



Finance (No.2) Act 1987

1987 CHAPTER 51

PART I

INCOME TAX, CORPORATION TAX AND CAPITAL GAINS TAX

CHAPTER I

PROFIT-RELATED PAY

Preliminary

1 Interpretation.

(1) In this Chapter—

“employment” means an office or employment whose emoluments fall to be assessed under Schedule E, and related expressions have corresponding meanings;

“employment unit” means an undertaking, or that part of an undertaking, to which a profit-related pay scheme relates;

“pay” (except in the expression “profit-related pay”) means emoluments paid under deduction of tax pursuant to section 204 of the Taxes Act (pay as you earn), reduced by any amounts included in them by virtue of Chapter II of Part III of the Finance Act 1976;

“profit period” means an accounting period by reference to which any profit-related pay is calculated;

“profit-related pay” means emoluments from an employment which are paid in accordance with a profit-related pay scheme;

“profit-related pay scheme” means a scheme providing for the payment of emoluments calculated by reference to profits;

“profits” or “losses”, in relation to a profit period, means the amount shown in the account prepared for that period in accordance with the relevant profit-

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related pay scheme as the profit, or as the case may be the loss, on ordinary activities after taxation;

“registered scheme” means a profit-related pay scheme registered under this Chapter;

“scheme employer” means the person on whose application a profit-related pay scheme is or may be registered under this Chapter.

- (2) References in this Chapter to the employees to whom a profit-related pay scheme relates are references to the employees who will receive any payments of profit-related pay under the scheme.

2 Taxation of profit-related pay.

Any charge to income tax on profit-related pay paid in accordance with a registered scheme shall be made for the year of assessment in which it is paid (rather than the period for which it is paid).

The relief

3 Relief from tax.

- (1) One half of any profit-related pay to which this section applies shall be exempt from income tax.
- (2) This section applies to any profit-related pay paid to an employee by reference to a profit period and in accordance with a registered scheme, but only so far as it does not exceed the lower of the two limits specified in the following provisions of this section.
- (3) The first of the limits referred to in subsection (2) above is one fifth of the aggregate of—
- (a) the pay (but not any profit-related pay) paid to the employee in the profit period in respect of his employment in the employment unit concerned (or, if the employee is eligible to receive profit-related pay by reference to part only of the period, so much of his pay, but not any profit-related pay, as is paid in that part), and
 - (b) the profit-related pay paid to him by reference to that period in respect of that employment.
- (4) The second of the limits referred to in subsection (2) above is £3000 (or, if the profit period is less than twelve months or the employee is eligible to receive profit-related pay by reference to part only of the profit period, a proportionately reduced amount).

4 Exceptions from relief.

- (1) Profit-related pay shall not be exempt from income tax by virtue of section 3 above if—
- (a) it is paid to an employee in respect of his employment in an employment unit during a time when he also has another employment, and
 - (b) he receives in respect of his other employment during that time profit-related pay which is exempt from income tax by virtue of that section.

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- (2) Subject to subsection (3) below, profit-related pay in respect of which no secondary Class 1 contributions under Part I of the Social Security Act 1975 or Part I of the Social Security (Northern Ireland) Act 1975 are payable shall not be exempt from income tax by virtue of section 3 above.
- (3) Subsection (2) above shall not apply to profit-related pay in respect of which no Class 1 contributions are payable only because the employee's earnings are below the lower earnings limit for such contributions.

Registration

5 Persons who may apply for registration.

- (1) Where the emoluments of all the employees to whom a profit-related pay scheme relates are paid by the same person, an application to register the scheme under this Chapter may be made to the Board by that person.
- (2) Where subsection (1) above does not apply to a profit-related pay scheme, no application to register it may be made unless all the persons who pay emoluments to employees to whom the scheme relates are bodies corporate which are members of the same group; and in that case an application may be made by the parent company of the group.
- (3) In subsection (2) above “group” means a body corporate and its 51 per cent. subsidiaries, and “parent company” means that body corporate; and in applying for the purposes of this section the definition of “51 per cent. subsidiary” in section 532 of the Taxes Act, any share capital of a registered industrial and provident society (within the meaning of section 340 of the Taxes Act) shall be treated as ordinary share capital.

6 Excluded employments.

- (1) No application may be made to register a scheme under this Chapter if any employment to which the scheme relates is—
 - (a) employment in an office under the Crown or otherwise in the service of the Crown, or
 - (b) employment by an excluded employer.
- (2) For the purposes of this section “excluded employer” means—
 - (a) a person in an employment within subsection (1) above;
 - (b) a body under the control of the Crown, or of one or more persons acting on behalf of the Crown;
 - (c) a local authority;
 - (d) a body under the control of one or more local authorities, or of the Crown (or one or more persons acting on behalf of the Crown) and one or more local authorities.
- (3) For the purposes of this section a person has control of a body only if one or more of the following conditions is satisfied—
 - (a) in the case of a body whose affairs are managed by its members, he has the power to appoint more than half of the members;
 - (b) in the case of a body having a share capital, he holds more than half of its issued share capital;

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- (c) in the case of a body whose members vote in general meeting, he has the power to exercise more than half of the votes exercisable in general meeting;
 - (d) the articles of association or other rules regulating the body give him the power to secure that the affairs of the body are conducted in accordance with his wishes.
- (4) For the purposes of this section a person shall be taken to possess any rights and powers possessed by—
- (a) a person appointed by him to an office by virtue of which the rights or powers are exercisable, or
 - (b) a body which he controls,
- including rights and powers which such an officer or body is taken to possess by virtue of this subsection.
- (5) Subsections (3) and (4) above apply with the necessary modifications for the purpose of determining whether persons together have control of a body.

7 Applications for registration.

- (1) An application for the registration of a profit-related pay scheme under this Chapter—
- (a) shall be in such form as the Board may prescribe;
 - (b) shall contain a declaration by the applicant that the scheme complies with the requirements of Schedule 1 to this Act;
 - (c) shall contain an undertaking by the applicant that the emoluments paid to any employee to whom the scheme relates and to whom minimum wage legislation applies will satisfy that legislation without taking account of profit-related pay;
 - (d) shall specify the profit period or periods to which the scheme relates;
 - (e) shall be supported by such information as the Board may require.
- (2) An application for the registration of a profit-related pay scheme under this Chapter shall be accompanied by a report by an independent accountant, in a form prescribed by the Board, to the effect that in his opinion—
- (a) the scheme complies with the requirements of Schedule 1 to this Act;
 - (b) the books and records maintained and proposed to be maintained by the applicant are adequate for the purpose of enabling the documents required by section 12(1) below to be produced.
- (3) An application for the registration of a profit-related pay scheme under this Chapter shall be made within the period of six months ending immediately before the beginning of the profit period, or the first of the profit periods, to which the scheme relates.
- (4) In subsection (1) above, “minimum wage legislation” means the provisions relating to remuneration in Part II of the Wages Act 1986, the Wages Councils (Northern Ireland) Order 1982, the Agricultural Wages Act 1948, the Agricultural Wages (Scotland) Act 1949 and the Agricultural Wages (Regulation) (Northern Ireland) Order 1977.

8 Registration.

- (1) If an application for the registration of a profit-related pay scheme under this Chapter is made more than three months (but not more than six months) before the beginning of the profit period, or the first of the profit periods, to which the scheme relates,

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then, subject to subsection (2) below, the Board shall register the scheme before the beginning of that period.

- (2) If the Board are not satisfied that an application made as mentioned in subsection (1) above complies with the requirements of this Chapter, they may within thirty days after the day on which they receive the application—
 - (a) refuse the application, or
 - (b) by written notice to the applicant either require him to amend the application or require him to give them such further information as may be specified in the notice, and in either case to do so within such time, not exceeding thirty days after the day on which the notice is given, as may be so specified.
- (3) If a notice under subsection (2) above is complied with and the Board are satisfied that the application complies with the requirements of this Chapter, the Board shall register the scheme before the beginning of the profit period.
- (4) If a notice under subsection (2) above is complied with but the Board remain not satisfied that the application complies with the requirements of this Chapter, the Board shall refuse the application.
- (5) If a notice under subsection (2) above is not complied with but the Board are before the beginning of the profit period satisfied that the application complies with the requirements of this Chapter, the Board may register the scheme before the beginning of the period; but if they do not do so, the application shall be regarded as having been refused.
- (6) If an application for the registration of a profit-related pay scheme under this Chapter is made within the period of three months before the beginning of the profit period, or the first of the profit periods, to which the scheme relates, then—
 - (a) if before the beginning of the profit period the Board are satisfied that the application complies with the requirements of this Chapter, they shall register the scheme before the beginning of the period; but
 - (b) in any other case, the application shall be regarded as having been refused.
- (7) After registering a scheme under this Chapter, the Board shall by written notice inform the applicant that they have done so.
- (8) The Board shall give written notice to the applicant if they refuse his application under subsection (2) or (4) above.
- (9) For the purposes of this section an application does not comply with the requirements of this Chapter if the scheme to which it relates does not comply with the requirements of Schedule 1 to this Act.

9 Change of scheme employer.

- (1) Where—
 - (a) a scheme employer ceases to fulfil the conditions which section 5 above requires to be fulfilled by an applicant for registration of the scheme, and
 - (b) he is succeeded by a person who would be eligible to apply for registration of the scheme, and
 - (c) there is otherwise no other material change in the employment unit or in the circumstances relating to the scheme,

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the scheme employer and his successor may make a joint written application to the Board under this section for the amendment of the registration of the scheme.

- (2) If on receiving an application under this section the Board are satisfied—
- (a) that the conditions in subsection (1)(a), (b) and (c) above are fulfilled, and
 - (b) that, apart from the change of scheme employer, there would be no grounds for cancelling the registration of the scheme,
- the Board shall amend the registration of the scheme by substituting the successor for the previous scheme employer.
- (3) An application under this section shall be made before the end of the period of one month beginning with the date of the succession.
- (4) Where the Board amend the registration of a scheme under this section, this Chapter shall (subject to any necessary modifications) have effect as if the successor had been the scheme employer throughout.
- (5) The Board shall give written notice to the applicants if they refuse an application under this section.

10 Cancellation of registration.

- (1) If after a scheme has been registered under this Chapter it appears to the Board—
- (a) that the scheme has not been or will not be administered in accordance with its terms or in accordance with this Chapter in relation to a profit period, or
 - (b) that the circumstances relating to the scheme have during a profit period become such that (if it were not registered) an application to register it under this Chapter would be excluded by section 6 above, or
 - (c) in the case of a scheme which employs (as the method of determining the distributable pool for a profit period) the method described as method B in paragraph 14 of Schedule 1 to this Act, that losses were incurred in a profit period or in the preceding period of twelve months, or
 - (d) that the undertaking given in compliance with section 7(1)(c) above has not been complied with in relation to employment at any time during a profit period,

the Board may cancel the registration and, subject to subsection (5) below, the cancellation shall have effect from the beginning of that profit period.

- (2) If after a scheme has been registered under this Chapter it appears to the Board—
- (a) that at the time of registration the scheme did not comply with the requirements of Schedule 1 to this Act or that the application did not comply with the requirements of this Chapter, or
 - (b) in the case of a scheme which employs (as the method of determining the distributable pool for a profit period) the method described as method A in paragraph 13 of Schedule 1, that losses were incurred in the base year specified in the scheme,

the Board may cancel the registration with effect from the beginning of the profit period (or first profit period) to which the scheme related.

- (3) If after a scheme has been registered under this Chapter the scheme employer fails to comply with the requirements of section 12 below in relation to a profit period, the Board may cancel the registration with effect from the beginning of that profit period.

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- (4) If the scheme employer, by written notice, requests the Board to cancel the registration of the scheme with effect from the beginning of a profit period specified in the notice, the Board shall comply with the request.
- (5) Where—
- (a) the scheme employer has given to the Board in accordance with section 13(3) below notice of a change in the employment unit, or in the circumstances relating to the scheme, which is a ground for cancellation of the registration of the scheme by virtue of subsection (1)(a) or (b) above, and
 - (b) the Board are satisfied that the change is not brought about with a view to the registration of a new scheme, and
 - (c) in the notice the scheme employer requests the Board to cancel the registration of the scheme with effect from the date of the change,
- then, if the notice is given before the end of the period of one month beginning with that date, the Board shall comply with the request.
- (6) The Board shall give written notice to the scheme employer of the cancellation of a scheme's registration.

Administration

11 Recovery of tax from scheme employer.

- (1) This section applies where—
- (a) payments of profit-related pay are made to an employee in accordance with a registered scheme, and
 - (b) in consequence of the relief given by this Chapter in respect of registered schemes, less income tax is deducted from the payments in accordance with section 204 of the Taxes Act (pay as you earn) than would have been deducted if the scheme had not been registered, and
 - (c) the registration of the scheme is subsequently cancelled with effect from a time before that relevant for the purposes of the relief.
- (2) Where this section applies, an amount equal to the shortfall in the deductions made in accordance with section 204 shall be payable by the scheme employer to the Board; and regulations under that section may include provision as to the collection and recovery of any such amount.

12 Annual returns etc.

- (1) After every profit period of a registered scheme, the scheme employer shall, within the period allowed by subsection (2) below, send to the Board—
- (a) a return in such form and containing such information as the Board may prescribe, and
 - (b) a report by an independent accountant in such form and containing such information as the Board may prescribe, and stating that in his opinion the terms of the scheme have been complied with in respect of the profit period.
- (2) Subject to subsection (3) below, the period allowed for complying with subsection (1) above is—

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- (a) seven months from the end of the profit period if the employment unit to which the scheme relates is an undertaking or part of an undertaking of a public company, and
 - (b) ten months from the end of the profit period in any other case.
- (3) If before the end of the period allowed by subsection (2) above the scheme employer gives the Board written notice that an extension of three months has been allowed under section 242(3) of the Companies Act 1985, or under Article 250(3) of the Companies (Northern Ireland) Order 1986, in relation to a financial year of the employer which corresponds with the profit period in question, then the period allowed by subsection (2) above shall be correspondingly extended.
- (4) In subsection (2)(a) above, “public company” has the meaning given by section 1(3) of the Companies Act 1985 or Article 12(3) of the Companies (Northern Ireland) Order 1986.

13 Other information.

- (1) The Board may by written notice require any person to give them, within a period of thirty days or such longer period as may be specified in the notice, any information which is so specified and which—
- (a) that person has or can reasonably be required to obtain, and
 - (b) the Board consider they need to have in order to perform their functions under this Chapter.
- (2) Without prejudice to the generality of subsection (1)(b) above, the Board may in particular require a person under subsection (1) to give them—
- (a) information to enable them to determine whether the registration of a scheme should be cancelled;
 - (b) information to enable them to determine the liability to tax of any person who is or has been an employee to whom a registered scheme relates or who pays or has paid emoluments to such an employee;
 - (c) information about the administration of a profit-related pay scheme which is or has been a registered scheme;
 - (d) information about any change of person paying emoluments to employees to whom a registered scheme relates.
- (3) The scheme employer of a registered scheme shall by written notice inform the Board without delay if he becomes aware of anything that is or may be a ground for cancellation of the registration of the scheme.

14 Information: penalties.

- (1) At the end of the first column in the Table in section 98 of the Taxes Management Act 1970 (penalties for failure to furnish information etc.) there shall be added—

“Section 13(1) of the Finance (No. 2) Act 1987”.

- (2) At the end of the second column of that Table there shall be added—

“Section 12(1) of the Finance (No. 2) Act 1987”.

15 Appeals.

- (1) An appeal to the Special Commissioners may be made by a scheme employer—
 - (a) against a refusal by the Board under section 8(2) or (4) above of an application for registration of the scheme;
 - (b) against a refusal by the Board of an application under section 9 above;
 - (c) against the cancellation by the Board of the registration of the scheme.
- (2) An appeal under this section shall be made by written notice given to the Board within thirty days of the day on which the scheme employer was notified of the refusal or, as the case may be, the cancellation.

Supplementary

16 Partnerships.

—For the purposes of this Chapter the members of a partnership which is a scheme employer shall be treated as a single continuing body of persons notwithstanding any change in their identity.

17 Independent accountants.

- (1) For the purposes of this Chapter, “independent accountant”, in relation to a profit-related pay scheme, means a person who—
 - (a) is within section 389(1)(a) or (b) of the Companies Act 1985 or Article 397(1) (a) or (b) of the Companies (Northern Ireland) Order 1986 (qualification for appointment as auditor), and
 - (b) is not excluded by subsections (2) to (5) below.
- (2) A person is not an independent accountant in relation to a profit-related pay scheme if—
 - (a) he is the employer of employees to whom the scheme relates, or
 - (b) he is a partner or an employee of, or a partner of an employee of, a person within subsection (3) below, or
 - (c) he is an employee of a person within paragraph (b) above.
- (3) The persons within this subsection are—
 - (a) any person having employees to whom the scheme relates;
 - (b) any body corporate which is the subsidiary or holding company of a body corporate within paragraph (a) above or a subsidiary of such a body’s holding company.
- (4) For the purposes of this section—
 - (a) an auditor of a company is not to be regarded as an employee of it, and
 - (b) “holding company” and “subsidiary” are to be construed in accordance with section 736 of the Companies Act 1985 or Article 4 of the Companies (Northern Ireland) Order 1986.
- (5) A body corporate cannot be an independent accountant in relation to a scheme.

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- (6) For the purposes of this Chapter, “independent accountant”, in relation to a scheme, includes a Scottish firm all the partners of which are independent accountants in relation to the scheme.