



Finance Act 1978

1978 CHAPTER 42

PART III

INCOME TAX, CORPORATION TAX AND CAPITAL GAINS TAX

CHAPTER III

PROFIT SHARING SCHEMES

53 Approved profit sharing schemes: appropriated shares

- (1) The provisions of this section apply where, after 5th April 1979, the trustees of a profit sharing scheme which has been approved in accordance with Part I of Schedule 9 to this Act appropriate shares—
 - (a) which have previously been acquired by the trustees, and
 - (b) as to which the conditions in Part II of that Schedule are fulfilled,to an individual who participates in the scheme.
- (2) In this Chapter references to an approved scheme are references to a scheme approved as mentioned in subsection (1) above, and in relation to such a scheme—
 - (a) any reference to a participant is a reference to an individual to whom the trustees of the scheme have appropriated shares; and
 - (b) subject to section 57 below, any reference to a participant's shares is a reference to the shares which have been appropriated to him by the trustees of an approved scheme.
- (3) Notwithstanding that, by virtue of such an appropriation of shares as is mentioned in subsection (1) above, the beneficial interest in the shares passes to the participant to whom they are appropriated—
 - (a) the value of the shares at the time of the appropriation shall be treated as not being income of his chargeable to tax under Schedule E; and

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- (b) he shall not be chargeable to income tax under that Schedule by virtue of section 79(4) of the Finance Act 1972 (share incentive schemes) in respect of an increase in the market value of the shares or by virtue of section 67 of the Finance Act 1976 (employee shareholdings) in any case where the shares are appropriated to him at an under value within the meaning of that section.
- (4) Any reference in this Chapter to the initial market value of any of a participant's shares is a reference to the market value of those shares determined,—
 - (a) except where paragraph (b) below applies, on the date on which the shares were appropriated to him; and
 - (b) if the Board and the trustees of the scheme agree in writing, on or by reference to such earlier date or dates as may be provided for in the agreement.
- (5) Notwithstanding anything in the approved scheme concerned or in the trust instrument or in section 54 below, for the purposes of capital gains tax a participant shall be treated as absolutely entitled to his shares as against the trustees.
- (6) Where the trustees of an approved scheme acquire any shares as to which the conditions in Part II of Schedule 9 to this Act are fulfilled and, within the period of eighteen months beginning with the date of their acquisition, those shares are appropriated in accordance with the scheme—
 - (a) section 16 of the Finance Act 1973 (additional rate tax on certain income accumulated under a trust) shall not apply to income consisting of dividends on those shares received by the trustees ; and
 - (b) any gain accruing to the trustees on the appropriation of those shares shall not be a chargeable gain;

and, for the purpose of determining whether any shares are appropriated within that period of eighteen months, shares which were acquired at an earlier time shall be taken to be appropriated before shares of the same class which were acquired at a later time.
- (7) The Board may by notice in writing require any person to furnish to them, within such time as the Board may direct (but not being less than thirty days), such information as the Board think necessary for the purposes of their functions under this Chapter, including, in particular, information to enable the Board—
 - (a) to determine whether to approve a scheme or withdraw an approval already given; and
 - (b) to determine the liability to tax, including capital gains tax, of any participant in an approved scheme.
- (8) In the Table in section 98 of the Taxes Management Act 1970 (failure to make returns, furnish information etc.) the following shall be added in the first column—

“Section 53(7) of the Finance Act 1978.”

54 The period of retention, the release date and the appropriate percentage

- (1) No scheme shall be approved as mentioned in subsection (1) of section 53 above unless the Board are satisfied that, whether under the terms of the scheme or otherwise, every participant in the scheme is bound in contract with the company concerned—
 - (a) to permit his shares to remain in the hands of the trustees throughout the period of retention; and

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- (b) not to assign, charge or otherwise dispose of his beneficial interest in his shares during that period; and
 - (c) if he directs the trustees to transfer the ownership of his shares to him at any time before the release date, to pay to the trustees before the transfer takes place a sum equal to income tax at the basic rate on the appropriate percentage of the locked-in value of the shares at the time of the direction ; and
 - (d) not to direct the trustees to dispose of his shares at any time before the release date in any other way except by sale for the best consideration in money that can reasonably be obtained at the time of the sale.
- (2) Any obligation imposed on a participant by virtue of subsection (1) above shall not prevent the participant from—
- (a) directing the trustees to accept an offer for any of his shares (in this paragraph referred to as " the original shares "), if the acceptance or agreement will result in a new holding, as defined in paragraph 4 of Schedule 7 to the Finance Act 1965 (roll-over relief for capital gains tax purposes in cases of reconstructions, amalgamations, etc.), being equated with the original shares for the purposes of capital gains tax; or
 - (b) directing the trustees to agree to a transaction affecting his shares or such of them as are of a particular class, if the transaction would be entered into pursuant to a compromise, arrangement or scheme applicable to or affecting—
 - (i) all the ordinary share capital of the company in question or, as the case may be, all the shares of the class in question ; or
 - (ii) all the shares, or shares of the class in question, which are held by a class of shareholders identified otherwise than by reference to their employment or their participation in an approved scheme; or
 - (c) directing the trustees to accept an offer of cash, with or without other assets, for his shares if the offer forms part of a general offer which is made to holders of shares of the same class as his or of shares in the same company and which is made in the first instance on a condition such that if it is satisfied the person making the offer will have control of that company, within the meaning of section 302 of the Taxes Act; or
 - (d) agreeing, after the expiry of the period of retention, to sell the beneficial interest in his shares to the trustees for the same consideration as, in accordance with subsection (1)(d) above, would be required to be obtained for the shares themselves.
- (3) If, in breach of his obligation under paragraph (b) of subsection (1) above, a participant assigns, charges or otherwise disposes of the beneficial interest in any of his shares, then, as respects those shares, he shall be treated for the purposes of this Chapter as if, at the time they were appropriated to him, he was ineligible to participate in the scheme; and section 58 below shall apply accordingly.
- (4) In this Chapter " the period of retention ", in relation to any of a participant's shares, means the period beginning on the date on which they are appropriated to him and ending on the fifth anniversary of that date or, if it is earlier,—
- (a) the date on which the participant ceases to be an employee or director of a relevant company by reason of injury or disability or on account of his being dismissed by reason of redundancy, within the meaning of the Redundancy Payments Act 1965 or the Contracts of Employment and Redundancy Payments Act (Northern Ireland) 1965 ; or

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- (b) the date on which the participant reaches pensionable age, as defined in Schedule 20 to the Social Security Act 1975; or
 - (c) the date of the participant's death.
- (5) In subsection (4)(a) above, " relevant company " means the company concerned or, if the scheme in question is a group scheme, a participating company; and in the application of subsection (4)(a) above to a participant in a group scheme, the participant shall not be treated as ceasing to be an employee or director of a relevant company until such time as he is no longer an employee or director of any of the participating companies.
- (6) In this Chapter " the release date ", in relation to any of a participant's shares, means the tenth anniversary of the date on which the shares were appropriated to him.
- (7) Subject to section 58(4) below, for the purposes of provisions of this Chapter charging an individual to income tax under Schedule E by reason of the occurrence of an event relating to any of his shares, any reference to " the appropriate percentage " in relation to those shares shall be determined according to the time of that event, as follows:—
- (a) if the event occurs during the period of retention of the shares, the appropriate percentage is 100 per cent.;
 - (b) if the event occurs after the expiry of the period of retention and before the seventh anniversary of the date on which the shares were appropriated to the participant, the appropriate percentage is 50 per cent.; and
 - (c) if the event occurs on or after the seventh anniversary of that date and before the tenth anniversary of it, the appropriate percentage is 25 per cent.

55 Disposal of scheme shares

- (1) If the trustees dispose of any of a participant's shares at any time before the release date or, if it is earlier, the date of the participant's death, then, subject to subsections (3) and (4) below, the participant shall be chargeable to income tax under Schedule E for the year of assessment in which the disposal takes place on the appropriate percentage of the locked-in value of the shares at the time of the disposal.
- (2) Subject to sections 57 and 58(6) below, any reference in this Chapter to the locked-in value of any of a participant's shares at any time shall be construed as follows:—
- (a) if prior to that time the participant has become chargeable to income tax by virtue of section 56 below on a percentage of the amount or value of any capital receipt (within the meaning of that section) which is referable to those shares, the locked-in value of the shares is the amount by which their initial market value exceeds the amount or value of that capital receipt or, if there has been more than one such receipt, the aggregate of them; and
 - (b) in any other case, the locked-in value of the shares is their initial market value.
- (3) Subject to subsection (4) below if, on a disposal of shares falling within subsection (1) above, the proceeds of the disposal are less than the locked-in value of the shares at the time of the disposal, subsection (1) above shall have effect as if that locked-in value were reduced to an amount equal to the proceeds of the disposal.
- (4) If, at any time prior to the disposal of any of a participant's shares, a payment was made to the trustees to enable them to exercise rights arising under a rights issue, then, subject to subsection (5) below, subsections (1) and (3) above shall have effect as if the proceeds of the disposal were reduced by an amount equal to that proportion of

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that payment or, if there was more than one, of the aggregate of those payments which, immediately before the disposal, the market value of the shares disposed of bore to the market value of all the participant's shares held by the trustees at that time.

- (5) For the purposes of subsection (4) above—
- (a) no account shall be taken of any payment to the trustees if or to the extent that it consists of the proceeds of a disposal of rights arising under a rights issue; and
 - (b) in relation to a particular disposal the amount of the payment or, as the case may be, of the aggregate of the payments referred to in that subsection shall be taken to be reduced by an amount equal to the total of the reduction (if any) previously made under that subsection in relation to earlier disposals ;

and any reference in subsection (4) or paragraph (a) above to the rights arising under a rights issue is a reference to rights conferred in respect of a participant's shares, being rights to be allotted, on payment, other shares in the same company.

- (6) Where the disposal referred to in subsection (1) above is made from a holding of shares which were appropriated to the participant at different times, then, in determining for the purposes of this Chapter—
- (a) the initial market value and the locked-in value of each of those shares, and
 - (b) the percentage which is the appropriate percentage in relation to each of those shares,

the disposal shall be treated as being of shares which were appropriated earlier before those which were appropriated later.

- (7) If at any time the participant's beneficial interest in any of his shares is disposed of, the shares in question shall be treated for the purposes of this Chapter as having been disposed of at that time by the trustees for (subject to subsection (8) below) the like consideration as was obtained for the disposal of the beneficial interest; and for the purpose of this subsection there is no disposal of the participant's beneficial interest if and at the time when—
- (a) in England and Wales or Northern Ireland that interest becomes vested in any person on the insolvency of the participant or otherwise by operation of law, or
 - (b) in Scotland, that interest becomes vested in a judicial factor, in a trustee on the participant's sequestrated estate or in a trustee for the benefit of the participant's creditors.

- (8) If—
- (a) a disposal of shares falling within subsection (1) above is a transfer to which section 54(1)(c) above applies, or
 - (b) the Board is of opinion that any other disposal falling within that subsection is not at arm's length and accordingly direct that this subsection shall apply, or
 - (c) a disposal of shares falling within that subsection is one which is treated as taking place by virtue of subsection (7) above and takes place within the period of retention,

then for the purposes of this Chapter the proceeds of the disposal shall be taken to be equal to the market value of the shares at the time of the disposal.

- (9) In subsection (5) above " shares ", in the context of shares allotted or to be allotted on a rights issue, includes securities and rights of any description.

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56 Capital receipts in respect of scheme shares

- (1) Subject to the provisions of this section if, in respect of or by reference to any of a participant's shares, the trustees become entitled, before the release date, to receive any money or money's worth (in this section referred to as a "capital receipt"), the participant shall be chargeable to income tax under Schedule E for the year of assessment in which the entitlement arises on the appropriate percentage (determined as at the time when the trustees become so entitled) of the amount or value of the receipt.
- (2) Money or money's worth is not a capital receipt for the purposes of this section if or, as the case may be, to the extent that—
 - (a) income in the hands of the recipient for the purposes of income tax; or
 - (b) it consists of the proceeds of a disposal falling within section 55 above; or
 - (c) it consists of new shares within the meaning of section 57 below.
- (3) If, pursuant to a direction given by or on behalf of the participant or any person in whom the beneficial interest in the participant's shares is for the time being vested, the trustees—
 - (a) dispose of some of the rights arising under a rights issue, as defined in section 55(5) above, and
 - (b) use the proceeds of that disposal to exercise other such rights,
 the money or money's worth which constitutes the proceeds of that disposal is not a capital receipt for the purposes of this section.
- (4) If, apart from this subsection, the amount or value of a capital receipt would exceed the sum which, immediately before the entitlement to the receipt arose, was the locked-in value of the shares to which the receipt is referable, subsection (1) above shall have effect as if the amount or value of the receipt were equal to that locked-in value.
- (5) Subsection (1) above does not apply in relation to a receipt if the entitlement to it arises after the death of the participant to whose shares it is referable.

57 Company reconstructions, amalgamations etc.

- (1) This section applies where there occurs in relation to any of a participant's shares (in this section referred to as "the original holding") a transaction (in this section referred to as a "company reconstruction") which results in a new holding, as defined in paragraph 4 of Schedule 7 to the Finance Act 1965 (roll-over relief for capital gains tax purposes in cases of reconstructions, amalgamations, etc.), being equated with the original holding for the purposes of capital gains tax.
- (2) Where an issue of shares of any of the following descriptions (in respect of which a charge to income tax arises) is made as part of a company reconstruction, those shares shall be treated for the purposes of this section as not forming part of the new holding, that is to say,—
 - (a) redeemable shares or securities issued as mentioned in section 233(2)(c) of the Taxes Act (issues not wholly for new consideration);
 - (b) share capital issued in circumstances such that section 234(1) of the Taxes Act applies (bonus issue following repayment of share capital); and
 - (c) share capital to which section 34 of the Finance (No. 2) Act 1975 applies (stock dividends).

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- (3) In this section—
- (a) " new shares" means shares comprised in the new holding which were issued in respect of, or otherwise represent, shares comprised in the original holding; and
 - (b) " the corresponding shares ", in relation to any new shares, means those shares in respect of which the new shares are issued or which the new shares otherwise represent.
- (4) Subject to the following provisions of this section, references in this Chapter to a participant's shares shall be construed, after the time of the company reconstruction, as being or, as the case may be, as including references to any new shares, and for the purposes of this Chapter—
- (a) a company reconstruction shall be treated as not involving a disposal of shares comprised in the original holding;
 - (b) the date on which any new shares are to be treated as having been appropriated to the participant shall be that on which the corresponding shares were appropriated; and
 - (c) the conditions in Part II of Schedule 9 to this Act shall be treated as fulfilled with respect to any new shares if they were (or were treated as) fulfilled with respect to the corresponding shares.
- (5) In relation to shares comprised in the new holding, subsection (2) of section 55 above shall apply as if the references in that subsection to the initial market value of the shares were references to their locked-in value immediately after the company reconstruction, which shall be determined as follows:—
- (a) ascertain the aggregate amount of the locked-in value immediately before the reconstruction of those shares comprised in the original holding which had at that time the same locked-in value; and
 - (b) distribute that amount *pro rata* among—
 - (i) such of those shares as remain in the new holding, and
 - (ii) any new shares in relation to which those shares are the corresponding shares, according to their market value immediately after the reconstruction;and paragraph (a) of that subsection shall apply only to capital receipts after the date of the reconstruction.
- (6) For the purposes of this Chapter if, as part of a company reconstruction, trustees become entitled to a capital receipt, within the meaning of section 56 above, their entitlement to the capital receipt shall be taken to arise before the new holding comes into being and, for the purposes of subsection (5) above, before the date on which the locked-in value of any shares comprised in the original holding falls to be ascertained.
- (7) In the context of a new holding, any reference in this section to shares includes securities and rights of any description which form part of the new holding for the purposes of Part III of the Finance Act 1965.

58 Excess or unauthorised shares

- (1) If the total of the initial market values of all the shares which are appropriated to an individual in any one year of assessment (whether under a single approved scheme or under two or more such schemes) exceeds £500, subsections (4) to (7) below shall

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apply to the excess shares, that is to say, any share which caused that limit to be exceeded and any share appropriated after that limit was exceeded.

- (2) For the purposes of subsection (1) above, if a number of shares is appropriated to an individual at the same time under two or more approved schemes, the same proportion of the shares appropriated at that time under each scheme shall be regarded as being appropriated before the limit of £500 is exceeded.
- (3) If the trustees of an approved scheme appropriate shares to an individual at a time when he is ineligible to participate in the scheme by virtue of Part III of Schedule 9 to this Act, the following provisions of this section shall apply in relation to those shares, and in those provisions those shares are referred to as " unauthorised shares " .
- (4) For the purposes of any provision of this Chapter charging an individual to income tax under Schedule E by reason of the occurrence of an event relating to any of his shares—
 - (a) the appropriate percentage in relation to excess or unauthorised shares shall in every case be 100 per cent; and
 - (b) without prejudice to section 55(6) above, the event shall be treated as relating to shares which are not excess or unauthorised shares before shares which are.
- (5) Excess or unauthorised shares which have not been disposed of before the release date or, if it is earlier, the date of the death of the participant whose shares they are shall be treated for the purposes of this Chapter as having been disposed of by the trustees immediately before the release date or, as the case may require, the date of the participant's death, for a consideration equal to their market value at that time.
- (6) The locked-in value at any time of any excess or unauthorised shares shall be their market value at that time.
- (7) Where there has been a company reconstruction to which section 57 above applies, a new share (within the meaning of that section) shall be treated as an excess or unauthorised share if the corresponding share (within the meaning of that section) or, if there was more than one corresponding share, each of them was an excess or unauthorised share.

59 P.A.Y.E. deduction of tax

- (1) Subject to subsections (3) and (4) below, where the trustees of an approved scheme receive a sum of money which constitutes (or forms part of)—
 - (a) the proceeds of a disposal of shares falling within section 55(1) above, or
 - (b) a capital receipt, within the meaning of section 56 above,
 the trustees shall pay out of that sum of money to the company specified in subsection (2) below an amount equal to that on which income tax is payable in accordance with the section in question; and the company shall then pay over that amount to the participant but in so doing shall make a P.A.Y.E. deduction.
- (2) The company to which the payment mentioned in subsection (1) above is to be made is the company—
 - (a) of which the participant is an employee or director at the time the trustees receive the sum of money referred to in that subsection, and
 - (b) whose employees are at that time eligible (subject to the terms of the scheme and to Schedule 9 to this Act) to be participants in the approved scheme concerned,

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and if there is more than one company which falls within paragraphs (a) and (b) above, such one of those companies as the Board may direct.

- (3) Where the trustees of an approved scheme receive a sum of money to which subsection (1) above applies but—
- (a) there is no company which falls within paragraphs (a) and (b) of subsection (2) above, or
 - (b) the Board is of opinion that it is impracticable for the company which falls within those paragraphs (or, as the case may be, any of them) to make a P.A.Y.E. deduction and accordingly direct that this subsection shall apply,
- then, in paying over to the participant the proceeds of the disposal or the capital receipt, the trustees shall make a P.A.Y.E. deduction in respect of an amount equal to that on which income tax is payable as mentioned in subsection (1) above as if the participant were a former employee of the trustees.
- (4) Where the trustees of an approved scheme receive a sum of money to which subsection (1) above applies and the Board direct that this subsection shall apply—
- (a) the trustees shall make the payment mentioned in that subsection to the company specified in the Board's direction; and
 - (b) that company shall pay over that amount to the participant but in so doing shall make a P.A.Y.E. deduction, and for that purpose if the participant is not an employee of that company he shall be treated as a former employee;
- but no such direction shall be given except with the consent of the trustees, the company or companies (if any) specified in subsection (2) above and the company specified in the direction.
- (5) Where in accordance with this section any person is required to make a P.A.Y.E. deduction in respect of any amount, that amount shall be treated for the purposes of section 204 of the Taxes Act (pay as you earn) and any regulations made under that section as an amount of income payable to the recipient and assessable to income tax under Schedule E, and accordingly such deduction shall be made as is required by those regulations.
- (6) Where, in connection with a transfer of a participant's shares to which paragraph (c) of subsection (1) of section 54 above applies, the trustees receive such a sum as is referred to in that paragraph, that sum shall be treated for the purposes of the Income Tax Acts—
- (a) as a sum deducted by the trustees pursuant to a requirement to make a P.A.Y.E. deduction under subsection (3) above; and
 - (b) as referable to the income tax to which, as a result of the transfer, the participant is chargeable by virtue of section 55 above.
- (7) Unless the Board otherwise direct, in the application of this section to a sum of money which constitutes (or forms part of) the proceeds of a disposal of, or a capital receipt referable to, excess or unauthorised shares, within the meaning of section 58 above, the trustees shall determine the amount of the payment mentioned in subsection (1) above or, as the case may be, the amount of the P.A.Y.E. deduction to be made under subsection (3) above as if the shares were not excess shares.

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60 Schedule D deduction of payments to trustees

- (1) Any sum expended by the company concerned or, in the case of a group scheme, by a participating company in making a payment to the trustees of an approved scheme shall be included—
- (a) in the sums to be deducted in computing for the purposes of Schedule D the profits or gains of a trade carried on by that company, or
 - (b) if that company is an investment company within the meaning of section 304 of the Taxes Act or a company in the case of which that section applies by virtue of section 305 of that Act, in the sums to be deducted as expenses of management in computing the profits of the company for the purposes of corporation tax,
- if, and only if, one of the conditions in subsection (2) below is fulfilled.
- (2) The conditions referred to in subsection (1) above are—
- (a) that before the expiry of the relevant period the sum in question is applied by the trustees in the acquisition of shares for appropriation to individuals who are eligible to participate in the scheme by virtue of their being or having been employees or directors of the company making the payment; and
 - (b) that the sum is necessary to meet the reasonable expenses of the trustees in administering the scheme.
- (3) For the purposes of subsection (2)(a) above, " the relevant period " means the period of nine months beginning on the day following the end of the period of account in which the sum in question is charged as an expense of the company incurring the expenditure or such longer period as the Board may allow by notice in writing given to that company.
- (4) For the purposes of this section, the trustees of an approved scheme shall be taken to apply sums paid to them in the order in which the sums are received by them.

61 Interpretation and construction

- (1) In this Chapter—
- " the appropriate percentage ", in relation to any shares, shall be construed in accordance with section 54(7) above;
 - " approved scheme " shall be construed in accordance with section 53(2) above ;
 - " the company concerned " has the meaning assigned to it by paragraph 1(1) of Schedule 9 to this Act;
 - " group scheme " and, in relation to such a scheme, " participating company " have the meaning assigned by paragraph 1(2) of that Schedule;
 - " initial market value ", in relation to any shares, shall be construed in accordance with section 53(4) above;
 - " locked-in value ", in relation to any shares, shall be construed in accordance with section 55(2) above;
 - " market value ", in relation to any shares, means their market value as determined in accordance with Part III of the Finance Act 1965 (capital gains tax);
 - " participant " shall be construed in accordance with section 53(2)(a) above ;

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" the period of retention " has the meaning assigned to it by section 54(4) above ;

" the release date " has the meaning assigned to it by section 54(6) above;

" shares " includes stock;

" the trust instrument ", in relation to an approved scheme, means the instrument referred to in paragraph 1(3)(c) of Schedule 9 to this Act; and

" the trustees", in relation to an approved scheme or a participant's shares, means the body of persons for the establishment of which the scheme must provide as mentioned in paragraph 1(3) of Schedule 9 to this Act.

(2) Any provision of this Chapter with respect to—

(a) the order in which any of a participant's shares are to be treated as disposed of for the purposes of this Chapter, or

(b) the shares in relation to which an event is to be treated as occurring for any such purpose,

shall have effect notwithstanding any direction given to the trustees with respect to shares of a particular description or to shares appropriated to the participant at a particular time.

(3) For the purposes of capital gains tax—

(a) no deduction shall be made from the consideration for the disposal of any shares by reason only that an amount determined under this Chapter is chargeable to income tax;

(b) any charge to income tax by virtue of section 56 above shall be disregarded in determining whether a distribution is a capital distribution within the meaning of paragraph 3 of Schedule 7 to the Finance Act 1965; and

(c) nothing in any such provision as is referred to in subsection (2) above shall affect the rules applicable to the computation of a gain accruing on a part disposal of a holding of shares or other securities which were acquired at different times.