Explanatory Note

Clause 10 and Schedule: Employee Share Schemes: Minor Amendments

Summary

1. This clause and Schedule introduce several changes to simplify the tax rules and administrative processes for employee share schemes, including permitting late notification of tax-advantaged share schemes where the taxpayer had a reasonable excuse.

Details of the clause and Schedule

2. Clause 10 introduces the Schedule.

3. Paragraph 1 amends section 534 of the Income Tax (Earnings and Pensions) Act 2003 (ITEPA), backdated to 1 October 2014. This amendment allows a company controlled by an Employee Ownership Trust to operate an Enterprise Management Incentive (EMI) scheme.

4. Paragraph 2 introduces amendments to Schedule 2 of ITEPA, which sets out the rules for Share Incentive Plans (SIP) by way of a new Part 10A. A SIP is a tax-advantaged share scheme which must be offered to all employees on a similar basis. A Schedule 2 SIP is one which meets criteria set out in Schedule 2 to ITEPA.

5. New Paragraph 85A within new Part 10A sets out certain events in consequence of which a scheme ceases to qualify as a Schedule 2 SIP. These disqualifying events enforce the principle that preferential shares in a SIP cannot be issued to select employees.

6. New sub-paragraph 85A(7) has the effect that any shares issued prior to the date of the disqualifying event will retain the SIP tax advantages.

7. Paragraphs 3 to 5 amend the rules in Schedules 2, 3 and 4 ITEPA for SIP, Save As You Earn Option Schemes (SAYE) and Company Share Option Plans (CSOP) respectively. Currently, the rules relating to a SIP, SAYE or CSOP require HMRC to be notified of the scheme by a specified date. Late notification means that the tax advantages will be lost for earlier tax years and will only apply for future tax years. The changes introduce a reasonable excuse provision. If the company or share scheme organiser satisfies HMRC that they had a reasonable excuse for the late notification the tax advantage will not be lost. The provisions also provide a right of appeal against a decision of HMRC that the excuse was not reasonable and impose time limits for making the decision.

8. Paragraph 6 makes changes to Schedule 3 ITEPA, which sets out the rules for SAYE. Paragraph 7 makes identical changes to Schedule 4 ITEPA, which sets out the rules for CSOP. These changes provide for HMRC to publish guidance to specify acceptable ways in which a company could value share options by reference to the value at a time before the option was

granted. These new provisions remove the need for specific HMRC agreement to the methodology.

9. Paragraph 8 introduces a change to paragraph 39 of Schedule 5 ITEPA, which sets out the rules for EMI schemes. This will preserve tax advantages of an EMI where minority shareholders in an EMI scheme exercise so-called "tag-along" rights. These are rights in a takeover to have their share options acquired by the offeror and exchanged for share options in the offeror company. This amendment is backdated to 17 July 2013.

10. Paragraph 9 amends section 14(4) of Schedule 7D of the Taxation of Chargeable Gains Act 1992 to increase the time limit for capital gains tax purposes for employees to exercise EMI options following a disqualifying event from 40 days to 90 days. This change will align the deadline for capital gains tax purposes with that contained in section 532(1)(b) ITEPA which states that if a disqualifying event occurs, EMI options can be exercised within 90 days and continue to enjoy tax advantages. This takes effect in relation to disqualifying events occurring on or after the day on which this Act is passed.

Background note

11. The measures give effect to a number of changes to the rules for employment-related securities (ERS) and ERS options. They take further the government's response to the Office of Tax Simplification report on employee share schemes by simplifying and clarifying the law as well as making some minor technical corrections.

12. There are four types of tax-advantaged employee share schemes.

- An employee that obtains shares through a SIP and keeps them in the plan for 5 years will not pay Income Tax or National Insurance on their value. They will not pay Capital gains Tax on shares they sell if they keep them in the plan until they sell them. An employer can give an employee a limited amount of free shares in a SIP in any tax year. Employees can also buy a limited number of shares to put in the SIP. Matching shares and dividend shares are also available.

- SAYE is a savings-related share scheme where the employee can buy shares with their savings within the scheme for a fixed price. The interest and any bonus at the end of the scheme is tax-free. The employee does not pay Income Tax or National Insurance on the difference between what they pay for the shares and what they are worth, within certain parameters set out in the legislation.

- In a CSOP an employee may have the option to buy up to £30,000 worth of shares at a fixed price. They do not pay Income Tax or National Insurance contributions on the difference between what they pay for the shares and what they are actually worth when the option is exercised.

- A company with assets of £30m or less that does not work in certain excluded activities may be able to offer EMIs. In EMIs an employee may be granted an option to buy shares worth up to £250,000 without paying Income Tax or National Insurance on the difference between what they pay for the shares and what they are worth when the option is exercised.

13. If you have any questions about this change, or comments on the legislation, please contact Tom Rollinson on 03000 585167 (email: tom.rollinson@hmrc.gsi.gov.uk).