

SOCIAL SECURITY CONTRIBUTIONS (SHARE OPTIONS) ACT 2001

EXPLANATORY NOTES

INTRODUCTION

1. These explanatory notes relate to the Social Security Contributions (Share Options) Act which received Royal Assent on 11 May 2001. They have been prepared by the Inland Revenue in order to assist the reader in understanding the Act. They do not form part of the Act and have not been endorsed by Parliament.
2. The notes need to be read in conjunction with the Act. They are not, and are not meant to be, a comprehensive description of the Act. So where a section or part of a section does not seem to require any explanation or comment, none is given.

SUMMARY AND BACKGROUND

3. The Chancellor announced in his Pre Budget report of 8 November 2000 a new National Insurance measure on employee share ownership. Commons Hansard 8 November 2000, Columns 316 to 327.
4. National Insurance Contributions (“NIC”) are charged on gains arising when share options are exercised outside an Inland Revenue approved scheme if the shares are readily convertible into cash. While employers can plan for NIC on regular pay, it is not as easy for them to plan for NIC on share options, particularly where the share price is volatile.
5. Legislation was introduced in summer 2000 and enacted in sections 77 and 81 of the Child Support, Pensions and Social Security Act 2000 to allow employees to agree that they will pay the employer’s NIC when they make a gain on their share options. However, some companies have said that they cannot make such agreements with their employees if an option has already been awarded.
6. This legislation will help companies that granted options between 6 April 1999 and 19 May 2000. Companies may limit the liability to the gain attributable to the growth in company share price up to 7 November 2000. 6 April 1999 was the date on which gains on the exercise of unapproved share options became liable to NIC. 19 May 2000 was the date on which the Government announced the legislation allowing employees to agree to pay the employer’s NIC.

Definitions

Shares

Those company shares or securities that are the subject of the option in question.

Exercise

The right to acquire shares is realised and the shares acquired in accordance with the company’s share scheme rules.

Assignment and release

Occasions where share options are traded for a consideration.

Roll-over

The exchange of one share option for another option over shares e.g. following a company reconstruction.

Replacement option

An option into which the original option is rolled-over or exchanged.

Special Contribution

An employer only NIC liability.

Special charge

Has the same meaning as Special Contribution. The rate will be 12.2% which, is equal to the Class 1A employer NIC charge for the 2000-2001 tax year.

Double tax deductions

This can arise where a special contribution under section 2 is not made within the 92 day deadline, and Section 187A Income and Corporation Taxes Act 1988 nevertheless allows relief.

COMMENTARY

Section 1: Notices relating to share options acquired before 19 May 2000

7. *Subsection (1)* defines the share option gains to which the provisions may relate. These are options granted during the period beginning on 6 April 1999 and ending on 19 May 2000, and exercised, assigned or released after 7 November 2000. The options must fall within the provisions of subsection (2) and a notice of entitlement to use these provisions must be lodged with the Inland Revenue within 92 days of the enactment of this legislation. Where such notification is made, the National Insurance liabilities on gains arising is to be determined in accordance with section 2.
8. *Subsection (2)* defines the options as those where the gain has or would be treated under section 4(4)(a) of the Social Security Contributions and Benefits Act 1992 (CBA) as remuneration from employment.
9. *Subsection (3)* specifies who is to provide the notice required by subsection (1) where the share option gain arises after the passing of this Act. Where an election to transfer the liability from the secondary contributor – normally the employer - to the employee is in force in respect of the whole of the liability, the notice can be given by either the company or the employee. Where an election is in force to cover only a part of the liability, the notice must be lodged jointly by the employee and the employer. Where no election is in force, the notice is to be lodged by the employer.
10. *Subsection (4)* specifies who is to lodge the notice in the case of gains realised after 7 November 2000 and before the passing of this Act. In these cases the notice is to be given by the person responsible for the secondary NI contribution, and, if the liability falls on more than one person, those people acting jointly.
11. *Subsection (5)* provides that the notice is to be given in writing or electronically in the form laid down by the Revenue, and once given is to be irrevocable.
12. *Subsection (6)* deems a notification to have been validly given where liability to the special contribution under section 2 would be nil.

Section 2: Effects of notice under section 1

13. *Subsection (1)* exempts from Class 1 contributions any gains arising from the exercise, assignment or release of options under circumstances described in section 1: that is, options granted between 6 April 1999 and 19 May 2000, and exercised, assigned or released after 7 November 2000, for which a notification has been made. Instead, there shall be a deemed gain subject to a special charge – described in subsection (2) - payable by the person who lodged the notice described in section 1.
14. *Subsection (2)* sets the rate of the special contribution at 12.2%, which is the 2000/2001 employer National Insurance Contribution rate. The charge is payable on the deemed gain, if any, which would have arisen had the option been exercised, assigned or released on 7 November 2000.
15. *Subsection (3)* deals with the case where consideration for the assignment or release of a right takes the form which is or includes something other than a replacement right e.g. cash. It provides an anti-avoidance measure to ensure that were an employee to be given consideration which exceeds the value of the old option only the part of the consideration which relates to the potential gain in the old option would be exempt from Class 1 liability. In testing the parity, account is taken of the amount that the employee would have to pay to exercise the option and/or the amount given for the option itself. The amount obtained for the assignment or release is compared with the inherent gain in the old option.
16. *Subsection (4)* provides that, if the special contribution is not paid within 92 days of Royal Assent, the normal rules for assessing the liability will apply. That is, Class 1 NIC will be chargeable under section 4(4)(a) of the Social Security Contributions and Benefits Act 1992 as now.
17. *Subsection (5)* allows the Inland Revenue to direct that the 92 day period be extended if it thinks that the person responsible for the payment had reasonable grounds for believing that the liability had been settled, or had reasonable excuse for failing to meet the deadline.
18. *Subsection (6)* provides that the direction to extend the 92 day deadline is to be given by an officer of the same description, and to be subject to the same right of appeal, as any other decision on the national insurance liability in question.
19. *Subsection (7)* provides that where Class 1 contributions have been paid on gains arising before the passing of this Act, the secondary Class 1 contributions may be offset against the special contribution payable, and the remaining balance of Class 1 contributions, if any, returned.

Section 3: Special provision for roll-overs

20. *Subsection (1)* defines the kind of roll-over to which these special provisions apply. It is an exchange of one option (the “original right”) granted between 6 April 1999 and 19 May 2000, for another option (the “replacement right”). The roll-over can take place at any time, either before or after the enactment of this Act.
21. *Subsection (2)* covers roll-overs taking place on or before 7 November 2000. In these cases, the new option is treated as if it was received between 6 April 1999 and 19 May 2000 and can be subject to the special charge described in section 2.
22. *Subsection (3)* deals with roll-overs taking place after 7 November 2000. Here, a notice can be lodged with the Inland Revenue under section 1 in respect of the original option, even though it has been replaced before the giving of the notice.
23. *Subsection (4)* deals with a liability that might arise when an option is assigned or released and provides the value of the replacement option that is to be used in the test of parity provided in section 2(3).

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24. *Subsection (5)* removes the exemption from Class 1 liability that may arise on the exercise, assignment or release of a replacement right where the original right or a replacement right is replaced by another. The relief is still available on the amount of the gain which is “capped” but this is achieved by charging Class 1 on a lesser amount i.e. only on the proportion of the replacement option that is in excess of parity. The basis of the Class 1 NIC charge on the gain on the replacement right is provided for in subsection (6).
25. *Subsection (6)* provides the basis of the Class 1 NIC charge on the gain on the replacement right. Class 1 is only applied to the gain on the new option to the extent that it is a right to acquire additional shares. Subsection (10) defines additional shares.
26. *Subsection (7)* deals with the liability on the amount of any consideration which is in a form other than an option (e.g. cash) and which is given on the assignment or release of an option which is not the original option i.e. on the event of the second or subsequent rollover. The subsection provides that the basis of the value that should be given to the old right (i.e. that being replaced) to be used in the parity tests contained within sections 2(3) and 3(4) is that assessed using the assumptions in subsection (8).
27. *Subsection (8)* provides that the value of the inherent gain that should be used in the parity test of the old option should be reduced by the amount of the additional shares (i.e. the proportion by value of the option being replaced). This will ensure that any Class 1 NIC taken on the event of the rollover itself (on consideration other than options) is adjusted so that the Class 1 liability on the rollover is preserved.
28. *Subsection (9)* provides protection against the avoidance of Class 1 NIC which may otherwise be exploited as a result of a rollover and the cap provided by this Act.
29. *Subsection (10)* defines additional shares as those of the shares obtainable by exercising the replacement option which are equivalent to the excess in market value of the shares obtainable by the exercise of the original option. The measure of additional shares takes account of the match in value of the old option compared to the new, measured at the time of the rollover.
30. *Subsection (11)* provides the definition of matching value which is referred to in subsection (10) in the definition of additional shares. The values of the options match where the inherent gain of each option is the same at the time immediately after the assignment or release of the old option.
31. *Subsection (12)* provides for the situation where a replacement option may be exercised bit by bit. Where this occurs that part of the new right which relates to “additional” shares for the purpose of subsection (10) shall be considered to be exercised, assigned or released before the remainder of the option.
32. *Subsection (13)* provides that where the number of additional shares that are produced by subsection (10) is not a whole number, an apportionment should be used.
33. *Subsection (14)* ensures that nothing in section 3 will affect the amount of the special contribution payable on an option which was rolled over before 7 November 2000.
34. *Subsection (15)* provides that where Class 1 contributions have been paid on gains arising before the passing of this Act, the secondary Class 1 contributions may be offset against the special contributions payable and the remaining balance of contributions, if any, refunded.
35. *Subsection (16)* defines subsequent replacement right.

Section 4: Consequential changes to tax relief provisions

36. *Subsection (1)* applies where the employer has previously agreed with the employed earner to transfer the liability for secondary contributions to the employed earner and

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a notice is given under section 1 of this Act to make a special contribution in respect of the share option right.

37. *Subsection (2)* ensures that tax relief will continue to be available to the employed earner, under section 187A of the Income and Corporation Taxes Act 1988, in respect of the employee's liability for special contributions on a share option right arising under this Act, as it would have applied for any employee's liability to a secondary contribution on a gain on the exercise, assignment or release of that right. This subsection continues to allow the tax relief to be given at the time a gain is made on exercise, assignment or release of the share options included within the notice to pay the special contribution.
38. *Subsection (3)* prevents double tax deductions. It prohibits tax relief from being given for a secondary Class 1 liability that has arisen when that liability is replaced by a special contribution under this Act. It also prevents tax relief from being given for a special contribution where the payment following a notice is not made within 92 days from the passing of this Act. In the latter case Section 187A of the Income and Corporation Taxes Act 1988 would allow tax relief for the employee's secondary Class 1 liability that is not displaced.
39. *Subsection (4)* disapplies the provisions of Section 203FB(6A) of the Income and Corporation Taxes Act 1988, in relation to relief for special contributions. This disapplication is required because relief for the special contribution is given at the time of option exercise and not at the time of payment of that special contribution. It is not therefore practical for the relief to be given through PAYE because of this timing difference.

Section 5: Interpretation

40. This section contains interpretation provisions.

Section 6: Short title and extent

41. This section extends the provisions to Northern Ireland.

COMMENCEMENT

42. The Act came into force on 11 May 2001.

HANSARD REFERENCES

The following table sets out the dates and Hansard references for each stage of this Act's passage through Parliament.

<i>Stage</i>	<i>Date</i>	<i>Hansard reference</i>
House of Commons		
Introduction	20 December 2000	Vol 360 Col 377
Second Reading	23 January 2001	Vol 22 Cols 801-831
Committee	30 January 2001	Hansard Standing Committee G
Report and Third Reading	8 February 2001	Vol 362 Cols 1089-1128
House of Lords		
Introduction	12 February 2001	Vol 622 Col 88
Second Reading	2 April 2001	Vol 624 Cols 604-616

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<i>Stage</i>	<i>Date</i>	<i>Hansard reference</i>
Committee, Report and Third Reading	10 May 2001	Vol 624 Cols 2229-2236
House of Commons		
Commons consideration	11 May 2001	Vol 368 Cols 383-388
Royal Assent – 11 May 2001	House of Commons Hansard Vol 368 Col 406	
	House of Lords Hansard Vol 624 Col 2282	