 2014-15 to support employee ownership models in order to incentivise growth of the sector. This will be in addition to the existing tax-advantaged share schemes.
149. The support is targeted at legal structures in which a trading company or group is owned by trustees which must act for the benefit of all employees (and any qualifying former employees). Structures of this kind have not until now received as much support as is given to arrangements under which employees own shares in their employer directly.
150. The CGT relief and income tax and inheritance tax exemptions further the Government's policy of supporting existing employee-owned companies and promoting the creation of new employee-owned companies. The capital gains tax relief and inheritance tax exemption will encourage the creation of new structures through which employees can benefit from the success of their employer's business. The income tax exemption will allow those businesses to share their successes with employees through tax-advantaged payments.
151. The Government is considering reviewing this exemption in five years' time to monitor take up, effectiveness and whether the spend is at the appropriate level.