

EMPLOYEE SHARE AND SECURITY SCHEMES AND CAPITAL GAINS TAX

This Help Sheet deals with the following:

- approved Share Incentive Plans (SIPs)
- other approved schemes
- transfers to Individual Savings Accounts (ISAs)
- transfers to certain pension schemes
- Enterprise Management Incentives (EMIs)
- unapproved share schemes
- same day share acquisitions after 5 April 2002
- indexation and taper relief
- a relief on certain disposals of unlisted shares to an approved Share Incentive Plan.

The information in this Help Sheet will help you complete the Capital Gains Pages of your Tax Return when you have disposed of shares you acquired because of your job, or by exercising a share option granted because you are (or were) a director or an employee. The Help Sheet describes the capital gains costs of shares and other securities that are chargeable assets that you get because of your employment both before and after Finance Act 2003.

If you have disposed of some of your shares and kept others in the same company, you may also need to look at *Help Sheet IR284: Shares and Capital Gains Tax*, which explains the rules applying to disposals of shares. If you held the shares you have disposed of for more than a year you may need to look at *Help Sheet IR279: Taper relief*. For information about Income Tax and employee shares please see the Notes on Share Schemes. All this information together with our leaflet *CGT1 Capital Gains Tax An introduction* is on our website at www.inlandrevenue.gov.uk. If you are in any doubt about how to calculate your gain or loss for capital gains purposes, ask your Inland Revenue office or your tax adviser.

Some Employee Share Schemes are approved by the Inland Revenue and others are not. The main difference is that employees do not usually pay Income Tax when they acquire shares under an approved scheme. Although EMI is not a formally approved share scheme, you will not usually pay Income Tax if you acquire shares by exercising an EMI share option.

In late 2002, a court decision, *Mansworth v Jelley* overturned the general understanding of the way the market value rule worked for certain shares acquired by exercising an employee share option. Finance Act 2003 restored the position to what it was thought to be before the court decision.

Finance Act 2003 reformed some of the income tax rules on employee shares. It widened the definition of equity remuneration to include a variety of financial products. Some of these financial products, for example UK government securities are outside the scope of Capital Gains Tax – see the Notes on Capital Gains. Finance Act 2003 also made changes to the capital gains acquisition cost of some shares and other securities.

APPROVED SHARE INCENTIVE PLANS (SIPs)

If you keep your shares in the SIP until you dispose of them, you will have no Capital Gains Tax to pay. If you keep the shares after you take them out of the plan and dispose of them later, your cost for capital gains purposes will be their market value on the date the shares leave the Plan.

APPROVED PROFIT SHARING SCHEMES

For capital gains purposes:

- the cost of your shares is their market value when the trustees of the scheme allocate them to you. The trustees will tell you what this is.
- you acquire your shares when the trustees allocate them to you (even though you cannot dispose of them freely at that time).

APPROVED SAVINGS-RELATED SHARE OPTION SCHEMES (SAYE SCHEMES)

The capital gains cost of your shares is usually what you pay for them when you exercise your option. Where exceptionally you pay Income Tax on the exercise of your option, the amount chargeable to Income Tax forms part of the cost of your shares. If you exercised your option before 10 April 2003 and paid Income Tax on the exercise the cost of your shares is the market value of the shares at the time you exercise the option together with the amount chargeable to Income Tax.

INDIVIDUAL SAVINGS ACCOUNTS (ISAs)

In the tax year to 5 April 2004, you could transfer shares worth up to £7,000 at the date of transfer into an ISA directly from a SIP, an approved profit sharing scheme or an SAYE scheme providing certain conditions were met. If you transferred your shares to an ISA, no Capital Gains Tax is payable on the transfer or on the later disposal of the shares in the ISA. For general information about ISAs, please read leaflet *IR2008: ISAs, PEPs and TESSAs*.

PERSONAL PENSION SCHEMES / STAKEHOLDER PENSION SCHEMES

In the tax year to 5 April 2004, you could transfer shares to some personal or stakeholder pension schemes from an SAYE scheme, an approved profit sharing scheme or a SIP, providing certain conditions were met. You dispose of the shares you transfer so if you make a gain, you may be liable to Capital Gains Tax. Usually you will make a gain on your SAYE and approved profit sharing scheme shares because you acquire them for less than the market value at the date of the transfer to your pension scheme. If you transfer shares directly from the SIP to your pension scheme you will not be liable to Capital Gains Tax. But if you take the shares out of the plan and transfer them later but within the 90 day limit, you may make a capital gain. For information about personal pensions, please read leaflet *IR3: Personal Pension Schemes (including Stakeholder Pension Schemes)*.

COMPANY SHARE OPTION PLANS (CSOPS)

The capital gains cost of your shares is usually what you pay for them when you exercise your option. Where exceptionally you pay Income Tax on the exercise of your option, the amount chargeable to Income Tax forms part of the cost of your shares. If you exercised your option before 10 April 2003 and paid Income Tax on the exercise the cost of your shares is the market value of the shares at the time you exercise the option together with the amount chargeable to Income Tax.

ENTERPRISE MANAGEMENT INCENTIVES (EMI)

If you exercise your EMI option before 10 April 2003, the capital gains cost of your shares is their market value at the time you exercise the option together with the amount charged to Income Tax, if any, on the exercise of your option.

If you exercise your EMI option after 9 April 2003 the capital gains cost of your shares is what you pay for them together with the amount charged to Income Tax, if any, on the exercise of your option.

UNAPPROVED EMPLOYEE SHARE / SECURITIES OPTIONS

If you exercise an unapproved share option before 10 April 2003, the capital gains cost of your shares is their market value at the time you exercise the option together with any amount charged to Income Tax on the exercise.

If you exercise an unapproved share option after 9 April 2003 the capital gains cost of your shares is the total of:

- what you pay for the option (if anything)
- the price you pay for the shares when you exercise the option, **and**
- the amount chargeable to Income Tax on the exercise.

If, after 15 April 2003, you exercise an option over securities that are chargeable assets but not shares the capital gains cost of your securities is the total of:

- what you pay for the option (if anything)
- the price you pay for the securities when you exercise the option

and

- the amount chargeable to Income Tax on the exercise.

ALL EMPLOYEE SHARE / SECURITIES OPTIONS

You are generally treated for capital gains purposes as acquiring your shares at the date when you exercise your option. For taper relief purposes only, shares acquired when you exercise a qualifying EMI share option are treated as if you acquired them on the date you were granted the option.

When you exercise your option, you may agree with your employer that you will pay part or all of your employer's National Insurance contribution if any is due. You can claim Income Tax relief for this payment. The amount on which you get Income Tax relief does not reduce the cost of your shares for capital gains purposes.

If you release your option in consideration of the grant of a new share option and do not receive anything else you will not be liable to Capital Gains Tax on receipt of the new option. You may be liable to Capital Gains Tax if you receive something else as well as the new share option and you do not pay Income Tax on whatever else you receive.

If you do not exercise an option and it lapses you do not make an allowable loss for capital gains purposes.

UNAPPROVED EMPLOYEE SHARE / SECURITIES SCHEMES

If, because of your job, you acquire free or cheap shares or other securities outside an approved share scheme and not by exercising a share option, the capital gains cost is generally their market value at the date you acquire them. For shares acquired before 16 April 2003, the main exception to this rule is where you got shares subject to the risk of forfeiture and pay Income Tax only when the risk is lifted or when you dispose of the shares. Finance Act 2003 made further exceptions from the rule.

The table below* sets out the capital gains costs of some shares and other securities that Finance Act 2003 has affected.

***Table of capital gains costs of some securities.**

Shares or securities	Acquired before 1 September 2003	Acquired after 31 August 2003
Shares subject to risk of forfeiture for 5 years or less	Actual cost <i>plus</i> amount charged to income tax on removal of risk or on disposal subject to risk	Actual cost <i>plus</i> amounts, if any, charged to income tax on acquisition, variation, removal of risk or on disposal subject to risk
Shares subject to restrictions other than risk above	Market value subject to the restrictions <i>plus</i> amount, if any, charged to income tax after acquisition	Actual cost <i>plus</i> amounts charged to income tax on acquisition, variation, removal of risk and disposal subject to risk
Securities other than shares subject to restrictions that are chargeable assets	Market value subject to the restrictions	
Convertible shares	Market value <i>plus</i> amount charged to income tax on conversion	Actual cost <i>plus</i> amounts charged to income tax on acquisition and conversion
Convertible Securities other than shares that are chargeable assets	Market value	

SHARES SUBJECT TO RESTRICTIONS ON DISPOSAL

If, because of your job, you acquire shares which you cannot dispose of freely, for example for three years after you receive them, these shares are treated as a separate class of shares from any other shares in the company that you hold until the restrictions are removed. So, if you hold other shares in the company and sell some of them, you will not be treated as selling the shares that you cannot dispose of freely.

SAME DAY SHARE ACQUISITIONS AFTER 5 APRIL 2002

Shares of the same class in the same company acquired on the same day are normally pooled. When you dispose of them you use the average cost per share in calculating any capital gain or loss. However there is a rule that may help you to reduce your Capital Gains Tax liability when you dispose of shares acquired after 5 April 2002.

You may elect to divide the shares you acquire on the same day into two categories. One category includes all the shares you acquire by exercising a qualifying EMI option and most shares that you acquire by exercising an SAYE or CSOP option. The other category includes any SAYE or CSOP shares where you pay income tax when you acquire them and all other shares of the same class in the same company that you acquire on the same day. You treat shares in this other category as disposed of first. Broadly the share that you treat as disposed first will give rise to smaller gains.

This election applies only to shares acquired on the same day. It overrides the normal rules. You will need to consider your individual circumstances to decide whether or not to elect.

WHEN CAN YOU ELECT

You can make the election after you dispose of shares you acquired after 5 April 2002. The time limit expires one year and 10 months after the end of the tax year in which you first dispose of some of the shares acquired on the same day. The election applies to all the shares of the same class in the same company acquired on one day. It applies to the first and all subsequent disposals of these shares.

HOW DO YOU ELECT

There is no special form. Explain that you are making a 'same day acquisition' election. Provide:

- the date you acquired the shares
- the name of the company
- the total number, class and cost or value of shares you acquired on the same day

- the number and cost of shares you acquired in the category treated as disposed of after other shares acquired by exercising
 - a qualifying EMI option
 - an SAYE option where you paid no Income Tax, **and**
 - a CSOP option where you paid no Income Tax
- the date, number of shares disposed of and the proceeds of your first disposal of some of the shares.

If, before the time limit is up, you make a self assessment return showing the first disposal of shares and you want to make an election, include it in that return. Show the information about the disposal of shares on pages CG1 or 2 to 3 and 4 of your Tax Return. Enter 'same day acquisition election' next to that disposal. Give further details on page CG7. Otherwise write to your Inland Revenue office.

You should mention the election each time you dispose of any of the remaining shares.

INDEXATION

Indexation allowance was frozen at April 1998 except for companies. For disposals in 2003-04 any indexation allowance due is calculated by reference to the Retail Prices Index in April 1998.

TAPER RELIEF

You only need to work out taper relief if your chargeable gains after losses are greater than the annual exempt amount, £7,900 for 2003-04.

Taper relief replaced indexation allowance for periods after 5 April 1998. Taper relief usually reduces the amount of gain chargeable to Capital Gains Tax according to the number of whole years you have held the shares after 5 April 1998. There are some special cases:

- where you dispose of shares that you acquired by exercising a qualifying EMI share option, taper relief runs from the date that you were granted the option rather than when you exercise your option and acquire the shares
- as you do not pay Capital Gains Tax on any increase in the value of shares that you hold in an approved SIP, taper relief runs from the date the shares leave the SIP
- if the shares are held in trust, taper relief runs from the date that you become absolutely entitled to the shares as against the trustee. 'Absolutely entitled as against the trustee' means that either the trustee has no right to deal with the shares except with your consent or you can take control of the shares on giving due notice to the trustee. The approved profit sharing scheme provides an exception to this. You are absolutely entitled to approved profit sharing scheme shares when the trustees allocate them to you even though you cannot sell them immediately. Taper relief therefore runs from the date the trustees allocate these shares to you.

The rate of taper relief depends on whether your shares are business or non-business assets. Most shares you hold in the company you work for were non-business assets up to 6 April 2000 and business assets from that date, see *Help Sheet IR279: Taper Relief*.

Unless the shares are in an unquoted trading company:

- they will usually stop being business assets if you stop working for the company (unless you move to work for another company in the same group). Stopping work for the company includes retiring
- if you transfer them to your husband or wife, the shares will usually be treated as non-business assets throughout the combined period of ownership (unless your spouse is an employee of the company, another company in the same trading group or of the holding company of the same trading group).

If you transfer shares to your husband or wife, the combined period of ownership runs from the time you acquired the shares. Even if the shares were originally acquired by exercising an EMI share option, the combined period of ownership does not include the period from the date you were granted the share option to the date you exercised it.

RELIEF ON TRANSFERS OF SHARES TO APPROVED SHARE INCENTIVE PLAN

This relief is designed to encourage shareholders disposing of their unquoted shares to sell them to the trustees of the company SIP for the benefit of all the employees of the company. You do not have to be an employee to claim it.

GETTING RELIEF

The conditions are:

- the person disposing of the shares cannot be a company
- the shares must be shares:
 - that are not listed on a recognised stock exchange and not shares in a subsidiary of a listed company, **and**
 - that may be held in the SIP
- you have to dispose of shares to the trustees of a SIP
- the trustees must have a minimum stake of 10% in the company
- there must be no arrangements under which you can reacquire any of the shares, except as a participant in the SIP
- you must acquire replacement assets, **and**
- you must claim the relief, **and**
- within two years from the date you acquire the replacement assets.

Replacement assets are assets which are:

- chargeable assets in your hands at the time you acquire them, but are not
- shares in, or debentures issued by, the company or any company which is in the same worldwide group as the company.

RELIEF AVAILABLE

If you use the whole of the amount you receive from the disposal of the shares to acquire replacement assets then none of your gain will be taxed. Instead, you reduce the cost of the replacement asset by the amount of the gain.

If you use part of the amount you receive from the disposal of the shares to acquire the replacement asset then you can defer that part of your gain by deducting it from the cost of the replacement asset. This only applies where the amount you use to acquire the replacement asset is not less than the amount of the gain.

There is no relief if the amount that you re-invest in the replacement asset is less than the amount of the original gain.

HOW TO CLAIM RELIEF

When you claim relief you must tell your Inland Revenue office about:

- the shares you have disposed of
- the amount you received
- the date when you disposed of the shares
- the name and address of the trustees of the SIP to whom you disposed of the shares
- the replacement asset you have acquired
- the date when you acquired it
- its cost
- the amount of proceeds from the disposal of the shares that you have used to acquire the replacement asset.

You can provide this information on the Capital Gains Pages of your Tax Return. Enter the information about the disposal of shares on pages CG2, CG3 and CG4 of your Tax Return, enter 'relief on disposal to Share Incentive Plan' and the amount claimed in column G on pages CG2 and CG3 next to that disposal. Give further details on page CG7 about the SIP and the replacement assets. The disposal of the shares should be entered on the Tax Return but you may prefer to claim the relief separately in a letter.

These notes are for guidance only, and reflect the position at the time of writing. They do not affect any rights of appeal.