

FINANCE ACT 2013

EXPLANATORY NOTES

INTRODUCTION

Section 64, Schedule 24: EMI Options and Entrepreneurs' Relief Etc

Summary

1. **Section 64** introduces Schedule 24 which extends entrepreneurs' relief to the disposal by an employee or officer of a company of shares in that company or a company in the same trading group when the shares meet the requirements of the enterprise management incentives (EMI) scheme. Relief applies from 6 April 2013 where the shares were acquired on or after 6 April 2012 as a result of that person exercising a qualifying option over them and that option had been granted at least one year before the date of the share disposal. The person disposing of the shares must have been an employee or officer of the company (or a company in the same trading group) throughout the year ending with the date of disposal. The relief is also extended to similar disposals that take place within three years of the company ceasing to be a trading company.

Details of the Schedule

2. Paragraph 1 of the Schedule widens section 169I of the Taxation of Chargeable Gains Act (TCGA) 1992, which, amongst other things, defines "Conditions" when a disposal by an individual of an asset consisting of (or consisting of interests in) shares in or securities of a company is a 'material disposal' that qualifies for entrepreneurs' relief. This legislation introduces two new conditions, C and D. A disposal is a material disposal if any of Conditions A to D apply.
3. New subsection 169I(7A) introduces new Condition C in relation to the disposal of 'relevant EMI shares' whilst the relevant company is a trading company or the holding company of a trading group.
4. New subsection 169I(7B) introduces new Condition D in relation to the disposal of 'relevant EMI shares' within three years of the relevant company ceasing to be a trading company.
5. New subsections (7C) to (7G) define "relevant EMI shares" for the purposes of subsections (7A)(a) and (7B)(a) as either:
 - shares acquired by an individual on or after 6 April 2013 as a result of exercising a qualifying EMI option within 10 years of the option being granted; or
 - shares acquired as replacements for such shares as a result of certain reorganisations.

Shares acquired on exercise of an option following a disqualifying event are 'relevant EMI shares' if the exercise takes place within the period after which modified income tax consequences apply. New subsections (7P) to (7R) below make further provision for this purpose.

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6. New subsections (7H) and (7I) allow, where there is a qualifying reorganisation, that the 1-year company and employment requirements at section 169I(7A)(c) be read as including that of and with the company whose shares are ‘the original relevant EMI shares’.
7. New subsection (7J) provides that where the shares disposed of are replacement shares following a qualifying reorganisation, the question of whether the shares were acquired before the cessation date of the company for the purposes of section 169I(7B)(a) is determined by reference to the date ‘the original relevant EMI shares’ were acquired.
8. New subsection (7K) defines “the option grant date” for the purposes of determining the 1-year period for sections 169I(7A)(b) and 169I(7B)(b). This is the date on which the qualifying option was granted but is subject to the requirements in new subsections (7L) to (7O), which deal with the replacement of a qualifying option as part of a company reorganisation.
9. New subsection (7L) sets out that subsections (7M) and (7N) will apply where the option is a ‘replacement option’ as defined in the EMI code.
10. New subsection (7M) defines “the option grant date” as that on which the old option was granted.
11. New subsection (7N) provides that the 1-year company and employment requirements in section 169I(7A)(c) are to be met by reference to the company whose shares were the subject of the old option.
12. New subsection (7O) defines “the cessation date”, for the purposes of section 169I(7B).
13. New subsections (7P) to (7R) modify new Conditions C and D at new subsections 169I(7A) and (7B) above where shares are acquired on the exercise of an option following a disqualifying event and the exercise takes place within the period after which modified income tax consequences apply. New subsection (7Q) holds that for the purposes of Condition C the 1-year company and employment requirements end with the date of the disqualifying event; and new subsection (7R) holds that, for the purposes of Condition D, where the disqualifying event is the relevant company ceasing to meet the company requirement then the relevant shares must have been acquired before the end of the period after which modified income tax consequences apply.
14. Paragraphs 2 to 4 of the Schedule amend the share identification rules at sections 105 and 106A of the TCGA, which deal with acquisitions and disposals of shares on the same day and make general provision for share identification for capital gains tax purposes. They also ensure that ‘relevant EMI shares’ are defined for these purposes in the same way as for sections 169I(7C) to (7H).
15. New subsection 105(4) applies new subsection 105(5) where an individual acquires shares of the same class on the same day and some of those are ‘relevant EMI shares’.
16. New subsection 105(5) sets out the treatment of the relevant EMI shares separate from other relevant shares.
17. New subsection 106A(5)(aa) provides that shares that are not relevant EMI shares are to be identified before relevant EMI shares when applying the rule in section 106A(5).
18. New subsection 106A(6A) provides that on disposal of a company’s shares any relevant EMI shares are to be regarded as being disposed of before other shares and the relevant EMI shares are to be regarded as being disposed of on a ‘first in, first out’ basis.
19. New subsection 106A(6B) provides that those shares identified with relevant EMI shares by virtue of subsection 106A(6A) shall not be regarded as forming part of an existing holding, or constituting a holding, that is regarded as a single asset for the purposes of the TCGA.

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20. Paragraph 5 of the Schedule provides that the amendments made by paragraphs 1 to 4 have effect in relation to disposals of shares on or after 6 April 2013, subject to subparagraph 6(4).
21. Paragraph 6 applies where shares are acquired during the tax year 2012-13 which would qualify as 'relevant EMI shares' if they were acquired on or after 6 April 2013.
22. Subparagraph 6(2) treats such shares as 'relevant EMI shares' where the individual makes no disposals of shares of that class in the 2012-13 tax year.
23. Subparagraph 6(3) provides that where shares of that class are disposed of in the tax year 2012-13 the individual may elect that the acquired shares are treated as 'relevant EMI shares'.
24. Subparagraphs 6(4) and 6(5) make consequential amendments pursuant to an election.
25. Subparagraph 6(6) provides that the election must be made (or revoked after it has been made) by 31 January 2014.
26. Subparagraphs 6(7) and (8) provide that shares in a company are not to be treated as being of the same class unless they would be treated as such by a relevant stock exchange (as defined in section 1005 of the Income Taxes Act 2007).

Background

27. Since 23 June 2010 capital gains tax for individuals has been charged at the rate of either 18 per cent or, for those paying the higher rate of income tax, 28 per cent.
28. Individuals may claim entrepreneurs' relief, under which qualifying chargeable gains are taxed at 10 per cent, on gains on disposals of shares in or securities of a company provided that throughout the period of one year immediately preceding the disposal (a) the claimant held a minimum five per cent stake in the company, (b) the company was either a trading company or the holding company of a trading group, and (c) the claimant was an officer or employee of the company or of one or more companies of a trading group to which the company is a member. There is a lifetime limit to the relief, which was increased to £10 million from 6 April 2011.
29. Entrepreneurs' relief is also available on the disposal of shares of a business where the conditions (a) to (c) at paragraph 28 above were met throughout the period of one year immediately preceding the company ceasing to be a trading company without continuing to be or becoming a member of a trading group, or ceasing to be a member of a trading group without continuing to be or becoming a trading company and that date is within the period of three years immediately preceding the disposal. The relief may apply, for example, to the deemed disposal by a shareholder of his interest in shares when he receives a capital distribution on the liquidation or winding-up of a trading company.
30. The Enterprise Management Incentives (EMI) scheme provides tax and National Insurance contributions advantages for qualifying share options granted by companies with gross assets not exceeding £30 million, to help them recruit and retain employees. In addition to the gross assets test, EMI is limited to companies or groups which are independent and whose trade does not consist in excluded trading activities.
31. Budget 2012 announced the Government's intention to allow EMI shares to qualify for Entrepreneurs' Relief on disposal by the employee/officer.
32. A number of representations were made to the Government that the normal rule that requires ownership of the qualifying shares for one year prior to disposal (see paragraph 28 above), would limit the ability of EMI shares to qualify. This was because EMI options would typically be exercised just before the employing company was taken over, meaning that they would then not be owned by the employee for one year.

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33. The Budget further announced that the measure would apply to shares acquired under the EMI scheme from 6 April 2012, but the one year share holding period meant it would have no effect for disposals made before 6 April 2013.
34. The legislation similarly applies to shares acquired on or after 6 April 2012 and disposed of on or after 6 April 2013 but allows the period the share option is held to be included towards the one year holding period requirement.
35. The legislation includes rules that modify the usual operation of the share identification rules in order to treat shares issued under the EMI scheme separately.
36. The inclusion of shares acquired from 6 April 2012 will affect the computation of gains on any disposal of shares of the same class during the tax year 2012-13. Therefore the new legislation will apply where there were such disposals only on the making of an election.