Part 1: Relief for employee share acquisitions: SIPs, SAYE option schemes, CSOP schemes and ESOTs

Overview

1. This Part and Part [2] give specific statutory deductions for various costs associated with setting up and operating employee share schemes. These are arrangements under which employers provide incentives for their employees in the form of shares.

2. Part 1 gives relief for the cost of setting up particular types of approved share scheme. It also gives relief for the provision of shares under an approved share incentive plan. Part 1 is based on sections 84A and 85A of ICTA and Schedule 4AA to ICTA. Part 2 is a general relief for the provision of shares to employees. It is based on Schedule 23 to FA 2003. It does not give relief for the costs of setting up a share scheme. [Part 2 is not included in this print. Draft clauses were published in February 2007 in committee paper CC/SC (07) 05.]

3. Neither Part gives relief for the day to day costs of running a scheme. These must be considered according to the ordinary rules that apply to the calculation of business profits for corporation tax purposes. Those rules also apply if relief is not available under either of these Parts for the costs of setting up a scheme or providing the shares under the scheme.

Chapter 1: Share incentive plans

Clause 1: Overview and priority of Chapter

4. This overview clause is new.

5. The Chapter gives a deduction for the costs of setting up an approved share incentive scheme (SIP) and for the provision of shares under the SIP. The qualifying conditions for approval of the SIP itself are in Schedule 2 to ITEPA and this Chapter is treated as part of the SIP code. See clause 2.

6. *Subsection (8)* overrides the rule in the trading income Part that prevents a deduction for items of a capital nature. This avoids a conflict between that general rule and the specific relief given by some clauses of this Chapter. For example, the cost of setting up a SIP would normally be considered to be capital expenditure.

Clause 2: Chapter to form part of SIP code etc

7. This clause provides the Chapter forms part of the SIP code and deals with the trustees' acquisition of forfeited shares. It is based on paragraphs 1 and 6 of Schedule 4AA to ICTA.

8. S*ubsection (2)* makes clear that a consequence of treating the Chapter as part of the SIP code is that the definitions in Schedule 2 to ITEPA apply to the Chapter.

9. *Subsection (4)* deals with the trustees' acquisition of forfeited shares. The plan rules may require an employee to forfeit his or her plan shares if the employee leaves

the company. No further deduction is allowed to the company if the forfeited shares are re-awarded. See clause 14 exclusion 5. But it may be necessary to identify whether these shares are included in a later award. See, for example, clause 12(6)(b). Subsection (4) identifies when forfeited shares are acquired for this purpose.

Clause 3: References to a deduction being allowed to a company

10. This clause explains how a deduction allowed by this Chapter is given to companies carrying on different types of business. It is based on paragraphs 1 and 13 of Schedule 4AA to ICTA.

11. Paragraph 1(3) of Schedule 4AA to ICTA allows for a deduction in calculating trade profits. Section 21A of ICTA applies this rule to the calculation of the profits of a property business. These deductions are dealt with in *subsection (2)*.

12. A property business may also be an investment business. *Subsection (3)* makes specific provision for a company with investment business. The deduction is allowed as an expense of management and section 75 of ICTA applies.

13. If the business is both a property business and an investment business subsection (3) gives priority to subsection (2). This priority is based on section 75(2) of ICTA which provides that a deduction as an expense of management is not given if the deduction is otherwise allowable.

Clause 4: Income received under Chapter

14. This clause explains how a withdrawal of relief is taxed. It is based on paragraphs 10 to 13 of Schedule 4AA to ICTA.

15. If relief is withdrawn the company is treated as receiving an amount of income equal to the amount of the deduction. See, for example, clause 8(4). Clause 4 tells you how this is taxed.

16. If the company is carrying on a trade or property business the income is treated as a receipt of that trade or business, *subsection (2)*.

17. *Subsection (3)* applies if the relief is recovered after the trade or property business has ceased. It makes clear that the recoveries are taxed as post-cessation receipts. In the source the amounts are taxed as trading receipts. See *Change 1* in Annex 1.

Q1. We welcome comments on the proposal to deal explicitly with trading receipts received after the trade has ceased.

18. If the company is not carrying on a trade or property business or has not carried on a trade or property business the income is simply charged to corporation

tax. This is the equivalent in this Bill of a charge under Schedule D Case VI, *subsection (4).*

19. We propose to apply this treatment to the recovery of relief given for contributions to a plan trust. In the source legislation paragraphs 10 and 12 of Schedule 4AA to ICTA charge these amounts as trade receipts. See *Change 1* in Annex 1.

Q2. We welcome comments on the proposal to tax recoveries of relief on a company that does not carry on a trade or property business as an amount charged to corporation tax.

20. The income in subsection (4) will not be added to the list of former Schedule D Case VI charges for which loss relief is available under section 396 of ICTA. This is because the income does not arise from a transaction as required by that section.

Clause 5: Deduction for costs of setting up an approved share incentive plan

21. This clause gives a deduction for the costs setting up a SIP. It is based on paragraph 7 of Schedule 4AA to ICTA.

22. *Subsection (4)* applies if there is a delay between the company incurring the costs and the SIP being approved. The deduction is given for the period of account in which the scheme is approved. This avoids the company having to amend its company tax return for the period in which the expenditure was incurred or in an extreme case being outside the time limit for amending that return.

Clause 6: Deductions for running expenses of an approved share incentive plan

23. This clause prevents any prohibitive rule in this Chapter denying a deduction for the costs of running a SIP. It is based on paragraph 8 of Schedule 4AA to ICTA.

24. The trustees of a SIP will incur costs related to the day to day running of the SIP. For example, they will have to operate a PAYE scheme to deal with the employees' income tax liabilities. They will also incur incidental costs acquiring the shares. The employing company will have to meet these costs.

25. The clause does not itself give the company a deduction for payments made to the trustees to enable them to meet the running costs. It provides none of the prohibitive rules in this Chapter, such as clause 12(7), prevent a deduction being given for running expenses. As the SIP is run for the benefit of its employees the costs would usually be allowed as a normal deduction in calculating the company's taxable profit. Whether or not a deduction is allowed is considered on first principles.

26. *Subsection (3)* makes clear that running expenses does not include the cost of acquiring the shares except for the incidental costs listed in *subsection (4)*. The reference to Stamp Duty Reserve Tax is new.

Clause 7: Deduction for contribution to plan trust

27. This clause allows a deduction for a payment to the trustees which they use to buy shares for later award under the SIP. It is based on paragraph 9 of Schedule 4AA to ICTA.

28. In broad terms the purpose of this clause is to give the company a deduction at the time when it funds the purchase of the shares and not when the shares are awarded to the employee. Without this clause it could be difficult for companies to finance the purchase of shares in advance of them being awarded.

29. The clause applies to payments made on or after 6 April 2003. This commencement is preserved in the transitionals Schedule.

30. "Plan trust" has the meaning in paragraph 71(3) of Schedule 2 to ITEPA. It means a trust

> (a) which is constituted under the law of a part of the United Kingdom, and
>
> (b) the terms of which are embodied in an instrument which complies with the requirements of this Part of this Schedule

31. *Subsection (1)* sets out the qualifying conditions. The company has to make a payment to the trustees of an approved SIP which they use to acquire shares for the purposes of the SIP.

32. *Subsection (2)* provides that at the end of the period of 12 months beginning when the trustees make the acquisition with the payment the trustees must hold at least 10% of the ordinary share capital of the company in which the shares are acquired. This total applies to all the shares held. There is no requirement that the total is made up of shares acquired using the payment.

33. Under the SIP rules shares will be appropriated to an employee but the employee is required to leave the shares with the trustees. For example, paragraph 36(1) of Schedule 2 to ITEPA requires free shares to remain in the hands of the trustees for a holding period of at least three years. *Subsection (3)* makes clear that these shares count towards the 10% total.

Clause 8: Withdrawal of deduction under section 7

34. This clause withdraws the relief given by clause 7 if the shares acquired with the payment are not awarded within specified time limits. It is based on paragraph 10 of Schedule 4AA to ICTA.

35. There are two time limits. *Subsection (2)* requires 30% of the shares to be awarded within five years of being acquired. *Subsection (3)* requires all the shares to be awarded within ten years of being acquired.

36. The relief is withdrawn by treating the amount of the deduction as an amount of income received by the company, *subsection (4)*. This income is taxed in accordance with the rules in clause 4.

37. *Subsection (6)* gives a share identification rule if the trustees acquire shares at different times. Shares are treated as awarded on a first in first out basis. This rule applies for the purpose of any clause where it is necessary to identify which shares have been awarded.

38. This clause refers to a deduction being given under clause 7. It is possible that the deduction may have been given under paragraph 9 of Schedule 4AA to ICTA if the relief was given in an accounting period before this Bill took effect. The general continuity of law provisions in Schedule 2 to this Bill provides that where necessary references to the new legislation should be read as applying also to the source legislation. So the recovery provisions still apply.

39. These continuity of law provisions are relevant also to other clauses which depend on relief being given or a direction being made under the source legislation.

Clause 9: Another deduction to be allowed if all acquired shares are awarded

40. This clause allows a further deduction if the relief is withdrawn under clause 8 but all the acquired shares are awarded at a later date. It is based on paragraph 10 of Schedule 4AA to ICTA.

Clause 10: Award of shares to excluded employee

41. This clause withdraws a proportion of the relief given under clauses 7 and 9 if shares are awarded to an excluded employee. It is based on paragraph 10 of Schedule 4AA to ICTA.

42. The definition of excluded employee in *subsection (2)* is the same as that in paragraph 4(2) of Schedule 4AA to ICTA which is rewritten as exclusion 1 in clause 14. Generally, excluded employees will be employees who are not resident in the United Kingdom.

Clause 11: Termination plan notice

43. This clause withdraws a proportion of the relief given by clause 7 if the company terminates the SIP before all the shares have been awarded. It is based on paragraph 12 to Schedule 4AA to ICTA.

Clause 12: Deduction for providing free or matching shares

44. This clause gives a deduction for providing free or matching shares. It is based on paragraph 2 of Schedule 4AA to ICTA.

45. A "free share" is defined in paragraph 2(1)(a) of Schedule 2 to ITEPA. It means a share appropriated to the employee without payment.

46. A “matching share” is defined in paragraph 3(1) of Schedule 2 to ITEPA. It means a share appropriated to the employee without payment in proportion to the partnership shares acquired by the employee.

47. A “partnership share” is defined in paragraph 2(1)(a) of Schedule 2 to ITEPA. It means a share acquired by the trustees on behalf of an employee out of sums deducted from the employee’s salary.

48. The deduction is given to the employing company, *subsection (1)*, in the period of account in which the shares are awarded to the employees, *subsection (2)*. The amount of the deduction is equal to the market value of the shares at the time they are acquired by the trustees, *subsections (3)* and *(6)*.

49. Paragraph 92 of Schedule 2 to ITEPA applies the definition of market value in the TCGA.

50. If the shares are awarded under a group plan the value of the shares is based on the value of the total number of shares acquired by the trustees and from which the award is made, *subsection (4)*.

51. A “group plan” is defined in paragraph 4 of Schedule 2 to ITEPA. It means a SIP established by a parent company in which the companies it controls are allowed to participate.

52. *Subsection (7)* prevents the company getting any other deduction for free and matching shares. It denies a deduction for expenditure that would be allowed under normal principles. This rule is complemented by exclusion 4 in clause 14 which denies a further deduction for any shares acquired using a payment for which the company got relief under clause 7.

53. *Subsection (8)* makes clear that the phrase “in relation to the provision of the shares” in subsection (7) does not prevent a deduction for the costs of setting up and running a SIP.

54. *Subsection (9)* applies if the employee is awarded free or matching shares because of his or her employment with more than one company. The deduction is not apportioned between them but is allowed to one of those companies only.

Clause 13: Deduction for additional expense in providing partnership shares

55. This clause gives a deduction for any contribution the company makes towards the acquisition of partnership shares. It is based on paragraph 3 of Schedule 4AA to ICTA.

56. This clause is concerned with the case to which paragraph 52 of Schedule 2 to ITEPA applies. Partnership shares are acquired by the trustees with funds provided by the employee. The rules of the SIP may require the employee to make payments to the

trustees over an accumulation period which cannot last longer than twelve months. Paragraph 52(3) of Schedule 2 to ITEPA provides the number of partnership shares awarded to the employee is calculated at the end of the accumulation period by reference to lower of:

- the market value at the beginning of the period; or
- the market value at date the shares are to be acquired.

57. If the market value of the shares at the end of the period is greater than the value at the beginning the company will make up the difference. Clause 13 gives the company a deduction for the excess.

Clause 14: Shares excluded from sections 12 and 13

58. This clause identifies the shares that do not qualify relief if they are awarded as free, matching or partnership shares. It is based on paragraphs 4 and 6 of Schedule 4AA to ICTA.

59. *Exclusion 1* is similar to the exclusion in clause 10(2). It requires the employee to whom the shares are awarded to be within the charge to income tax on any earnings from the employment in respect of which the shares were awarded. Generally, it has the effect of excluding any shares awarded to non-UK resident employees.

60. *Exclusion 2* is intended to protect the employee by acting as a disincentive to the award of shares that are intended to reduce in value.

61. *Exclusion 3* applies if the company or an associated company operates another share scheme, including another SIP, and has already had a deduction for the cost of providing the shares for use by that scheme. As shares are not identifiable individually rules are needed to identify when the shares included in an award were acquired. The last paragraph of exclusion 3 identifies whether shares included in an award have already had relief under another SIP or share scheme.

62. *Exclusion 4* is complementary to clause 7(6).

63. *Exclusion 5* prevents relief being given twice if forfeited shares are re-awarded.

Clause 15: No deduction for expenses in providing dividend shares

64. This clause provides no deduction is allowed for the cost of providing dividend shares. It is based on paragraph 5 of Schedule 4AA to ICTA.

65. "Dividend shares" are defined in paragraph 62(3)(b) of Schedule 2 to ITEPA. They are shares acquired by the trustees reinvesting cash dividends declared on plan shares the trustees hold on behalf of employees participating in the SIP.

Clause 16: Withdrawal of deductions if approval for share incentive plan withdrawn

66. This clause withdraws any deduction given under this Chapter if approval for the SIP is withdrawn. It is based on paragraph 11 of Schedule 4AA to ICTA.

67. Paragraph 83 of Schedule 2 to ITEPA allows an officer of Revenue and Customs to issue a notice to the company withdrawing approval of a SIP. If approval is withdrawn a separate notice must be issued under *subsection (2)* of this clause to recover any relief given under this Chapter.

68. The relief is withdrawn by treating the company as receiving an amount of income equal to the net amount of the relief. Clause 4 tells you how this amount is taxed.

Chapter 2: SAYE option schemes, CSOP schemes and ESOTs

Clause 17: Deduction for costs of setting up SAYE option scheme or CSOP scheme

69. This clause allows a deduction for the costs of setting up an approved SAYE option scheme or an approved CSOP scheme. It is based on section 84A of ICTA. A CSOP scheme is commonly known as a company share option plan.

70. This expenditure would normally be treated as a capital item for which a deduction is denied in calculating the business profits. *Subsection (7)* overrides the clauses which prevent a deduction being given for capital expenditure.

71. The clause is very similar to clauses 4 and 18. The deduction is given in calculating the trade or property business profits, *subsection (3)*, or as an expense of managing an investment business, *subsection (4)*. If the business is both an investment business and a property business subsection (4) gives priority to the property business. This order of priority is based on section 75(2) of ICTA which provides that a deduction as an expense of management is not given if the deduction is otherwise allowable.

72. *Subsection (6)* applies if there is a delay between the company incurring the costs and the scheme being approved. The deduction is given for the period of account in which the scheme is approved. This avoids the company having to amend its company tax return for the period in which the expenditure is incurred or in an extreme case being outside the time limit for amending that return.

73. Relief for providing the shares under the schemes is given by Part 2 which rewrites Schedule 23 to FA 2003.

Clause 18: Deduction for costs of setting up employee share ownership trust

74. This clause gives relief for the costs of setting up a qualifying employee share ownership trust (QUEST). It is based on section 85A of ICTA.

75. In practice it is unlikely that a QUEST would be set up in an accounting period to which this Bill applies. Section 67 of FA 1989 gave relief for employers' contributions to QUESTs. That relief was withdrawn by section 142 of FA 2003 with effect for contributions made in accounting periods beginning on or after 1 January 2003. Relief for the provision of shares through a QUEST is given now by Schedule 23 to FA 2003 rewritten as Part 2.

76. The relief given by section 85A of ICTA for the setting up costs was not withdrawn and is still available in the event that a company did set up a new QUEST. The clause is very similar to clause 17.

Change 1: Recovery of relief given in respect of approved Share Incentive Plans (SIPs): clause 4

This change deals with the withdrawal of relief given in respect of an approved SIP.

Schedule 4AA to ICTA gives relief for the costs of setting up an approved SIP, contributions to a plan trust and the provision of shares awarded to employees under the SIP. It has been rewritten as Chapter [1] of Part [1] of this Bill.

Paragraphs 10, 11 and 12 of Schedule 4AA withdraw relief in certain circumstances.

If relief is withdrawn, Schedule 4AA provides for the company in question to have a trading receipt. If the business is a property business the effect of section 21A of ICTA is to treat that as a receipt of the property business. If relief is withdrawn under paragraph 11 of Schedule 4AA and the company is carrying on an investment or insurance business, paragraph 13 of Schedule 4AA provides for an amount to be taxed under Schedule D Case VI. But paragraph 13 does not cover withdrawal of relief under paragraphs 10 and 12 of Schedule 4AA.

The purpose of this change is to clarify and make more consistent the way in which withdrawn relief is treated. This is done in clause 4, which deals with the treatment of income arising under the Chapter when relief is withdrawn. See clauses 8(4) and (5), 10(4) to (6), 11(2) to (4) and 16(3) and (4). This income is treated as arising when the event withdrawing the relief occurs. In the source legislation it is treated as arising in the period of account in which the event occurs.

If the company is carrying on a trade or property business the income is treated as a receipt of that trade or business, clause 4(2).

If the company has ceased to carry on the trade or property business the income is treated as a post-cessation receipt, clause 4(3). This clarifies the existing law which does not expressly deal with the case of a trading receipt received after the trade has ceased.

If the company is not carrying on, or has not carried on, a trade or property business the income is treated as an amount on which corporation tax is charged, clause 4(4). This includes not only the income that is currently taxed under Schedule D Case VI by paragraph 13 of Schedule 4AA but also income which paragraphs 10 and 12 of Schedule 4AA treat as a trading receipt even though the company is not carrying on a trade.

This change clarifies the law and removes uncertainty. But it is expected to have no practical effect as it is in line with current practice.