

# FINANCE ACT 2014

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## EXPLANATORY NOTES

### INTRODUCTION

#### *Section 51 and Schedule 8: Employee Share Schemes*

#### **Details of the Schedule**

#### **Part 3: CSOP Schemes**

77. Paragraph 158 introduces amendments to Chapter 8 of Part 7 of ITEPA, which provides for exemption from income tax in connection with share options granted under CSOP schemes.
78. Paragraphs 159-162 make various changes to Chapter 7 to reflect the replacement of the present arrangements for HMRC approval of CSOPs with self certification by scheme organisers. In particular these paragraphs remove legislative references to 'approved CSOP schemes'. Instead the concept is introduced of schemes that meet the conditions being certified by scheme organisers as 'Schedule 4 CSOP schemes'. In addition, paragraph 161 makes changes to section 524 ITEPA to reflect the tax relief available for certain exercises of CSOP options in the case of a 'non-UK company reorganisation arrangement'.
79. Paragraphs 163-182 set out amendments to Schedule 4 ITEPA. Many of these are consequential changes caused by the shift from HMRC approval of CSOPs to self certification by employers, and there are new powers for HMRC to determine that a scheme is not to be a Schedule 4 CSOP, and to make enquiries into the running of a scheme.
80. Paragraph 166 amends the introductory provision for the CSOP rules in paragraph 1 Schedule 4, taking account of the new self certification arrangements for CSOP and HMRC powers to enquire into schemes and decide that certain schemes should not be Schedule 4 CSOPs.
81. Paragraph 169 amends paragraph 5 Schedule 4 to introduce a new purpose test that must met by Schedule 4 CSOPs. Key conditions are that schemes must provide benefits for employees and directors in the form of share options, and must not provide benefits other than in accordance with Schedule 4. In particular, schemes must not provide participants with cash as an alternative to shares or share options.
82. Paragraph 171 amends the requirements relating to shares that may be subject to CSOP options, to reflect changes made in paragraph 175 of this Schedule concerning the exercise of options on certain company events, where shares in the company to which an option relates cease to meet the conditions of Schedule 4.
83. Paragraph 173 inserts new paragraph 21A in Schedule 4, which sets out a series of general conditions that CSOP options must satisfy. In particular, certain terms of the option must be stated at the time the option is granted. Terms of an option may be changed after grant, but only as provided for in paragraph 22 of Schedule 4 (concerning requirements as to the price for acquisition of shares) or on the basis of a mechanism

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stated at the grant of the option. Any such mechanism must be applied in a fair and reasonable way. The terms of the option and any mechanism for varying it must be notified to the participant as soon as practicable after grant of the option.

84. Paragraph 174 amends the provisions of paragraph 22 Schedule 4, which allow adjustment of the price, amount or description of shares under a CSOP option where there is a variation in the share capital of the company. This amendment removes the requirement for these adjustments to be approved by HMRC, but provides that the market value of the shares that may be acquired under the option and the exercise price of the option must be substantially the same immediately before and after the variation.
85. Paragraph 175 amends provisions in paragraph 25 Schedule 4 concerning the exercise of options after the death of the participant, to make clear that the twelve month exercise period for options held by a participant who dies is a minimum.
86. Paragraph 176 amends provisions in paragraph 25A Schedule 4 allowing exercise of CSOP options where certain 'company events' occur.
  - The circumstances in which paragraph 25A may apply in 'non-UK company reorganisations' are clarified in new sub-paragraph (6A).
  - Where shares in the company to which an option relates cease to meet the conditions of Schedule 4, because control of the original company has changed hands in various specified circumstances, new sub-paragraphs (7B) to (7D) of paragraph 25A allow scheme rules to provide that the option may still be exercised by the participant within a period of 20 days after the relevant event.
  - New sub-paragraphs (7E) to (7F) allow scheme rules to provide for options to be exercised within a period of 20 days before a general offer to acquire the whole of the issued share capital of the company to which an option relates, or before certain takeovers sanctioned by the courts where an offeror has the right to buy out minority shareholders. Where scheme rules make such a provision, they must also provide that if in such cases an option has been exercised in anticipation of a change of control and this does not in the event take place within 20 days of the exercise, that exercise is treated as having had no effect.
87. Paragraph 177 concerns provisions in paragraph 26 Schedule 4 allowing exchange of option on a company reorganisation. Scheme rules may provide for exchange of options if a company acquires control as a result of a 'non-UK company reorganisation arrangement', where certain conditions are met.
88. Paragraph 178 amends provisions in paragraph 27 Schedule 4 concerning the requirements about share options granted in exchange for other CSOP options on a company reorganisation. In such an exchange, the market value of the shares and the price payable for the shares by the participant must be substantially the same under the new options as it was under the old options. The market value of shares for the purposes of paragraph 27 must be determined using a methodology agreed by HMRC.
89. Paragraph 179 inserts a new Part 7 in Schedule 4, setting out rules for notification of CSOPs, annual returns and HMRC enquiries. The new provisions reflect the shift to self certification of schemes and online filing of returns. They include HMRC powers to apply penalties, determine that a scheme is not a Schedule 4 CSOP and make enquiries into the running of a scheme, as well as appeal rights in respect of these powers.
90. New paragraph 28A of Schedule 4 provides new rules concerning notification of CSOPs to HMRC. For a scheme to be a Schedule 4 CSOP and qualify for favourable tax treatment, the scheme organiser must give notice to HMRC and make a declaration that it meets and, where the declaration is made after the first grant of options, has met the conditions of Schedule 4. The notice should be given by 6 July following the tax year in which the first option is granted under the scheme and sub-paragraph (5) explains when a scheme will be a Schedule 4 CSOP in cases where this deadline is missed.

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91. New paragraph 28B obliges scheme organisers to make annual returns to HMRC in respect of Schedule 4 CSOPs, containing the information required by HMRC. Returns must give details of any alterations made to a key feature of the CSOP in the tax year in question and of any variations made to terms of CSOP options to take account of variations in share capital; and must contain a declaration by the scheme organiser. Returns must be made not later than 6 July following the end of the tax year to which they relate, and must be in the form required by HMRC. This requirement to make an annual return to HMRC applies for each year prior to and including the year of the termination of a scheme. This will be where there are no outstanding options under the scheme, and no intention to grant any further options under the scheme. If scheme organisers become aware of errors or inaccuracies in returns, they must provide amended returns correcting the position without delay.
92. New paragraph 28C lays down the penalties to which scheme organisers may be liable for failure to deliver annual returns by the specified deadline. An exception is specified where scheme organisers have a 'reasonable excuse' for the failure.
93. New paragraph 28D provides that notification of CSOPs and annual CSOP returns must be delivered in electronic form in a manner prescribed by HMRC, unless a scheme organiser has been specifically allowed by HMRC to use some other form. The Commissioners for HMRC must prescribe how the notices and returns must be submitted.
94. New paragraph 28E sets out the penalties that may apply where returns are not delivered in the form required by HMRC; or where they contain material inaccuracies that are careless or deliberate, or are not corrected by the scheme organiser.
95. New paragraph 28F empowers HMRC to make enquiries into a CSOP after giving notice to scheme organisers of their intention to do so, and sets out time periods for providing this notice. This is allowed in specified circumstances, including where HMRC have reasonable grounds for believing the requirements of Schedule 4 are not or have not been met in relation to the scheme.
96. New paragraph 28G provides the rules for closure of HMRC enquiries, the decisions that may be included in an HMRC closure notice, the right of scheme organisers to apply to tribunals to direct that closure notices be given and the requirement on the tribunal to provide such a direction in certain circumstances.
97. New paragraph 28H sets out the action HMRC may take where a CSOP does not meet or has not met the conditions of Schedule 4. If the breach of the CSOP rules is considered serious enough to warrant it, HMRC may decide that a scheme is not to be a Schedule 4 CSOP either from the time of the closure notice or such time as is specified in the notice, and the scheme organiser is liable for a penalty.
98. New paragraph 28I sets out the action that HMRC may take in cases where a breach of the CSOP rules is not considered serious enough that the scheme is not to be a Schedule 4 CSOP. HMRC will require the scheme organiser to put right any failure within a specified period, and the scheme organiser is liable for a penalty. Where the breach is not put right within the specified period, HMRC may provide by a 'default notice' that a scheme is not to be a Schedule 4 CSOP either from the time of the notice or such time as is specified in the notice, and the scheme organiser is liable for a further penalty.
99. New paragraph 28J sets out procedures for the assessment and enforcement of penalties by HMRC, including time limits as to when penalties may be imposed and when payment must be made.
100. New paragraph 28K provides rights for scheme organisers to appeal against decisions of HMRC, for example that a scheme is not to be a Schedule 4 CSOP and on imposition of penalties, and lays down time limits for appeals, rules for the handling of appeals and the action tribunals may take in response to an appeal.

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101. Paragraph 180 amends HMRC's powers in paragraph 33 Schedule 4 to require information concerning a CSOP. In particular HMRC are empowered to require information needed to check details supplied by a scheme organiser in their notification of a CSOP scheme or annual CSOP returns, or to determine the liability to tax of any relevant person.
102. Paragraph 181 explains the term 'non-UK company reorganisation arrangement', involving companies set up under the law of an overseas territory, for the purposes of the CSOP code.
103. Paragraphs 183-189 make amendments to various provisions of TCGA arising from the move to self certification of CSOPs.
104. Paragraphs 190-203 make amendments to various provisions of ITEPA.
105. Paragraph 204 provides that the new rules for CSOPs come into force on 6 April 2014, and paragraph 205 introduces transitional provisions for schemes approved by HMRC before that date.
106. Paragraph 206 provides that in the case of CSOPs approved immediately before 6 April 2014, any provisions of the scheme which require HMRC approval for any purpose will have effect from that date without the requirement for approval (except where approval is expressly required under Schedule 4).
107. Paragraph 207 provides that for these existing approved schemes the new purpose test introduced by paragraph 168 of this Schedule only applies from such time as there is alteration to a key feature of the scheme.
108. Paragraphs 208-212 provide that these existing approved schemes have effect from 6 April 2014 as if the scheme includes various modifications made by Part 3 of this Schedule, and also provides that other modifications made by Part 3 do not have effect in relation to options granted under the scheme before that date.
109. Paragraph 213 modifies the arrangements for the notification of these existing approved schemes under self certification (including the declaration required within the notice), as well as HMRC's powers of enquiry. In the case of CSOP options granted before 6 April 2014, the CSOP code (and tax advantages where appropriate) will apply in relation to these options, unless the scheme is not notified to HMRC or prior to 6 April 2014 HMRC refused to approve the scheme or decided to withdraw approval. HMRC's ability to determine that a scheme is not a Schedule 4 CSOP applies in relation to breaches of the CSOP rules that occurred prior to 6 April 2014.
110. Paragraph 214 ensures that the availability of certain corporation tax deductions in relation to set up costs for a CSOP scheme approved by HMRC before 6 April 2014 is not affected by any changes in Part 3 of the Schedule.