Inland Revenue

tax BULLETIN

SPECIAL EDITION

Amendments to NICs legislation following introduction of Schedule 22 in Finance Act 2003

Schedule 22 is designed to deliver the policy of subjecting to income tax and National Insurance contributions (NICs) value obtained as a result of acquiring shares and other types of securities by reason of employment. Schedule 22 is not purely anti-avoidance but a robust and fair regime that ensures that those in the mainstream who acquire shares or other securities as part of their remuneration package are taxed on the value they receive. It removes inconsistencies that sometimes led to unfairly high taxation.

This special Tax Bulletin explains the main changes introduced by the Social Security (Contributions) (Amendment No. 5) Regulations 2003 to the principal Social Security (Contributions) Regulations 2001 to align National Insurance treatment with tax treatment in this area. It may help your understanding if we first explain the changes to the tax treatment of employment related securities and securities options introduced by Schedule 22 in Finance Act 2003 (FA03).

To aid reading we have used common terms which are defined in appendix 2.

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Overview of tax changes introduced by Schedule 22 in Finance Act 2003

1. Schedule 22, FA03 replaces Chapters 1 to 5 and introduces four new Chapters into Part 7 of Income Tax (Earnings & Pensions) Act 2003 (ITEPA 2003). Part 7 provides the income tax rules in cases where securities, interests in securities or securities options are acquired in connection with an employment.

2. There are three effective dates for the introduction of the legislation in Schedule 22:

   - some of the provisions came into effect from 16 April 2003, the date of the publication of the Finance Bill;
   - the new definition of “readily convertible assets” came into effect from the date of Royal Assent of the FA03 on 10 July 2003;
   - the remaining provisions came into effect from 1 September 2003, which is the day appointed in the Treasury Order (Statutory Instrument 2003 No.1997 (C.83)).

3. New Chapter 2 combines the treatment of what were termed “conditional shares” under the previous rules in Chapter 2 with what were termed “restricted shares” under the rules in old Chapter 4 (sections 449-451) of Part 7 of ITEPA 2003. New Chapter 2 now covers all restricted securities and restricted interests in securities (using the definition of securities in new section 420).

4. New Chapter 2 is effective from 1 September 2003 but only in relation to securities, or interests in securities, acquired on or after 16 April 2003. Conditional shares acquired before 16 April 2003, which have been subject to a depreciatory transaction on or after 16 April 2003, may be subject to a charge under section 446F ITEPA 2003, introduced by Schedule 22, FA03.

5. New Chapter 3 deals with the taxation of “convertible securities”. Although the chapter already existed in ITEPA 2003 it has been fundamentally amended by Schedule 22 FA03. New Chapter 3 treats convertible securities as two assets. First, the underlying securities, ignoring the value of the right to convert, and second, the right to acquire securities of a different description, which is similar to a securities option.

6. New Chapter 3 applies from 1 September 2003, irrespective of the date when the securities were acquired. However, new Section 437 (adjustment of charge on acquisition of convertible securities) applies only to securities acquired on or after 1 September 2003.

7. The following new Chapters are effective from 16 April 2003:

   - Chapter 3A (securities with artificially depressed market value);
   - Chapter 3B (securities with artificially enhanced market value);
   - Chapter 3C (securities acquired for less than market value);
   - Chapter 3D (securities disposed of for more than market value);
   - Chapter 4 (post-acquisition benefits from securities).

8. New Chapter 5 applies to share options (including company loan stock) from 1 September 2003 (with the provisions in old Chapter 5 continuing to apply to share options exercised before that date). It applies to all other securities options from 16 April 2003.

9. Schedule 22 FA03 also changes the rules on determining what is a readily convertible asset (RCA) with effect from Royal Assent of FA03 on 10 July 2003. Only shares that are not RCAs under the normal definition and are qualifying shares for the new Corporation Tax deduction in Schedule 23 FA03 are exempt from PAYE and NIC.

10. New sections 698 and 700 replace the old sections 698, 699 and 700 ITEPA 2003 from 1 September 2003, and require PAYE to be operated by the employer on all chargeable events within the new Chapters (2, 3, 3A, 3B, 3C, 3D, 4 & 5) of ITEPA 2003, subject to the amended RCA rules described in paragraph 9 above.

Changes to the National Insurance legislation

11. Changes were also introduced in NI legislation to ensure consistent income tax and National Insurance treatment of payments of earnings by way of securities.

12. The Social Security (Contributions)(Amendment No 5) Regulations 2003 (SI 2003/2085), took effect from 1 September 2003.

Readily Convertible Assets

13. For NICs purposes, a readily convertible asset has the same meaning as in section 702 of ITEPA 2003 as amended by the Finance Act 2003.

Meaning of securities

14. Securities and securities options have the meaning given by section 420 of ITEPA 2003 as substituted by the Finance Act 2003.

Amounts liable to Class 1 NICs

15. Section 4(4)(a) Social Security Contributions and Benefits Act 1992 (SSCBA) was amended, effective from 16 April 2003, by FA03. Section 4(4)(a) imposes a Class 1 NICs liability on the amount of any gain calculated under section 479 of ITEPA 2003, in respect of which an amount counts as employment income of the earner under section 476 of that Act, reduced by any amounts deducted under section 480(1) to (6) of ITEPA (2003).

Amounts treated as earnings and liable to Class 1 NICs

16. Regulation 22 SSCR 2001, as amended by SI 2003/2085, provides for certain amounts to be treated as earnings for NICs purposes. Class 1 NICs are due at the same time and on the same amount, which counts as employment income of the employed earner in relation to employment-related securities, provided that the amount is subject to tax through PAYE. This applies to:

   - restricted securities acquired after 16 April 2003;
   - convertible shares;
   - securities with an artificially depressed value;
   - securities with an artificially enhanced value;
   - securities acquired for less than the market value - discharge of notional loan;
   - securities disposed of for more than market value;
   - post-acquisition benefits from securities;
   - securities options.

Conditional shares acquired before 16 April 2003

17. A class 1 NICs liability arises, in respect of conditional shares, or interests in conditional shares, acquired before 16 April 2003, on an amount which counts as employment income of the employed earner under Chapter 2 of Part 7 of ITEPA 2003, computed in accordance with section 428 of ITEPA 2003 as originally enacted.

Approved share incentive plans (SIP)

18. A Class 1 NICs liability arises on an amount which counts as employment income of the employed earner, by virtue of sections 500 to 508 of ITEPA 2003, and in respect of which income tax is recoverable in accordance with PAYE regulations. SI 2003/2085 simply updated these PAYE cross-references with respect to SIP.

PAYE income tax met by employer

19. Following amendment of section 222(1) of ITEPA 2003 by the FA03, the period in which an employee can reimburse PAYE tax met by their employer without incurring a further charge to income tax, is extended from 30 days to 90 days. Where an employer pays tax on behalf of an employee, because deduction is not possible at the time the earnings are paid and the employee does not make reimbursement within 90 days, the payment of tax is treated as earnings and attracts a Class 1 NICs liability.

Annual charge on notional loans - Class 1A

20. When an employee acquires securities, including shares, for less than the market value, section 446S of ITEPA 2003, as amended by the FA03, treats the difference as an interest free loan to the employed earner by the employer at the time of acquisition. A Class 1A NICs liability arises on the same amount which is chargeable to income tax.

Discharge of a notional loan - Class 1

21. A notional loan is treated as discharged when the employed earner disposes of the securities or the outstanding loan is released, transferred or adjusted. The amount of the outstanding notional loan at the time of discharge, which counts as employment income and is subject to an income tax charge through PAYE, attracts a Class 1 NICs liability.

Long options

22. A payment by way of a right to acquire securities is disregarded for NICs purposes and, from 1 September 2003, this includes securities options capable of being exercised more than 10 years after the date of grant. A Class 1 NICs liability only arises on gains from an option, irrespective of the vesting period.

Gains obtained by exercise, assignment or release of options where the original option was acquired before 6 April 1999

23. Gains from share options were brought into the scope of Class 1 NICs liability from 6 April 1999, but the charge did not apply to options granted before 6 April 1999. This provision was sometimes exploited by the use of artificial arrangements to pay cash bonuses through such pre-April 1999 options, followed by a series of partial exercises of the option. SI 2003/1059 introduced changes, effective from 10 April 2003, so that all gains from such manipulated options gives rise to a Class 1 NICs liability. Paragraph 17 of Part 9, Schedule 3 SSCR 2001 refers.

24. SI 2003/2085 makes some amendments to SSCR 2001 to clarify the position and reflect the policy intention on the NICs treatment of gains from share options first acquired before 6 April 1999. We explained that we intended to do this in Tax Bulletin 46 (Q16).

    Appendix 1 contains illustrative examples to show how the legislation applies to share options granted before 6 April 1999, as well as replacement share options received in respect of such options.

Assignment or release of share options first acquired before 6 April 1999

25. **Option replaced in whole or part by a replacement option**

    Some concerns have been expressed about the omission of paragraph 15 of Part 9 of Schedule 3 SSCR 2001 (assignment or release of share options). As a result, it has been suggested that where a share option is assigned or released, and the whole or part of the consideration for the assignment or release consists of or includes another share option (the “replacement option”), the replacement option is liable for Class 1 NICs when acquired.

    However, this is not the case and the Revenue’s view is that the replacement option is not earnings, because it is not chargeable to tax by virtue of section 483(2) ITEPA 2003 (previously section 136(1) of the Income and Corporation Taxes Act 1988 (ICTA)). Consequently, the Revenue believe that there was no need to make provision to specifically disregard from earnings, for Class 1 NICs purposes, replacement options within the SSCR 2001.

26. **Option exchanged in whole or part for something other than, or in addition to, a replacement option**

    In certain circumstances and before amendment by SI 2003/2085, paragraphs 15 and 16 of Part 9 of Schedule 3 SSCR 2001 disregarded “a gain” on the assignment or release of share options. The term “a gain” was not defined in legislation and was not clearly limited to the value of the shares that could be acquired. Cash and money’s worth are included in “gain” and if either paragraph 15 or 16 applied, cash or money’s worth was disregarded from earnings and no Class 1 NICs liability arose. It was never the intention to disregard cash or money’s worth received by way of a share option but there was some ambiguity in paragraphs 15 and 16 about this. We therefore needed to rewrite these provisions to put the matter beyond doubt.

Part 9 of Schedule 3 to the SSCR 2001 has been amended to clarify that all gains, (excepting replacement options), which are:

- chargeable to income tax;
- treated as earnings under section 4(4)(a) of the Social Security Contributions and Benefits Act 1992 (SSCBA), and
- acquired pursuant to a share option
- are liable for Class 1 NICs.

Exercise of share options first acquired before 6 April 1999

27. When a share option was acquired before 6 April 1999 and exercised before that date, any gains from exercise were not earnings, or treated as earnings, derived from an employment. From 6 April 1999, any gains on the exercise of a share option, which were chargeable to income tax under section 135 of ICTA, were treated as earnings under section 4(4)(a) SSCBA and subject to a Class 1 NICs liability, unless specifically disregarded under Part 9 of Schedule 3 of the SSCR 2001.

Exercise of share options on or after 6 April 1999, but before 1 September 2003, where the share option was acquired before 6 April 1999

28. Paragraph 16, Part 9, Schedule 3 of the SSCR 2001 disregarded “a gain realised on the assignment or release of” share options first acquired before 6 April 1999. In addition, “a gain” on the exercise of such options was also disregarded from earnings, so that Class 1 NICs liability did not arise. Example 1, Appendix 1, illustrates how the legislation applied in a situation where cash was received on exercise of a share option.

Exercise of share options on or after 1 September 2003, where the share option was acquired before 6 April 1999

29. Paragraph 16, Part 9, Schedule 3 of the SSCR 2001, as amended, only disregards from earnings a gain realised by the exercise (in whole or in part) of a share option, obtained before 6 April 1999, to the extent that the gain realised consists of the shares acquired.

Exercise of replacement options on or after 1 September 2003, where the original option was obtained before 6 April 1999

30. Paragraph 16A, Part 9, Schedule 3 of the SSCR 2001 provides for the disregard of certain gains realised by the exercise of a replacement share option where the original option was obtained before 6 April 1999, unless:

- the market value of the shares obtained by the exercise of the replacement right, less any consideration that would have to be given, is **substantially greater** than the market value of the shares subject to the original right, immediately before their release or assignment, less any consideration given; or
- the market value of the shares has been increased by more than 10% by things done, on or after 6 April 1999, otherwise than for genuine commercial purposes.

If paragraph 16A applies, all that can be disregarded from earnings is the value of the shares acquired by the exercise of the replacement right. So, any other gains treated as earnings under section 4(4)(a) SSCBA, which are not disregarded by any other provision within Schedule 3 SSCR 2001, will be liable for Class 1 NICs - for example cash or money’s worth. Example 3, Appendix 1, illustrates when Class 1 NICs liability will not be due and example 4 illustrates when Class 1 NICs liability will be due.

Meaning of “Substantially Greater” (as used in paragraph 16A)

31. The term “substantially greater” (as used in paragraph 16A of Part 9, Schedule 3 SSCR 2001) is not defined in legislation, but should not be difficult to determine in most situations. However, a degree of common sense and application of the intention of the law is required.

It is not our intention to treat small, unintended changes in the value of an option, as a result of replacing the option, as an event which will trigger a NICs liability on the gain from exercise. The use of the phrase “substantially greater” recognises the fact that when options are replaced for commercial reasons it is not always possible to achieve an exact match in value between the two options. The intention of paragraph 16A is to ensure that only that part of the gain from exercise which is clearly derived from the original option is disregarded from NICs. If an option granted before 6 April 1999 is deliberately replaced with an option of greater value (any increase in the total discount which, for example, can not be explained by very short-term movements in market value), the earnings from the exercise of the replacement option cannot be said to derive in full from the original pre-6 April 1999 option. They can not, therefore, be disregarded in full from NICs on exercise. In this situation only the value of the discount on the option immediately before replacement with a more valuable option (a greater total discount) can clearly be said to derive from the original option. See example 9, Appendix 1.

Calculating the amount of earnings where Class 1 NICs liability arises on exercise of replacement options, where original option was acquired before 6 April 1999

32. If gains on exercise of replacement options (where the original option was acquired before 6 April 1999) cannot be disregarded in full from earnings under paragraph 16A, paragraph 11, Schedule 2 of the SSCR 2001 sets out how to calculate the amount of the earnings. The basis for calculating the amount treated as earnings realised by the exercise of the replacement right is the best estimate that can be reasonably be made of the amount found as follows:

Step One
Find the amount (if any) by which the sum of

(a) the market value of the shares acquired by the exercise of the replacement right, and

(b) the market value of any other benefit in money or money's worth obtained by the exercise of the replacement right

exceeds the amount required to be paid for the exercise of that right.

Step Two
Find the amount (if any) by which the market value of the shares, which were the subject of the right assigned or released on the first occasion in respect of which the condition in paragraph 16A(4) of Part 9 of Schedule 3 is not satisfied (i.e. discount on replacement option more than discount on the option assigned or release), exceeds the amount required to be paid for the exercise of that right immediately before that time.

Step Three
Subtract the amount found by Step Two from the amount found by Step One.

Step Four
Subtract from the result of Step Three

- any amount taken into account in computing the earner's earnings for the purposes of Class 1 contributions at the time of the grant of the first right; and

- any amount given by or on behalf of the earner as consideration for the acquisition of the first right or any replacement right, but "consideration" does not include the value of any right assigned or released in exchange for the acquisition of a replacement right.

Subject to the following qualification, the result of this step is the amount of earnings.

If the result of this step is a negative value, it is treated as nil for the purposes of computing the earner's earnings.

Example 5 in Appendix 1 shows how this is applied to example 4.

Appendix 1 illustrates how to calculate earnings in three other scenarios where replacement share options have been exercised on or after 1 September 2003.

Application of Regulation 40(2)(c) SSCR 2001

33. We are aware that Regulation 40(2)c SSCR2001 does not provide for the exclusion of general earnings, for the purposes of Class 1A, in respect of securities and interests in securities which are not readily convertible assets as set out in paragraph 7A, Schedule 3, Part 9, SSCR2001. This was unintended and will be put right as soon as possible. In the meantime, the Inland Revenue can confirm that a Class 1A liability will not arise in these circumstances.

Further advice

For further advice on this bulletin, or any other technical queries about liability to pay NICs on employment-related securities or securities options, please contact

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Illustrative examples

Appendix 1

Example 1 - Share option acquired before 6 April 1999, exercised after 6 April 1999, shares and cash acquired on exercise before 1 September 2003. No Class 1 NICs liability.

- Option A acquired on 6 February 1999 - Market value of shares equal to exercise price.
- Option A exercised on 10 May 2002 - The employee acquired shares and £1 in cash per share acquired.

The gains on exercise of the share option, i.e. market value of shares acquired less price paid to acquire the shares plus cash, are treated as earnings under section 4(4)(a) SSCBA if chargeable to tax under section 135 ICTA 1988, but Class 1 NICs are not due. All the gains are disregarded from earnings under paragraph 16 of Part 9 of Schedule 3 SSCR 2001.

Example 2 - Share option acquired before 6 April 1999 and exercised on or after 1 September 2003. Shares and cash acquired on exercise. Class 1 NICs liability on cash.

- Option A acquired on 6 February 1999 - Market value of shares equal to exercise price.
- Option A was exercised on 10 October 2003 - The employee acquired shares and £1 in cash per share.

The gains on exercise of the share option, i.e. market value of shares acquired less price paid to acquire the shares plus cash, are treated as earnings under section 4(4)(a) SSCBA. Class 1 NICs are not due on the gain realised by the acquisition of the shares as this is disregarded from earnings under paragraph 16 of Part 9 of Schedule 3 to the SSCR 2001. Class 1 NICs are due on the cash as this is not disregarded by paragraph 16.

Example 3 - Original share option acquired before 6 April 1999, replacement share option exercised on or after 1 September 2003 and only shares acquired. No Class 1 NICs liability on exercise.

- Option A acquired 6 February 1999 - Exercise price same as market value of shares.
- Option A released for option B (replacement option) on 10 April 2000 - No increase in total discount.
- Option B exercised on 10 October 2003 - Shares acquired and nothing else.

Date	6/2/99	10/4/00	10/4/00	10/10/03
Event	A acquired	A released	B acquired	B exercised
MV(£)	10,000	20,000	30,000	50,000
EP(£)	10,000	10,000	30,000	30,000
Discount(£)	Nil	10,000	Nil	20,000

The gains on 10 October 2003 of £20,000 are treated as earnings under section 4(4)(a) SSCBA 1992. However, the discount of option B on acquisition on 10 April 2000 was Nil which was less than the discount of option A on 10 April 2000, i.e. £10,000. Therefore, paragraph 16A is satisfied and the gains on exercise of option B, i.e. £20,000, can be disregarded from earnings.

Example 4 - Original share option acquired before 6 April 1999, replacement share option exercised on or after 1 September 2003 and only shares acquired. Class 1 NICs liability on exercise

- Option A acquired 6 February 1999 - Exercise price same as market value of shares.
- Option A released for option B on 10 April 2000 - No increase in total discount.
- Option B released for option C on 16 May 2002 - Increase in total discount.
- Option C exercised on 10 October 2003 - Shares acquired and nothing else.

Date	6/2/99	10/4/00	10/4/00	16/5/02	16/5/02	10/10/03
Event	A acquired	A released	B acquired	B released	C acquired	C exercised
MV(£)	10,000	20,000	30,000	50,000	60,000	80,000
EP(£)	10,000	10,000	30,000	30,000	30,000	30,000
Discount (£)	Nil	10,000	Nil	20,000	30,000	50,000

Acquisition of option A
No NIC liability arose because the discount was Nil.

Release of option A for option B
No NICs liability arose because option B was not chargeable to tax under section 135 ICTA so nothing was treated as earnings under section 4(4)(a) SSCBA 1992.

Release of option B for option C
No NIC liability arose because option C was not chargeable to tax under section 135 ICTA so nothing was treated as earnings under section 4(4)(a) SSCBA 1992.

Option C exercised
The £50,000 gains paid on 10 October 2003 are treated as earnings under section 4(4)(a) SSCBA 1992. The discount of option C on acquisition on 16 May 2002 was £30,000, which was substantially greater than the discount of option B on 16 May 2002, i.e. £20,000. Therefore, paragraph 16A is not satisfied. The gains on exercise of option C cannot be disregarded in full from earnings. Example 5 below explains how the amount of earnings subject to a Class 1 NIC liability is calculated in this case.

Example 5 - Calculating the amount of earnings liable for Class 1 NICs using facts in example 4

Step one
Market value of shares on exercise of option C = £80,000
Exercise price paid for shares = £30,000
Difference = £50,000

Step Two
When option B was released for option C on 16 May 2002, paragraph 16A(4) was not satisfied because there was an increase in the discount, i.e. from £20,000 to £30,000. The discount on option B was £20,000, i.e. the amount that could have been gained if the employee had exercised the option at that time.

Step Three
Step One amount £50,000 less Step Two
amount £20,000 = £30,000

Step Four
There is nothing to subtract from the result of Step Three because nothing was taken into account in computing the earner's earnings at the time of the grant of option, nor did the earner give any consideration (excepting options A and B) to acquire options B or C. Therefore, the amount of the earnings on exercise of option C is £30,000.

Example 6 - Original share option acquired before 6 April 1999 and replaced with cash and new option. Replacement share option exercised on or after 1 September 2003, shares acquired on exercise. Class 1 NICs liability on exercise.

- Option A acquired 6 February 1999 - Exercise price same as market value of shares.
- Option A released for option B on 10 April 2000 plus £10,000 cash - No increase in total discount.
- Option B released for option C on 16 May 2002 - Increase in total discount.
- Option C exercised on 10 October 2003 - Shares acquired and nothing else.

Date	6/2/99	10/4/00	10/4/00	10/4/00	16/5/02	16/5/02	10/10/03
Event	**A acquired**	**A released**	**B acquired**	**£10,000 cash acquired**	**B released**	**C acquired**	**C exercised**
MV(£)	10,000	20,000	30,000	N/A	50,000	60,000	80,000
EP(£)	10,000	10,000	30,000	N/A	30,000	30,000	30,000
Discount(£)	Nil	10,000	Nil	N/A	20,000	30,000	50,000

Option A released for option B and cash - No NICs liability

At the time when option B is acquired the option was not treated as earnings under section 4(4)(a) SSCBA 1992 because it was not chargeable to tax under section 135 ICTA 1988, by virtue of section 136(1) ICTA 1988. The £10,000 cash was treated as earnings and chargeable to tax under section 135 ICTA. **However, the cash is disregarded from earnings under paragraph 15 of Part 9 Schedule 3 SSCR 2001 because it is treated as part of the gain realised on release of option A and the total discount on the total market value on option B is not substantially greater than the discount on option A.**

Option C exercised

The gains of £50,000 acquired on 10 October 2003 are treated as earnings under section 4(4)(a) SSCBA 1992. The discount of option B on acquisition on 10 April 2000 was Nil which was less than the discount of option A on 10 April 2000, i.e. £10,000. However, when option C is acquired the discount was £30,000, which was greater than the discount on option B on its release, i.e. £20,000. Therefore, paragraph 16A is not satisfied. The gains on exercise of option C cannot be disregarded in full from earnings. The amount of earnings on exercise is calculated as shown in example 5.

Example 7 - Original share option acquired before 6 April 1999 and replaced with cash and new option. Replacement share option exercised on or after 1 September 2003, shares and cash acquired. Class 1 NICs liability arises on exercise and cash payment

- Option A acquired 6 February 1999 - Exercise price same as market value of shares.
- Option A released for option B on 10 April 2000 plus £10,000 cash - No increase in total discount.
- Option B released for option C on 16 May 2002 - Increase in total discount.
- Option C exercised on 10 October 2003 - Shares and cash acquired.

Date	6/2/99	10/4/00	10/4/00	10/4/00	16/5/02	16/5/02	10/10/03
Event	**A acquired**	**A released**	**B acquired**	**£10,000 cash acquired**	**B released**	**C acquired**	**C exercised £10,000 cash paid**
MV(£)	10,000	20,000	30,000	N/A	50,000	60,000	80,000
EP(£)	10,000	10,000	30,000	N/A	30,000	30,000	30,000
Discount(£)	Nil	10,000	Nil	N/A	20,000	30,000	50,000

The amount of earnings is calculated as in example 5. In addition, the cash acquired on exercise is treated as earnings and liable for Class 1 NICs.

Example 8 - Partial assignment or release of options acquired before 6 April 1999. Exercise of replacement right on or after 1 September 2003 and exercise of original option. No Class 1 NICs liability.

- Option A acquired 6 February 1999 - Exercise price same as market value of shares.
- Part of Option A released for option B on 10 April 2000.
- Option B released for option C on 16 May 2002.
- Option C exercised on 10 October 2003.
- Option A exercised on 15 January 2004.

Date	6/2/99	10/4/00	10/4/00	10/4/00	16/5/02	16/5/02	10/10/03	15/01/04
Event	A acquired	Part of A retained	Part of A released for option B	B acquired	B released	C acquired	C exercised	A exercised
MV(£)	10,000	15,000	15,000	30,000	50,000	60,000	80,000	40,000
EP(£)	10,000	5,000	5,000	30,000	30,000	60,000	60,000	5,000
Discount(£)	Nil	10,000	10,000	Nil	20,000	NIL	20,000	35,000

Acquisition of option A
There was no Class 1 NICs liability as there was no discount on 6 February 1999.

Part of option A released for option B
Option B was not treated as earnings under section 4(4)(a) SSCBA because option B was not chargeable to tax under section 135 ICTA 1988.

Option B released for option C
Option C was not treated as earnings under section 4(4)(a) SSCBA because option C was not chargeable to tax under section 135 ICTA 1988.

Option C exercised
The gains on 10 October 2003 of £20,000 are treated as earnings under section 4(4)(a) SSCBA 1992. The discount of option C when first acquired on 16 May 2002 was Nil. Therefore, paragraph 16A is satisfied. The gains on exercise of option C can be disregarded from earnings.

Option A exercised
When option A is exercised, although the gains are treated as earnings under section 4(4)(a) SSCBA 1992, paragraph 16A does not apply as this only applies to the exercise of replacement share options. Paragraph 16 disregards gains on exercise of share options acquired before 6 April 1999 to the extent that the gain realised consists of the shares acquired. Therefore, there is no Class 1 NICs liability.

Example 9 - Original share option acquired before 6 April 1999 and replaced with new option. Total discount of replacement right not substantially greater than total discount of the original right released.

- 6 February 1999 - Option A acquired
- 10 April 2000 - Option A released for option B

Date	6/2/99	10/4/00	10/4/00
Event	A acquired	A released	B acquired
No. of Shares	1000	1000	709
MV(£)	1000	2680	2687
EP(£)	1000	1000	999
Discount(£)	Nil	1680	1688

The value of the total discount on option B is not substantially greater than the discount on Option A and therefore the gains from exercise of option B can be disregarded from NICs liability (Paragraph 16A, Schedule 3, SSCR 2001).

Definition of terms

Appendix 2

Replacement share option - Is defined in paragraph 16(3) of the SSCR 2001 (as amended by the amendment regulations) as a right to acquire shares in a body corporate, obtained, whether as the result of one transaction or a series of transactions, and whether directly or indirectly, in consequence of:

- the assignment or release of the original right; or
- the assignment or release of a right which was itself obtained in consequence of the assignment or release of that right.

Original share option or right - Is defined in paragraph 16(3) (as amended by the amendment regulations) as the right acquired before 6 April 1999, to acquire shares in a body corporate.

Share option - A right to acquire shares in a body corporate

Substantially greater - is not defined in legislation but its intended application is described in paragraph 31.

More details on employee share schemes can be found on the Inland Revenue's website at www.inlandrevenue.gov.uk/shareschemes

CONTENT

The content of Tax Bulletin gives the views of our technical specialists on particular issues. The information published is reported because it may be of interest to tax practitioners. Publication will be six times a year, and include a cumulative index issued on an annual basis.

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