

# **Employment-Related Securities**

***A Guide to  
completing Form 42***

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## About this guidance

This guidance provides help in completing [Form 42](#) (reporting of transactions in employment-related securities). This includes shares and options over securities used to remunerate employees, including directors. It gives advice on when a report is **not** due and when a report **is** due.

More detailed guidance about the rules relating to the taxation of employment-related securities can be found in HMRCs [Employment-Related Securities Manual \(ERSM\)](#).

## **What is a Form 42 and when should it be completed?**

Form 42 asks for details of [reportable events](#) in relation to Securities and Options that are obtained [by reason of employment](#). The information is to be provided by one of four [responsible persons](#) and in most cases, the employer, as one of the responsible persons, will usually make the report and complete the declaration. The completed form 42 must be sent to ESSU before 7 July following the end of the tax year in which the reportable events occurred.

### **Notice to file**

Following the introduction of [e-filing](#) of forms 42 through an on-line facility accessed through HMRC's website, companies will no longer be sent a paper copy of Form 42. Instead they will receive a "Notice to File a Form 42" and companies must then file the information required electronically or send a completed paper copy of Form 42 to the Employee Shares and Securities Unit (ESSU) before 7 July. Please note that companies are required to notify ESSU of any reportable events arising in a tax year without a notice being issued by HMRC.

### **e-filing**

From 6 April 2007, companies will, for the first time, be able to file details of reportable events electronically using an on-line filing facility available on HMRC's internet site. Companies that have not yet registered with HMRC to use the on-line filing facility will need to register before they can use the service.

A technical pack 'Employee Share Schemes Online: 2006-2007 Internet Service' has been published for Software Developers and can be found at:

<http://www.hmrc.gov.uk/ebu/ess-techpack.htm>

### **Employer CD-ROM**

An interactive Form 42 is also available on the [Employer's CD-ROM](#) which is sent to employers each February with an updated version issued following the Budget. This includes interactive guidance on completion of Form 42. Once the CD-ROM is installed on your computer you will be able to complete the form and submit the printed version to ESSU in the normal way. There is also a PDF version of the form on the CD-ROM which can be printed and completed manually.

### **Manual completion**

Companies can still send ESSU a completed paper copy of Form 42 by printing a copy of Form 42 from HMRC's website [www.hmrc.gov.uk/shareschemes/ann-app-schemes.htm](http://www.hmrc.gov.uk/shareschemes/ann-app-schemes.htm).

**Companies that do not file on-line or do not have internet access should contact ESSU who will provide paper copies of Form 42 for completion.**

The address for contacting ESSU and submitting completed Form 42 is:

**Employee Shares and Securities Unit  
Room G52  
100 Parliament Street  
London  
SW1A 2BQ**

**Tel:** 020 7147 2841 or 2843

**Fax:** 020 7147 2747

## Do you need to fill in a Form 42?

If you have been issued with a Notice to File a Form 42 and you have no events to report you must either file a Nil report by using the [on-line facility](#) or complete sections 5 and 6 on page 12 of the form and return it to the Employee Shares and Securities Unit (ESSU) at the address shown on the form before 7 July.

If you have **not** been issued with a Notice to File and you have **no** events to report you **do not** need to complete a form.

If you have **not** been issued with a Notice to File and you have events to report you must complete the appropriate sections of the form either by using the [on-line facility](#) or completing a paper copy of the form and returning it to the Employee Shares and Securities Unit before 7 July. You can also use the interactive Form 42 on the Employer CD-ROM which is available at

[www.hmrc.gov.uk/shareschemes/ann-app-schemes.htm](http://www.hmrc.gov.uk/shareschemes/ann-app-schemes.htm)

## Events that **do not** need to be reported on Form 42

You **do not** need to report any of the following transactions on Form 42.

### 1. Newly incorporated companies

Where a limited company is incorporated in the UK and the initial subscriber shares (also called founder shares) are acquired

- directly on incorporation, or
- on transfer from a company formation agent, or
- from another person forming the company, for example a solicitor or accountant:

a report is **not** required if **all** of the following conditions are met:

- all the initial subscriber shares are acquired at nominal value **and**
- no form of security other than shares is acquired, and
- the shares are not acquired by reason of or in connection with another employment (whether that is the only employment or one of a number of employments) **and**
- the shares are acquired by a person who is a director or prospective director of the company, or
- someone who has a personal family relationship with the director and the right or opportunity is made available in the normal course of the domestic, family or personal relationship of that person.

### 2. Newly incorporated Companies - allotment of further shares

Where a limited company has been incorporated in the UK and further shares are allotted prior to the commencement of trading or transfer of assets to the company and **all** of the following conditions are met:

- the additional shares are acquired by a person to whom some of the initial subscriber shares have been transferred or the person is a director or prospective director of the company, **and**
- the shares are acquired at nominal value, **and**
- the shares are not acquired by reason of or in connection with another employment (whether that is the only employment or one of a number of employments).

If such shares are allotted following the incorporation of the company it will not be reportable even if the initial subscriber shares (1 above) were acquired before 5th April and the allotment of further shares (2 above) is made after the 5th April.

The majority of newly incorporated companies should meet the above conditions and will **not** have to complete Form 42 in respect of the founder shares or the further allotment.

#### *Example 1*

XYZ Ltd is the company formation agent and two initial subscriber shares in ABC Ltd are issued to it in April 2006. XYZ Ltd then transferred the two subscriber shares in ABC Ltd to 2 directors of ABC Ltd in May 2006. ABC Ltd has not commenced trading and has no assets and/or liabilities. A report is **not** required.

#### *Example 2*

The facts are as in Example 1 above. ABC Ltd allotted further shares in ABC Ltd to the two directors in June 2006. A report on Form 42 is not required as ABC Ltd has not commenced trading and has no assets and/or liabilities at this point in time.

Where a company incorporated in the year ended 5 April 2007 and has any other transactions in its shares or securities in addition to the acquisition of shares described above a report of those additional transactions will have to be made on Form 42.

#### *Example 3*

The facts are as in Example 1 above but the company commenced trading in July 2006. ABC Ltd issued further shares in ABC Ltd to the two directors in August 2006. A report on Form 42 is required but only in respect of the shares issued in August 2006.

### **Company formation agents**

Shares acquired by the company formation agent (initial subscriber shares) on incorporation will **not** be employment-related securities and no report is required.

#### *Example*

XYZ Limited is a company formation agent and two initial subscriber shares in ABC Limited are issued to employees of the agent on formation. This is **not** a reportable event.

## HMRC Approved Schemes

### *Save As You Earn schemes (SAYE)*

If the employees are granted options and/or exercised options under an HMRC Savings Related Share Option scheme, **do not** provide details on Form 42. Details should be shown on [Form 34](#).

### *Company Share Option Plans (CSOPs)*

If the employees are granted options and/or exercised options under an HMRC Company Share Option Plan, **do not** provide details on Form 42. Details should be shown on [Form 35](#).

### *Share Incentive Plans (SIP)*

**Do not** include shares awarded to an employee under an approved SIP. Instead include this information on [Form 39](#).

### *Enterprise Management Incentives (EMI)*

The limit for options granted under EMI is £100,000 and EMI options up to this limit **must** be reported on [Form 40](#). If options in excess of £100,000 are granted, you must provide details of options granted in excess of £100,000 in section 1a of the Form 42. Any subsequent exercise/assignment/release of these “excess” options should also be reported on Form 42 (section 1b or 1c as appropriate).

## **Other events where reports *may not* be required**

- Transfers of shares in the normal course of the domestic, family or personal relationships
- Flat Management Companies
- Members' clubs (formed as companies)
- Share for share exchange
- Rights issues
- Bonus issues
- Scrip dividends
- Dividend reinvestment plans (DRIPs)
- Shares acquired independently by employees

## **Transfers of shares in the normal course of domestic, family or personal relationships**

A report is not normally required where shares are transferred by an individual in the normal course of domestic, family or personal relationships of the person transferring the shares. It will be for the individual making the transfer to determine whether the transfer has been made for purely personal reasons as they are in possession of all the facts relating to the transfer.

### *Example 1*

In family businesses, the ownership of shares usually passes from one generation to another where children work in the business. Where shares pass solely to those children involved in the business, we will accept that the transfer of those shares will have been made in the normal course of the domestic, family or personal relationships of the person making the gift. This is on the basis:

- that the shares or option are provided by an individual, or a company where that company is controlled by an individual or a family,
- that individual or family have procured the award of the securities or grant of the option,
- there was a demonstrable relationship between the individual or family and the employee, and
- there was no element of remuneration in the award or grant (in other words, the normal course of familial relationship will need to be demonstrated, as against the desire of an employer to reward an employee),

then the award or grant does not need to be reported.

## **Flat Management Companies**

If the company is incorporated in a tax year ended 5 April and unrestricted shares are, or will be, allocated to all residents (including flat owners where the owner leases the flat) at nominal value then this transaction does not need to be reported.

Where on the sale of a flat the resident has to sell their share(s) at nominal value either to the company or to a new resident, no report is required. However, a report would be required if the shares were disposed of for more than nominal value and the transferor or transferee is an employee (office holder) in the company

If the shares acquired by the residents are restricted shares and the transferor or transferee is an employee (office holder) in the company, then a report must be made in section 2 on page 7 of Form 42. We do not consider that a requirement to sell the share(s) back to the company or another resident on disposal of the flat makes the share(s) a restricted share and in that case a report is not required.

### **Members' clubs formed as companies**

If a Members' club is incorporated in a tax year ended 5 April and unrestricted shares are allocated to members at nominal value during that tax year, then a report is not required.

Shares transferred between members at nominal value during the tax year also do not need to be reported.

However, if the shares are [restricted shares](#), and the transferor or transferee is an employee (office holder) in the company then a report must be made in section 2 on page 7 of Form 42.

### **Share for share exchange**

If a person has received shares by reason of employment any additional shares are also treated as received by reason of employment. However, where:

- the employer is a company or part of a group listed on a recognised stock exchange, and
- the opportunity to acquire unrestricted shares/securities is made available to all shareholders, including director and employee shareholders, and
- the unrestricted shares/securities are acquired independently of the company, for example through a broker at full market value

a report of those shares acquired by directors and employees is not required.

### **Rights issues**

A company can raise more capital by asking current shareholders to purchase new shares, usually at a discount – a 'rights issue'. A rights issue is a right to acquire securities and therefore is an employment-related securities option in relation to employees acquiring those rights. However, if the following conditions apply:

- the employer is a company or part of a group listed on a [recognised stock exchange](#), and
- the opportunity to acquire unrestricted shares/securities is made available to all shareholders, including employee shareholders,

a report of such shares/securities acquired by directors and employees is not required.

## **Bonus issues**

Bonus shares acquired by directors and employees from employing companies will be treated as received by reason of employment. However, if the following conditions apply;

- the employer is a company or part of a group listed on a [recognised stock exchange](#), and
- the opportunity to acquire unrestricted shares/securities is made available to all shareholders, including employee shareholders,

a report of such shares/securities acquired by directors and employees is not required.

## **Scrip Dividends**

Where we have been given details of the arrangements relating to the Scrip Dividend by the employer and

- the employer is a company or part of a group listed on a [recognised stock exchange](#), and
- the opportunity to acquire unrestricted shares/securities is made available to all shareholders, including employee shareholders

then, provided we are satisfied with the arrangements and that they meet those conditions, there will be no need to report details of the unrestricted shares/securities acquired by directors and employees through the Scrip Dividends.

If, following a compliance review, we find that this is not the case then we will require the company to report the full details.

## **Dividend Reinvestment Plans (DRIPs)**

In the case of DRIPs where we have been given details of the arrangements by the employer and where:

- the employer is a company or part of a group listed on a [recognised stock exchange](#), and
- the opportunity to acquire shares/securities is made available to all shareholders, including employee shareholders, and
- the shares/securities are acquired independently of the company, for example through a broker at full market value on the open-market,

then, provided we are satisfied that the arrangements meet those conditions, there will be no need to report the details of the shares/securities acquired by directors and employees through the DRIP.

If, following a compliance review, we find that this is not the case then we will require the company to report the full details.

## **Shares acquired independently by directors and employees**

Where directors and employees acquire shares in their employing company and have purchased those shares on the open market, for example through an independent broker, then if:

- the employer is a company or part of a group listed on a [recognised stock exchange](#), and
- the opportunity to acquire unrestricted shares/securities is made available to all shareholders, including employee shareholders, and
- the unrestricted shares/securities are acquired independently of the company, for example through a broker at full market value

a report of those shares acquired by directors and employees is not required.

## Failure to make a report

If a “responsible person” fails to make a report then penalties can arise.

Penalties are not imposed automatically and in any case where we intend to seek penalties the company is warned of their failure to make a report on a minimum of two occasions before the case is referred to the Commissioners. All the facts and the company’s explanation, if received, are considered before a decision is made whether to proceed and, of course, the Commissioners may decide not to award penalties.

Where there is more than one person responsible for making a report they should agree between themselves who should make that report. Where one person agrees to make the report and then fails to do so we will consider all the facts and circumstances before making a decision on whether to proceed.

Penalties can arise under **either or both** of the following in relation to a failure:

- by a “responsible person” to provide information of reportable events **before 7 July following the end of the tax year**. Penalties may be imposed on **each** “responsible person”. Where information of reportable events is not provided to HMRC by **one** of the four “responsible persons” before 7 July following the end of the tax year, then penalty proceedings can be taken against **each** of them. The Commissioners can award an initial penalty of up to £300 for **each** reportable event against **each** “responsible person”. Where the information remains outstanding after the award of the initial penalty, further penalties may be awarded, not exceeding £60 per day, against each “responsible person” for each day the information remains outstanding.
- to comply with the notice to make a “return”. If a “notice to file” has been issued and remains outstanding at the date of the Commissioners meeting, an initial penalty of up to £300 may be imposed against the person to whom the notice was sent. Where the return remains outstanding after the award of the initial penalty, further penalties may be awarded, not exceeding £60 for each day the return remains outstanding.

It is important to remember penalties can arise under one or both of the above bullet points. The first relates to a failure to meet a statutory deadline to provide information; the second relates to failure to comply with a notice issued by HMRC.

These penalty provisions will not affect the large number of companies who continue to provide information or returns within the time allowed. But they should encourage companies who previously failed to provide that information to comply with their statutory obligations.

If companies have difficulty in completing their forms, or want to discuss how they can meet their statutory obligations, they should contact:

**Compliance Manager  
Employee Shares and Securities Unit  
Room G52  
100 Parliament Street  
London  
SW1A 2BQ**

## Completion of Form 42

A report on Form 42 is required if a reportable event occurs in the tax year ended 5 April, or where there are no reportable events you have been issued with a Notice to File a Form 42. The following are reportable events:

- (a) an acquisition, by a person, of securities (including by exercise of a securities option), an interest in securities or a securities option
  - by reason of his or her employment, or
  - by reason of employment of any other person.
- (b) an event which is a “chargeable event” in relation to restricted securities and restricted interests in securities,
- (c) an event which is a “chargeable event” in relation to convertible securities and interests in convertible securities,
- (d) the doing of anything which artificially enhances the market value of the securities,
- (e) an event which discharges a notional loan relating to securities and interests in securities acquired for less than market value,
- (f) disposal of securities and interests in securities for more than their market value,
- (g) the receipt of a benefit from securities or interest in securities, which gives rise to a taxable amount counting as employment income or would give rise to such an amount but for Chapter 4A (shares in research institution spin-out companies),
- (h) the assignment or release of a securities option acquired pursuant to a right or opportunity available by reason of the employment of the person who acquires the securities option of any other person, and
- (i) the receipt of a benefit in money or money’s worth in connection with either failing or undertaking not to acquire securities pursuant to the employment-related securities option, or granting or undertaking to grant to another person a right to acquire securities which are subject to the employment-related securities option.

If there are reportable events to disclose, [the index on page 2 of Form 42](#) will help you identify which sections of the form you need to complete and will direct you to the appropriate page. You only need to complete those pages where there is a reportable event. Further guidance and examples can be obtained by using the links in the appropriate section of the index.

## Tax avoidance arrangements

You must complete section 2 and/or sections 3(a)-(g) if you acquired options under arrangements the main purpose of which is the avoidance of tax and NICs. You will need to do this even if the grant of the options has been reported in an earlier tax year.

The types of options affected are those options:

- acquired on or after 2 December 2004 as part of an avoidance arrangement, or
- acquired before 2 December 2004, where something has been done in relation to the option as part of an avoidance arrangement on or after 2 December 2004.

## Completing the Index

For example, if an event occurred under section 1a, indicate in the box opposite section 1a as shown below, then go to section 1a and complete the boxes in that section.

<i>Page</i>	<i>Reportable Events</i>	<input checked="" type="checkbox"/>
	<b>Section 1 - Securities options (including share options)</b> You must complete this section if employees were granted or exercised options (including consideration received for giving up the option).	<input type="checkbox"/>
4	<a href="#">1a Summary of grants of securities options</a>	<input checked="" type="checkbox"/>
5	<a href="#">1b Acquisition of securities in connection with (including exercise of) securities options</a>	<input type="checkbox"/>
6	<a href="#">1c Assignment and release of securities options</a>	<input type="checkbox"/>
7	<a href="#">Section 2 - Acquisition of Securities (including shares)</a> You must complete this section if securities were acquired by employees.	<input type="checkbox"/>
	<b>Section 3 - Events occurring after the acquisition of securities</b> You must complete this section if taxable events occurred after the employee has acquired the securities.	
8	<a href="#">3a Restricted securities (including shares)</a>	<input type="checkbox"/>
8	<a href="#">3b Variation of restrictions for shares acquired before 16 April 2003</a>	<input type="checkbox"/>
9	<a href="#">3c Conversion of securities on or after 6 April 2005</a>	<input type="checkbox"/>
9	<a href="#">3d Discharge of notional loans</a>	<input type="checkbox"/>
10	<a href="#">3e Receipt of other benefits from securities</a>	<input type="checkbox"/>
10	<a href="#">3f Securities sold for more than market value</a>	<input type="checkbox"/>
11	<a href="#">3g Artificial enhancement of market value</a>	<input type="checkbox"/>

### *Market value*

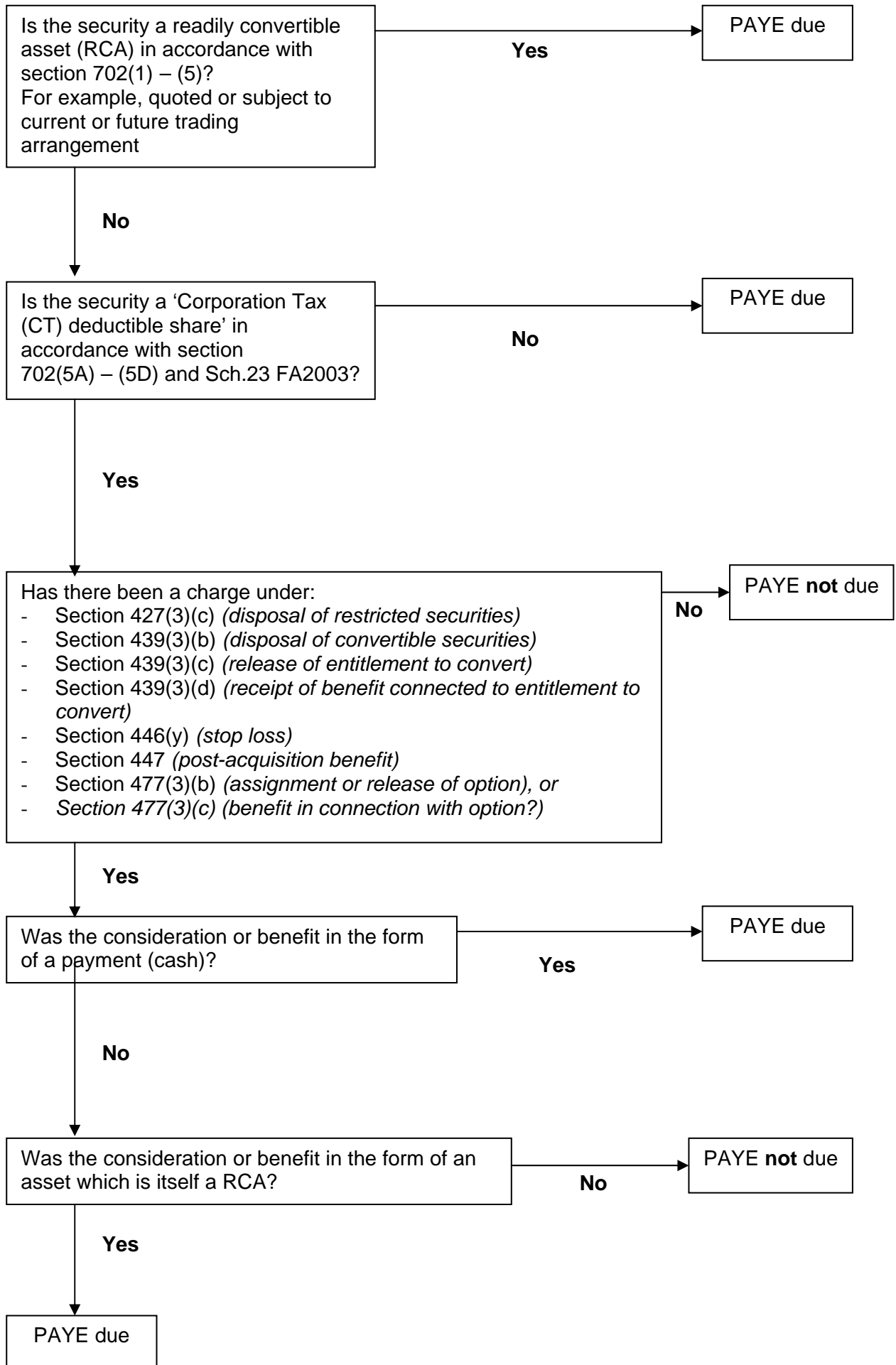
For the purposes of completing Form 42 **it is not necessary to have a formally agreed valuation of the securities.** The [market value to be shown](#) should be the best available value at the time of the particular transaction.

### *PAYE and National Insurance contributions (NICs)*

PAYE and NICs must be operated on all taxable amounts provided in the form of [readily convertible assets \(RCA's\)](#). The employer's obligation is to operate PAYE at the right time on an amount which is the best estimate that can be reasonably made, at that time, of the amount chargeable to tax. Where the employer has done this any discrepancy between the amount on which PAYE is operated and the final tax liability will be dealt with after the end of the year through the employee's Self Assessment. For NICs purposes the 'best estimate' amount in gross pay at the time the payment is paid or treated as paid. Add the amount to any other payments made in the relevant earnings period and work out NICs on the total in the normal way. The NICs liability will arise at the same time as income tax is due under PAYE.

The [flowchart](#) on the following page may help you decide whether or not PAYE is due.

## Flow chart for the operation of PAYE



## Section 1.a Grant of securities options

### How to fill in Section 1a

This section should be completed if employment-related securities options were granted during the tax year ended 5 April.

Any EMI options granted in excess of £100,000 per employee during the same tax year ended 5 April should also be shown in this section.

There is no need to complete this section if options were granted to employees who

- were non-resident at the date of grant
- did not have any UK duties and
- are unlikely to come to the UK.

Do not complete this section for options acquired under arrangements the main purpose of which is the avoidance of tax, see [Tax avoidance arrangements](#).

### Example

On 20 July 2006, XYZ Plc 5 employees were each granted options over 10 shares. The shares used were £1 ordinary shares in XYZ Plc and the market value of the shares at the date of grant was £2.50 per share. Form 42 would require the following entries at section 1.a.

1a.01 Date of grant	1a.02 Description of securities	1a.03 Total number of securities over which options granted	1a.04 Acquisition price for each security	1a.05 Number of employees granted options
20-07-2006	£1.00 ordinary shares in XYZ Plc <sup>(1)</sup>	50	£2.50	5

### Notes

(1) This is the full description of the shares used in the options.

## Section 1.b Acquisition of securities in connection with (including exercise of) securities options

### How to fill in Section 1b

This section should be completed where securities including shares were acquired in connection with an employment-related option during the tax year ended 5 April. If you acquire shares by exercise of an option and details are shown in this section, there is no need to complete section 2 in respect of the acquisition.

#### Example 1

On 1 February 2005 Stumps PLC (PAYE ref. 106/S2516) granted an option over 10,000 £1 ordinary shares at par to F.Lintoff (NINo.AB654321M) in Stumps PLC. F.Lintoff was both resident and ordinarily resident in the UK at this time. On 25 September 2006 he exercised his option when the Market Value of the shares was £3 each. At this time the shares were fully listed on the London Stock Exchange. Form 42 would require the following entries at section 1b

1b.01 Employee name	1b.02 National Insurance number	1b.03 Employer	1b.04 PAYE reference	1b.05 Description	1b.06 Not resident and ordinarily resident at grant	1b.07 Date securities acquired	1b.08 Elections
F.Lintoff	AB654321M	Stumps PLC	106/S2516	£1 Ordinary shares in Stumps PLC <sup>(1)</sup>	(2)	25-9-2006 <sup>(3)</sup>	(4)

1b.09 Number of securities acquired	1b.10 Total MV of securities acquired	1b.11 Deductible amounts (including exercise price)	1b.12 If tax arises has PAYE/NICs been operated (Yes/No)	1b.13 NICs Election (amount paid)	1b.14 NICs Agreement (amount paid)	1b.15 Date NICs paid by employee	1b.16 Date NICs paid over to HMRC
10,000 <sup>(5)</sup>	£30,000 <sup>(6)</sup>	£10,000 <sup>(7)</sup>	Yes <sup>(8)</sup>	(9)	(9)	(9)	(9)

#### Notes

- 1) This should be a full description of the securities obtained
- 2) Leave blank as F Lintoff is resident in the UK
- 3) In the case of options this is normally the date of exercise
- 4) As no restrictions attach to the shares then there is no reason to enter into an election, this column is therefore left blank
- 5) Total number of shares acquired
- 6) On the date of exercise the Market Value (MV) of each share was £3, so the total MV is 10,000 x £3 = £30,000. (For the purposes of completing Form 42 it is not necessary to have a formally agreed valuation of the securities and the market value to be shown should be the best available value at the time of the particular transaction.)
- 7) In this case the option was granted at par which is £1 per share. The total exercise price is therefore 10,000 x £1 = £10,000. There are no other costs of acquisition so £10,000 should be entered.
- 8) As the shares are listed on the London Stock Exchange then they are considered to be **Readily Convertible Assets**. Because tax is due on the taxable gain then you must advise whether or not PAYE has been operated by indicating Yes or No. In this case PAYE has been operated so 'Yes' is entered.
- 9) As there is neither an election nor agreement in place then no entry is required in this column.

## Example 2

On February 1 2005 a colleague of F. Lintoff, M. Aughan (NINO CD765432M) was also granted an option over 100,000 shares who like his colleague was both resident and ordinarily resident. In this case however M. Aughan agreed to meet the company's liability for secondary NIC in the event that the option was exercised. After a very successful summer M. Aughan also decided to exercise his option on 25 September 2006. Form 42 would require the following entries at section 1b.

1b.01 Employee name	1b.02 National Insurance number	1b.03 Employer	1b.04 PAYE reference	1b.05 Description	1b.06 Not resident and ordinarily resident at grant	1b.07 Date securities acquired	1b.08 Elections
M. Aughan	CD765432M	Stumps Plc	106/S2516	£1 Ordinary shares in Stumps PLC		25-09-2006	

1b.09 Number of securities acquired	1b.10 Total MV of securities acquired	1b.11 Deductible amounts (including exercise price)	1b.12 If tax arises has PAYE/NIC been operated (Yes/No)	1b.13 NICs Election (amount paid)	1b.14 NICs Agreement (amount paid)	1b.15 Date NICs paid by employee	1b.16 Date NICs paid over to HMRC
100,000	£300,000	£100,000	Yes		£25,600 <sup>(1)</sup>	28-02-2007 <sup>(2)</sup>	19-10-2006 <sup>(3)</sup>

### Notes

- 1) M. Aughan has agreed with his employer to meet the company's liability for secondary NIC so the amount of this liability is entered here. In this case the gain is £200,000 so at 12.8% the amount due is £25,600.
- 2) At the time of exercise M. Aughan did not have sufficient funds to meet this liability. It was also not possible to deduct this liability from his monthly salary, which was insufficient to cover such a large amount. M. Aughan was able to sell some securities in February 2007 and was then able to reimburse his employer.
- 3) The date of the remittance to HMRC, the gain occurred in September 2006 so PAYE should have been operated in that month and paid over to HMRC by the 19 of the following month. In this case the employer has met the liability on behalf of the employee.

### Example 3

On February 1 2005 A. Batsman (NINO EF123456M) & B. Bowler (NINO GH234567M) were each granted options over 10,000 £1 Ordinary shares in Stumps PLC. In this case however the shares to be obtained were A Ordinary shares which had a 3 year forfeiture restriction and a 4 year sale restriction attached. Due to these restrictions the options were granted at an exercise price of £0.50. Like their colleagues, A. Batsman & B. Bowler had confidence in the future prospects of the company and both chose to exercise their options on 25 September 2006. In this case however due to the restrictions attaching to the shares, the company offered both individuals the opportunity to enter into elections to disregard some or all of the restrictions. A. Batsman was somewhat more confident than B. Bowler and chose to enter into an election to disregard all restrictions, whereas B. Bowler chose not to enter into any election. Form 42 would require the following entries in section 1b.

1b.01 Employee name	1b.02 National Insurance number	1b.03 Employer	1b.04 PAYE reference	1b.05 Description	1b.06 Not resident and ordinarily resident at grant	1b.07 Date securities acquired	1b.08 Elections
A. Batsman B. Bowler	EF123456M GH234567M	Stumps Plc	106/S2516	A Ordinary £1 restricted shares in Stumps Plc		25-09-2006	1 <sup>(1)</sup>

1b.09 Number of securities acquired	1b.10 Total MV of securities acquired	1b.11 Deductible amounts (including exercise price)	1b.12 If tax arises has PAYE/NIC been operated (Yes/No)	1b.13 NICs Election (amount paid)	1b.14 NICs Agreement (amount paid)	1b.15 Date NICs paid by employee	1b.16 Date NICs paid over to HMRC
10,000 10,000	£30,000 <sup>(2)</sup> £15,000 <sup>(5)</sup>	£5,000 <sup>(3)</sup> £5,000 <sup>(6)</sup>	Yes <sup>(4)</sup> Yes				

#### Notes

- 1) A. Batsman has entered into an election to disregard all restrictions, therefore liability will arise on acquisition (date of exercise).
- 2) This will be based on the full unrestricted Market Value (10,000 x £3 =£30,000). If the shares were forfeited at some stage then the tax paid cannot be recovered. (For the purposes of completing Form 42 it is not necessary to have a formally agreed valuation of the securities. The market value to be shown should be the best available value at the time of the particular transaction.)
- 3) The exercise price is 10,000 x £0.50 = £5,000 (the deductible amount)
- 4) As an election has been entered into to disregard the forfeiture restriction then tax arises upon acquisition, so as the shares are RCA's then PAYE/NIC will apply. As there has been no election or agreement to meet the employers liability for NIC then columns 1b.13-1b.16 do not require an entry.
- 5) The company consider that the value of the restrictions is 50% therefore the value to be entered here is the Market Value taking into account the restrictions (Full unrestricted MV is £30,000 so less 50% = £15,000)
- 6) The exercise price is 10,000 x £0.50 = £5,000 (the deductible amount)

#### Example 4

In the above example B Bowler chose not to enter into an election to disregard restrictions whereas A Batsman chose to enter into an election to disregard both restrictions. As the securities had more than one type of restriction it is possible to enter into an election to disregard only one restriction and leave the remaining restriction (s) in place. If A Batsmen chose only to ignore the forfeiture restriction and B Bowler chose only to ignore the sale restriction then the entries for Form 42 would be as follows:

1b.01 Employee name	1b.02 National Insurance number	1b.03 Employer	1b.04 PAYE reference	1b.05 Description	1b.06 Not resident and ordinarily resident at grant	1b.07 Date securities acquired	1b.08 Elections
A. Batsman B. Bowler	EF123456M GH234567M	Stumps PLC	106/S2516	A Ordinary £1 restricted shares in Stumps PLC		25-09-2006	2 <sup>(1)</sup> 2 <sup>(1)</sup>

1b.09 Number of securities acquired	1b.10 Total MV of securities acquired	1b.11 Deductible amounts (including exercise price)	1b.12 If tax arises has PAYE/NIC been operated (Yes/No)	1b.13 NIC Election (amount paid)	1b.14 NIC Agreement (amount paid)	1b.15 Date NIC paid by employee	1b.16 Date NIC paid over to HMRC
10,000 10,000	£27,000 <sup>(2)</sup> £18,000 <sup>(3)</sup>	£5,000 <sup>(4)</sup> £5,000 <sup>(4)</sup>	Yes <sup>(5) (6)</sup> Yes	(6)	(6)		

#### Notes

- 1) In both examples a restriction still attaches to the shares therefore 2 must be entered here.
- 2) A Batsman has chosen to ignore the forfeiture restriction which means that the market value in this column needs only to take into account the value of the sale restriction. This type of restriction has less impact on the market value of the security and the company has estimated this to be only 10%. So the entry required is the full market value 10,000 x £3 = £30,000 less 10% = £27,000.
- 3) B Bowler has chosen only to ignore the sale restriction. The entry should be the full market value, £30,000 less 40% (the value of the forfeiture restriction) =£18,000.
- 4) The deductible amount is the same as in the previous example.
- 5) As A Batsman has chosen to ignore the forfeiture restriction then tax will arise on the market value less the value of the sale restriction (10%). As the shares are RCA's then PAYE should be operated and 'Yes' entered here. The amount liable to PAYE will be £27,000 less £5,000 = £22,000.
- 6) As there have been no NICs elections or agreements columns 1b.13 – 1b.16 can be left blank.

### Example 5

The 20/20 Company PLC operated a Long Term Incentive Plan (LTIP) for its directors and senior employees. The LTIP provided for two types of award, the directors were entitled to dividends in respect of the shares, however they were held in trust until such time as they vested. The awards in respect of senior employees carried no right to dividends. All awards were made at Nil cost and were subject to forfeiture during the two year vesting period if there was cessation of employment for any reason. Performance conditions also applied to all awards. On 1 December 2006 as all performance conditions were met the awards automatically vested for those granted in November 2004.

Form 42 will require the following entries at section 1b in respect of the awards made to senior employees M. Strauss (NINO. JK123456M) & H. Armison (NINO. FD234567M). The awards made to the directors F. Letcher & D. Gough would require an entry in section 3a of Form 42, see example 2 in that section. All of the awards made in November 2004 were for 10,000 £0.10 ordinary shares in The 20/20 Company PLC, a company listed on the London Stock Exchange at Nil cost. On the date of the initial award the shares had a MV of £5, on 1 December 2006 the MV was £8.

1b.01 Employee name	1b.02 National Insurance number	1b.03 Employer	1b.04 PAYE reference	1b.05 Description	1b.06 Not resident and ordinarily resident at grant	1b.07 Date securities acquired	1b.08 Elections
M Strauss H Armison	JK123456M FD234567M	The 20/20 Company Plc	521/T476	£0.10 Ordinary Shares in The 20/20 Company Plc		01-12-2006 <sup>(1)</sup> 01-12-2006 <sup>(1)</sup>	

1b.09 Number of securities acquired	1b.10 Total MV of securities acquired	1b.11 Deductible amounts (including exercise price)	1b.12 If tax arises has PAYE/NIC been operated (Yes/No)	1b.13 NIC Election (amount paid)	1b.14 NIC Agreement (amount paid)	1b.15 Date NIC paid by employee	1b.16 Date NIC paid over to HMRC
10,000 10,000	£80,000 <sup>(2)</sup> £80,000 <sup>(2)</sup>	£0 <sup>(2)</sup> £0 <sup>(2)</sup>	Yes <sup>(3)</sup> Yes <sup>(3)</sup>				

#### Notes

- 1) The initial award in November 2004 entails a promise to award shares, subject to conditions, at a specified time in the future. Unlike an option no action is required on the part of the employee, on the specified date the shares are released and full beneficial interests rests with the employee. This is the date of acquisition.
- 2) These are Nil cost options therefore £0 should be entered here.
- 3) The shares are fully listed on a recognised stock exchange and are therefore RCA's, PAYE should be operated and a Yes entered here. As there has been no NICs elections or agreements to meet the employer's liability for NICs then columns 1b.13-1b.16 do not require an entry.

### Example 6

The 20/20 Company plc have a number of overseas subsidiaries and also grant options to senior employees of those companies. On February 1 2005 the company granted options to F. Warne who is normally resident in Australia but regularly works on assignment in other countries including the United Kingdom. On December 1 2006 F. Warne exercised the options that were granted to him in February of the previous year. F. Warne was working in the UK at the time he exercised his options. The entry required on Form 42 would be as follows:

1b.01 Employee name	1b.02 National Insurance number	1b.03 Employer	1b.04 PAYE reference	1b.05 Description	1b.06 Not resident and ordinarily resident at grant	1b.07 Date securities acquired	1b.08 Elections
F. Warne		The 20/20 Company Plc	521/T476	£0.10 Ordinary Shares in The 20/20 Company PLC	Yes <sup>(1)</sup>	01-12-2006	

1b.09 Number of securities acquired	1b.10 Total MV of securities acquired	1b.11 Deductible amounts (including exercise price)	1b.12 If tax arises has PAYE/NICs been operated (Yes/No)	1b.13 NICs Election (amount paid)	1b.14 NICs Agreement (amount paid)	1b.15 Date NICs paid by employee	1b.16 Date NICs paid over to HMRC
10,000	£80,000 <sup>(2)</sup>	£50,000 <sup>(3)</sup>	(4)				

#### Notes

- 1) At the time of grant F Warne was **not** both resident & ordinarily resident in the UK, therefore a Yes needs to be entered here.
- 2) The market value on December 1 2006 was £8 so the total market value to be entered here is 10,000 x £8 = £80,000
- 3) The options were granted with an exercise price of £5 so the total deductible amount is 10,000 x £5 = £50,000 (assuming there are no other costs arising at acquisition).
- 4) As F Warne was non resident at the time of grant no tax arises at acquisition (exercise) therefore this column, as well as columns 1b.13 – 1b.16 should be left blank. An entry is only required if tax is due at the time of acquisition.

## Section 1.c Assignment and release of securities options

### How to fill in Section 1c

This section must be completed if a chargeable event occurs during the tax year ended 5 April.

Do **not** complete this section if the option lapses for nil consideration.

The chargeable events are:

- the assignment for consideration of the employment-related securities option by an associated person otherwise than to another associated person or release for consideration of the employment-related securities option by an associated person, or
- the receipt by an associated person of a benefit in connection with the employment-related securities option.

#### Example

On 1 February 2005 XYZ plc (PAYE reference 106/A2006), a company whose shares are listed on the London Stock Exchange granted an option to J Bloggs (NINO AB123456A) to acquire 10,000 £1.00 ordinary shares in XYZ plc. J Bloggs entered into an agreement with XYZ plc that he will pay all of XYZ plc's liability for secondary NICs when he exercises the option.

On 10 July 2006, J Bloggs released his option and in return he received £50,000 from XYZ plc for releasing his option. The amount of XYZ plc's secondary NIC was £6,400 and income tax and NIC was collected through PAYE on 31 July 2006. Form 42 would require the following entries in section 1c.

1c.01 Employee name	1c.02 national insurance number	1c.03 Employer	1c.04 PAYE reference	1c.05 Description	1c.06 Date of chargeable event	1c.07 Number of securities affected	1c.08 Total amount of consideration or money's worth
J Bloggs	AB123456A	XYZ plc	106/A2006	£1.00 ordinary shares in XYZ plc	10-07-2006	10,000	£50,000

1c.09 If tax arises, has PAYE/NIC been operated	1c.10 NICs election (amount paid)	1c.11 NICs Agreement (amount paid)	1c.12 Date NICs paid by employee	1c.13 Date NICs paid over to HMRC
Yes	Leave blank	£6,400	31-07-2006	15-09-2006

## Section 2 Acquisition of securities (including shares)

### How to fill in Section 2

This section must be completed if securities were acquired during the tax year ended 5 April.

You do not have to complete this section for any securities that have already been reported in section 1b unless the securities have an artificially reduced market value ([security Type F](#)).

Section 2 requires you to identify the particular type of security being provided. By using the links below further guidance is provided on the nature of the different types of securities.

Type A	<a href="#">unrestricted securities</a>
Type B	<a href="#">Restricted securities with a forfeiture provision lasting 5 years or less</a>
Type C	<a href="#">Restricted securities with a forfeiture provision lasting more than 5 years</a>
Type D	<a href="#">Restricted securities without a forfeiture provision</a>
Type E	<a href="#">Convertible securities</a>
Type F	<a href="#">Securities with an artificially reduced market value</a>
Type G	<a href="#">Research Institution Spin Out Company</a>

## Type A - unrestricted securities

Listed below are some examples of unrestricted securities.

### Example 1

I have been given some shares in the company I work for. If I wish to sell them within the next 5 years, I have to sell the shares back to the company at full market value at that time. Are the shares restricted?

No. Although the shares carry restrictions on disposal, they are not “restricted securities” because you will receive their full market value on disposal.

### Example 2

Subscriber shares transferred to directors and the companies have adopted Table A Articles of Association without modification.

### Example 3

The limited company’s Articles of Association contain pre-emption rights on transfer and compulsory fair valuation. Are these restrictions on the shares?

In general terms, the shares will not be restricted securities because ‘fair valuation’ may be higher than unrestricted market value. Also, if shareholders do not exercise their fair value rights, such shares are often freely transferable.

### Example

On 1 July 2006, XYZ plc, whose shares are listed on the London Stock Exchange (PAYE reference 106/A2006) awarded 10,000 £1.00 ordinary shares to J Bloggs (NINO AB123456A). The shares were unrestricted and the market value of the shares at the date of award was £3.00 each. Form 42 would require the following entries in section 1b.

2.01 Employee name	2.02 National Insurance number	2.03 Employer	2.04 PAYE reference	2.05 Description	2.06 Date securities acquired	2.07 Number of securities	2.08 Type of securities
J Bloggs	AB123456A	XYZ Plc	106/A2006	£1.00 ordinary shares in XYZ Plc	01-07-2006	10,000	A <sup>(1)</sup>

2.09 Nature of artificial reduction	2.10 Elections	2.11 Price paid	2.12 If tax arises, has PAYE/NICs been operated
Leave blank <sup>(5)</sup>	Leave blank <sup>(5)</sup>	£10,000 <sup>(2)</sup>	Yes <sup>(3)</sup>

### Notes

- (1) This example is for unrestricted securities -Type A
- (2) J Bloggs paid £1.00 per share, so the total price paid was 10,000 X £1.00 = £10,000.
- (3) As the shares were quoted on a [recognised stock exchange](#), they are [Readily Convertible Assets](#) and therefore the company must operate PAYE/NICs.

### How to calculate amount liable to tax

The market value for each share was £3.00 and J Bloggs paid £1.00 each and the gain for each share is £2.00. Multiply the gain by the number of shares, the overall gain is therefore 10,000 X £2.00 = £20,000

## Type B – Restricted securities with a forfeiture provision lasting 5 years or less

### Example 1

I have been given some shares in the company I work for. If I leave the company within the next two years, the shares have to be sold back to my employer for 50% of their then market value. Are the shares restricted?

Yes. The amount received for the sale of the shares to the company would be less than you would receive if you could otherwise dispose of the shares in the open market. Such shares are forfeitable securities.

### Example 2

On 1 July 2006, XYZ plc whose shares are listed on the London Stock Exchange (PAYE reference 106/A2006) awarded 10,000 £1.00 ordinary shares to J Bloggs (NINO AB123456A) for no consideration. J Bloggs entered into an agreement with the company that if he leaves the company within two years of the date of award the shares have to be sold back to the company at £1.00 each.

The unrestricted market value of the shares on 1 July 2006 was £3.00 each and the restricted market value at that date was £2.00 per share. XYZ Ltd and J Bloggs entered into an election to ignore the deferral of the tax liability so that tax would arise on the acquisition of the shares. Form 42 would require the following entries in section 2.

2.01 Employee name	2.02 national insurance number	2.03 Employer	2.04 PAYE reference	2.05 Description	2.06 Date securities acquired	2.07 Number of securities	2.08 Type of securities
J Bloggs	AB123456A	XYZ Plc	106/A2006	£1.00 ordinary shares in XYZ plc	01-07-2006	10,000	B <sup>(1)</sup>

2.09 Nature of artificial reduction	2.10 Elections	2.11 Price paid	2.12 If tax arises, has PAYE/nic been operated
Leave blank <sup>(3)</sup>	3 <sup>(2)</sup>	Nil	Yes

### Notes

- (1) This example is for restricted securities Type B
- (2) The s425 election was made to ignore the deferral of the tax liability so that tax arises on acquisition of the shares on the actual market value.

### How to calculate amount liable to tax

As an election has been entered into only to disregard the forfeiture restriction, tax will arise on acquisition on the actual market value.

Chargeable amount will be 10,000 x £2 = £20,000.

If an election had been entered into to disregard all restrictions then the chargeable amount would be 10,000 x £3 = £30,000 (the Unrestricted Market Value)

## Type C – Restricted securities with a forfeiture provision lasting more than 5 years

### Example 1

I have been given some shares in the company I work for. If I leave the company within the next 7 years, the shares would be forfeited without compensation.

The shares are forfeitable securities as the market value of the shares given to you would be lower as a result of the forfeiture provision.

### Example 2

On 1 July 2006, XYZ plc, whose shares are listed on the London Stock Exchange (PAYE reference 106/A2006) awarded 10,000 £1.00 ordinary shares to J Bloggs (NINO AB123456A) for nil consideration. J Bloggs entered into an agreement with the company that if he leaves the company within the next 7 years of the date of award, the shares would be forfeited.

The Actual Market Value of the shares taking into account the restriction at the date of award was £2.00 per share. Form 42 would require the following entries in section 2.

2.01 Employee name	2.02 national insurance number	2.03 Employer	2.04 PAYE reference	2.05 Description	2.06 Date securities acquired	2.07 Number of securities	2.08 Type of securities
J Bloggs	AB123456A	XYZ Plc	106/A2006	£1.00 ordinary shares in XYZ Plc	01-07-2006	10,000	C <sup>(1)</sup>

2.09 Nature of artificial reduction	2.10 Elections	2.11 Price paid	2.12 If tax arises, has PAYE/NICs been operated
Leave blank <sup>(3)</sup>	<sup>(2)</sup>	Nil	yes

#### Notes

- (1) This is an example for restricted securities Type C
- (2) As the forfeiture restriction lasts for more than 5 years tax arises at acquisition on the restricted market value
- (3) This column does not need an entry.

#### How to calculate amount liable to tax

The amount chargeable to tax is the restricted market value less the price paid multiplied by the number of shares, £2 - £0 = £2 x 10,000 = £20,000

## **Type D – Restricted securities without a forfeiture provision**

### **Chargeable events for restricted securities**

They are:

- (a) the employment-related securities ceasing to be restricted securities, or a restricted interest in securities, in circumstances in which an *associated person* is beneficially entitled to the employment-related securities after the event,
- (b) the variation of any restriction relating to the employment-related securities in such circumstances (without the employment-related securities ceasing to be restricted securities or a restricted interest in securities), and
- (c) the disposal for consideration of the employment-related securities, or any interest in them, by an associated person otherwise than to another *associated person* (at a time when they are still restricted securities or a restricted interest in securities).

An associated person in relation to employment-related securities is:

- (a) the person who acquired the employment-related securities on the acquisition,
- (b) (if different) the employee, and
- (c) any relevant linked person.

A person is a relevant linked person if:

- (a) that person (on the one hand), and
- (b) either the person who acquired the employment-related securities on the acquisition or the employee (on the other hand),

are or have been connected or (without being or having been connected) are or have been members of the same household.

### Example

I have been given some shares in the company that I work for and I am not allowed to sell them for 3 years. Are the shares restricted?

Yes. The market value of the shares will be lower than it would otherwise have been if they had been unrestricted, i.e. you do not have to wait for 3 years before you can sell the shares.

### Example – without an election

On 1 July 2006, XYZ plc, whose shares are listed on the London Stock Exchange (PAYE reference 106/A2006) awarded 10,000 £1.00 ordinary shares to J Bloggs (NINO AB123456A) for nil consideration. J Bloggs must work for the company for 3 years and cannot sell the shares during that period. The unrestricted market value of the shares on 1 July 2006 was £3.00 each and the restricted market value (AMV) at that date was £2.70. Form 42 would require the following entries in section 2.

2.01 Employee name	2.02 national insurance number	2.03 Employer	2.04 PAYE reference	2.05 Description	2.06 Date securities acquired	2.07 Number of securities	2.08 Type of securities
J Bloggs	AB123456A	XYZ Plc	106/A2006	£1.00 ordinary shares in XYZ plc	01-07-2006	10,000	D <sup>(1)</sup>

2.09 Nature of artificial reduction	2.10 Elections	2.11 Price paid	2.12 If tax arises, has PAYE/NIC been operated
Leave blank <sup>(2)</sup>	Leave blank	Nil	Yes

### Notes

- (1) This is an example for restricted securities without a forfeiture provision and without an election.
- (2) This column does not need an entry.

### How to calculate amount liable to tax

Tax is charged on the actual market value of the shares which is  $10,000 \times £2.70 = £27,000$ . A further charge to tax will arise when the sale restriction is lifted after 3 years.

### Example – with an election

On 1 July 2006, XYZ plc, whose shares are listed on the London Stock Exchange (PAYE reference 106/A2006) awarded 10,000 £1.00 ordinary shares to J Blogg (NINO AB123456A) for no consideration. J Bloggs must work for the company for 3 years and cannot sell the shares during that period. The unrestricted market value of the shares on 1 July 2005 was £3.00 each and the restricted market value (AMV) at that date was £2.70. J Bloggs entered into an election to disregard all the restrictions. Form 42 would require the following entries in section 2.

2.01 Employee name	2.02 national insurance number	2.03 Employer	2.04 PAYE reference	2.05 Description	2.06 Date securities acquired	2.07 Number of securities	2.08 Type of securities
J Bloggs	AB123456A	XYZ Plc	106/A2006	£1.00 ordinary shares in XYZ Plc	01-07-2006	10,000	D <sup>(1)</sup>

2.09 Nature of artificial reduction	2.10 Elections	2.11 Price paid	2.12 If tax arises, has PAYE/NICs been operated
Leave blank <sup>(3)</sup>	1 <sup>(2)</sup>	Nil	Yes

### Notes

- (1) This is an example for restricted securities without a forfeiture provision and with an election.
- (2) J Bloggs entered into a s431 election to ignore all the restrictions.
- (3) This column does not need an entry.

### How to calculate amount liable to tax

The chargeable amount is the unrestricted market value (as s431 election in place) of each share less the price paid (nil) multiplied by the number of shares,  $£3 - 0 = £3 \times 10,000 = £30,000$

## Type E – Convertible securities

*What are convertible securities?*

Securities are convertible securities if:

- (a) they confer on the holder an immediate or conditional entitlement to convert them into securities of a different description,
- (b) a contract, agreement, arrangement or condition authorises or requires the grant of such an entitlement to the holder if certain circumstances arise, or do not arise, or
- (c) a contract, agreement, arrangement or condition makes provision for the conversion of the securities (otherwise than by the holder) into securities of a different description.

*Chargeable event for convertible securities*

The events are:

- (a) the conversion of the employment-related securities (or the securities in which they are an interest) into securities of a different description in circumstances in which an *associated person* is beneficially entitled to the securities into which the employment-related securities are converted,
- (b) the disposal for consideration of the employment-related securities, or any interest in them, by an associated person otherwise than to another *associated person* (at a time when they are still convertible securities or an interest in convertible securities),
- (c) the release for consideration of the entitlement to convert the employment-related securities (or the securities in which they are an interest) into securities of a different description, and
- (d) the receipt by an *associated person* of a benefit in money or money's worth in connection with the entitlement to convert (other than securities acquired on the conversion of the employment-related securities or consideration such as is mentioned in paragraph (b) or (c)).

A benefit received on account of any disability (within the meaning of the Disability Discrimination Act 1995) of the employee is disregarded for the purposes of (d) above.

### *Example 1*

On 1 July 2006, XYZ plc whose shares are listed on the London Stock Exchange (PAYE reference 106/A2006) awarded 10,000 £1.00 "A" ordinary shares in XYZ Ltd to J Bloggs (NINO AB123456A) for nil consideration. J Bloggs must work for the company for 3 years and cannot sell the shares during that period. At the end of 3 years and provided J Bloggs is still working for XYZ plc, the "A" shares are convertible to £1.00 ordinary shares of the company. The "A" shares have no voting and dividend rights whereas the ordinary shares have voting, dividend and winding-up rights. The market value of the ordinary shares at the date of acquisition was £5.00 per share and the "A" ordinary shares had a market value of £3.00 per share and £2 per share ignoring the value of the right to convert.

2.01 Employee name	2.02 national insurance number	2.03 Employer	2.04 PAYE reference	2.05 Description	2.06 Date securities acquired	2.07 Number of securities	2.08 Type of securities
J Bloggs	AB123456A	XYZ Plc	106/A2006	£1.00 "A" ordinary shares in XYZ Ltd	01-07-2006	10,000	E <sup>(1)</sup>

2.09 Nature of artificial reduction	2.10 Elections	2.11 Price paid	2.12 If tax arises, has PAYE/NICs been operated
Leave blank <sup>(2)</sup>	Leave blank <sup>(2)</sup>	Nil	Yes

#### Notes

- (1) This is an example on convertible securities Type E.  
(2) These columns do not require an entry.

#### How to calculate amount liable to tax

Charge on acquisition under Section 62 ITEPA 2003 (money's worth) is therefore reduced from £30,000 to £20,000. The right to convert worth £10,000 is ignored.

#### Example 2

Edina Jones works for Fabulous Agency Ltd. The holding company of the group, Fabulous (Holdings) Ltd, gives Edina a £1000 convertible loan note (with 4% coupon) on 6 May 2006. The loan note can be converted after 3 years, if Edina chooses, into 1000 £1 ordinary shares.

The convertible loan note is treated as if it were two separate assets – the loan note itself (valued without the right to convert) and the right of conversion into shares. If the value of the loan note was £1200 in total when Edina received it and £200 of this related to the right to convert, Edina would be taxed on £1000 at 6 May 2006. (Note that these values are only examples; the actual values need to be established in each case.) There is no tax on the right to convert until conversion actually takes place.

2.01 Employee name	2.02 National insurance number	2.03 Employer	2.04 PAYE reference	2.05 Description	2.06 Date securities acquired	2.07 Number of securities	2.08 type of securities
Edina Jones	WZ001122B	Fabulous Agency Ltd	123/FX4321	£1,000 (4%) Convertible loan note in Fabulous (Holdings) Ltd	06-05- 2006	1	E

2.09 Nature of artificial reduction	2.10 Elections	2.11 Price Paid	2.12 If tax arises, has PAYE/NICs been operated (Yes/No)?
Leave blank	Leave blank	Nil	Yes

#### How to calculate amount liable to tax

If Edina decided to convert her loan note into shares on 1 June 2009, there would be a tax charge based on the market value of the shares she receives less the market value of the loan note at that time (again ignoring the right to convert). If an ordinary share was

worth £2 at that date and the loan note was still worth £1000 in total, the taxable amount would be  $(1000 \times £2) - £1000 = £1000$ .

## Type F – Securities with an artificially reduced market value

On 1 June 2006 ABC Ltd granted a non-commercial option (the intention being that the option would never be exercised) over the majority of un-issued shares in the company to a family trust. This would have the effect of reducing the market value of shares to be issued to J Bloggs on 1 July 2006 to £2,000.

ABC Ltd (PAYE reference 111/B2006) awarded 1,000 £1.00 ordinary shares to J Bloggs (NINO BB654321A) on 1 July 2006 for no consideration. The company's shares were valued at £2.00 each but this was arrived at by taking into account the effect of the option issued to the family trust. If the effect of granting the option was ignored the market value for each share was £1,000.

### Example

2.01 Employee name	2.02 National Insurance Number	2.03 Employer	2.04 PAYE reference	2.05 Description	2.06 Date securities acquired	2.07 Number of securities	2.08 Type of securities
J Bloggs	BB654321A	ABC Ltd	111/B2006	£1.00 ordinary shares in ABC Ltd	01-07-2006	1,000	F <sup>(1)</sup>

2.09 Nature of artificial reduction	2.10 Elections	2.11 Price paid	2.12 If tax arises, has PAYE/NICs been operated
X	Leave blank <sup>(3)</sup>	Nil	No <sup>(2)</sup>

### Notes

- (1) This is an example where securities acquired with an artificial reduced market value Type F
- (2) The shares in this company are not RCA's so the tax due on acquisition and in respect of the artificial reduction of market value would be collected via self-assessment.
- (3) This column does not need an entry.

## **Type G – Research Institute Spin Out Company**

Research Institutions (“RIs”) own any Intellectual Property (“IP”) created by their employees in the course of their employment. They have “IP sharing policies” (sometimes also called “employee incentive or compensation schemes”) to reward employees who have created IP – the researchers – if it is subsequently exploited.

Liability on the IP sharing element acquired by the researcher gives rise to Income Tax and NICs and a report on Form 42 is required.

Where -

- (a) an agreement is made for one or more transfers of intellectual property from one or more research institutions to a company (a “spin-out company”),
- (b) a person acquires shares (or an interest in shares) in the spin-out company before the intellectual property agreement is made or within the period of 183 days beginning with the date on which it is made,
- (c) the right or opportunity to acquire the shares (or interest in shares) was available by reason of employment by the research institution (or any of them) or by the spin-out company, and
- (d) the person is involved in research in relation to any of the intellectual property that is the subject of the intellectual property agreement

tax relief will be available if:

- (e) the date of acquisition of the shares (or interest in shares), or
- (f) the date on which the agreement was made, or both, fell on or after 2 December 2004,

provided that the avoidance of tax or NICs were not the main purpose (or one of the main purposes) of the arrangements under which the right or opportunity to acquire the shares (or interest in shares) is made available.

### Example

A Legg (NINO SS456789S) acquired 10,000 £1.00 shares in CAT Ltd (PAYE 222/C2006), a spin out company on 1 July 2006 for no consideration.

2.01 Employee name	2.02 National Insurance number	2.03 Employer	2.04 PAYE reference	2.05 Description	2.06 Date securities acquired	2.07 Number of securities	2.08 Type of securities
A Legg	SS456789S	CAT Ltd	222/C2006	£1.00 ordinary shares in CAT Ltd	01-07-2006	10,000	G <sup>(1)</sup>

2.09 Nature of artificial reduction	2.10 Elections	2.11 Price paid	2.12 If tax arises, has PAYE/NICs been operated?
Leave blank	"spin out relief" <sup>(2)</sup>	Nil	Leave blank

### Note

(1) This is an example for a Research Institution Spin Out Company.

(2) Enter "spin out relief" in this column.

## Section 3 Events occurring after the acquisition of securities

### 3.a Restricted securities (including shares)

You must complete this section if a chargeable event arises during the tax year ended 5 April. The chargeable events are:

- the securities cease to be subject to forfeiture
- any restriction relating to the securities is removed or varied by any means, including the passage of time
- the securities are sold to an unconnected person while still restricted
- the adjustment of the terms of the shares so that they cease to be “conditional shares” within the meaning of Section 424 ITEPA 2003 (before the changes made by Finance Act 2003).

#### Example 1

On 1 July 2004, XYZ plc whose shares are listed on the London Stock Exchange (PAYE reference 106/A2006) awarded 10,000 £1.00 ordinary shares in XYZ plc to J Bloggs (NINO AB123456A) for nil consideration. There was no charge to income tax on acquisition due to the forfeiture provision lasting 3 years, The shares would be forfeited if J Bloggs ceases to be employed by the company before the third anniversary of the award – 1 July 2007.

On 1 July 2006, XYZ plc and J Bloggs entered into an agreement whereby the forfeiture provision (along with all other restrictions) relating to the award made on 1 July 2004 was lifted. The unrestricted market value of the shares on 1 July 2006 was £3.00 each. As a condition for lifting the restrictions early J Bloggs entered into an election with XYZ plc to pay the employers’ NIC and income tax and NIC was collected through PAYE on 31 July 2006. Form 42 would require the following entries in section 3a.

3a.01 Employee name	3a.02 national insurance number	3a.03 Employer	3a.04 PAYE reference	3a.05 Description	3a.06 Date securities originally acquired	3a.07 Number of securities	3a.08 Date of chargeable event
J Bloggs	AB123456A	XYZ plc	106/A2006	£1.00 ordinary shares in XYZ Plc	01-07-2004	10,000	01-07-2006

3a.09 Total chargeable amount	3a.10 Nature of artificial reduction	3a.11 Has PAYE/NICs been operated (Yes/No)?	3a.12 NICs election (amount paid)	3a.13 NICs agreement (amount paid)	3a.14 Date NICs paid by employee	3a.15 Date NICs paid over to HMRC
£30,000	Leave blank	Yes	£3,840	Leave blank	31-07-2006	15-09-2006

#### How to calculate amount liable to tax

As all restrictions have been lifted a charge to income tax arises on the full unrestricted market value (UMV). The chargeable amount is calculated by multiplying the number of shares by the UMV, that is, 10,000 X £3.00 = £30,000

## Example 2

In November 2004 The 20/20 Company Plc awarded restricted shares to F Letcher & D Gough. For a period of 2 years the shares were liable to forfeiture if performance conditions were not met or if they left employment. At the time of the award F Letcher chose to enter into an election to ignore the deferral of tax liability and to pay income tax on the restricted (actual) market value at that time. D Gough was more cautious and chose not to enter into any elections at that time. The shares vested on 1 December 2006 when all the performance conditions were achieved. The entries required on Form 42 are as follows:

3a.01 Employee name	3a.02 National Insurance number	3a.03 Employer	3a.04 PAYE reference	3a.05 Description	3a.06 Date securities originally acquired	3a.07 Number of securities	3a.08 Date of chargeable event
F Letcher (2)	XY245678C	20/20 Company Plc	521/T476	£0.10 Ordinary Shares	15-11-2004 <sup>(1)</sup>	10,000	1-12-2006
JD Gough	LM124578B	20/20 Company Plc	521/T476	£0.10 Ordinary Shares	15-11-2004 <sup>(1)</sup>	10,000	1-12-2006

3a.09 Total chargeable amount	3a.10 Nature of artificial reduction	3a.11 Has PAYE/NICs been operated (Yes/No)?	3a.12 NICs election (amount paid)	3a.13 NICs agreement (amount paid)	3a.14 Date NICs paid by employee	3a.15 Date NICs paid over to HMRC
£16,000 (2)	-	Yes	(4)	-	-	-
£80,000 (3)	-	Yes	(4)	-	-	-

### Notes

- 1) This is the date of the original award
- 2) F. Letcher entered into an election to ignore the deferral of tax liability at the time of the award. The value of the restriction was considered to be 20% so PAYE was operated on 80% of the unrestricted Market Value, which at the time of the award was £5. F.Letcher, therefore, paid tax on  $10,000 \times £5 \times 80\% = £40,000$ .  
Applying the formulae shown in [ERSM30400](#), tax is now due on the initial untaxed proportion (IUP). Tax was initially paid on 80% of Market Value at the time of the award so tax is now due on 20% of the Market Value at the time the forfeiture restriction is lifted, that is,  $10,000 \times £8 \times 20\% = £16,000$ .
- 3) D Gough chose not to enter any elections so income tax is due on the full unrestricted Market Value at the time the restriction is lifted, that is,  $10,000 \times £8 = £80,000$ .
- 4) Neither individual has elected or agreed to meet the employer's secondary NICs liability so columns 3a.12 – 3a.15 are left blank.

### 3.b. Variation of restrictions for Shares acquired before 16 April 2003

This section should be used to provide details of chargeable events in the tax year ended 5 April if the value of shares acquired before 16 April 2003 is increased by an alteration in the rights or any restrictions attached to them or to other shares in the company.

**Do not** complete this section in connection with the variation if:

- all of the shares of the same class are similarly restricted, **and**
- the majority of the shares are held by persons other than employees or directors, **or**
- employees or directors control the company by virtue of their holdings of that class of shares, **or**
- the company is a subsidiary and has only one class of shares.

**Do not** complete this section if the exceptions detailed at Section 429 ITEPA 2003 apply, or a Section 431(1) ITEPA 2003 election to ignore all restrictions has been entered into.

#### *Example*

J Bloggs (NINO AB123456A) works for XYZ plc (PAYE reference 106/A2006) and he was awarded 10,000 £1.00 "A" ordinary shares in XYZ plc on 1 April 2003 for no consideration. The "A" ordinary shares of XYZ plc were non-voting shares and carried no dividend rights.

On 1 July 2006, XYZ plc removed the restrictions attaching to J Bloggs "A" ordinary shares so that they now shared the same dividend & voting rights as the £1.00 ordinary shares. On the date immediately before the variation the "A" shares were worth £2.50 each, immediately after the variation they were worth the same as the ordinary shares which was £3.00 per share. Form 42 would require the following entries in section 3b.

3b.01 Employee name	3b.02 National Insurance number	3b.03 Employer	3b.04 PAYE reference	3b.05 Date securities originally acquired	3b.06 Date of variation	3b.07 Total MV of shares directly before variation	3b.08 Total MV of shares directly after variation	3b.09 Number of shares
J Bloggs	AB123456A	XYZ Plc	106/A2006	01-04-2003	01-07-2006	£25,000	£30,000	10,000

#### **How to calculate amount liable to tax**

The chargeable amount in this example is £5,000, that is, £30,000 - £25,000, the difference between the total MV before and after the variation.

### 3.c. Conversion of Securities on or after 6 April 2006

Complete this section if an employee has acquired employment-related securities that carry an immediate or potential entitlement to be converted into securities of a different description and a chargeable event occurs on or after 6 April 2006.

The chargeable events are:

- the conversion of securities into securities of a different description
- the disposal of the securities whilst they carry the entitlement to convert
- the release of the entitlement to convert
- the receipt of money or money's worth in connection with the entitlement to convert.

**Do not** complete this section if:

- all the shares of the same class are convertible securities, **and**
- all the shares of the same class are affected by an event similar to the chargeable event, and either immediately before the chargeable event
  - employees hold the majority of the company's shares of that class and as a consequence can control the company, **or**
  - associated companies, employers and their relations do not hold the majority of the company's shares of the same class as those shares acquired
- and the avoidance of tax and NICs was not the main purpose, or one of the main purposes, of the arrangements under which the right or opportunity to acquire the employment-related securities was made available.

*Example*

On 1 July 2006 J Bloggs (NINO AB123456A) received 10,000 £1.00 convertible shares in XYZ plc (an entry should be made in section 2 for this acquisition) whose shares are listed on the London Stock Exchange (PAYE reference 106/A2006) for no consideration. At the time of acquisition the market value of the shares was £1 each on a **non-convertible** basis and £1.25 each on a CONVERTIBLE basis. On 1 December 2006 the 10,000 £1.00 convertible shares were converted into £10,000 £1.00 ordinary shares in XYZ plc and J Bloggs paid £500 for the conversion. J Bloggs entered into an election with the company to pay the employer's NIC and income tax and NICs was collected through PAYE on 1 February 2007. At conversion the ordinary shares were worth £3 each and the original convertible shares were worth £2 (on a **non-convertible** basis). Form 42 would require the following entries in section 3c.

3c.01 Employee name	3c.02 National Insurance number	3c.03 Employer	3c.04 PAYE reference	3c.05 Description	3c.06 Date securities originally acquired	3c.07 Number of securities	3c.08 Date of chargeable event
J Bloggs	AB123456A	XYZ plc	106/A2006	£1.00 convertible shares in XYZ Ltd	01-07-2006	10,000	01-12-2006

3c.09 Nature of chargeable event	3c.10 Nature of artificial reduction	3c.11 Total chargeable amount	3c.12 Has PAYE/NICs been operated (Yes/No)?	3c.13 NICs election (amount paid)	3c.14 NICs Agreement (amount paid)	3c.15 Date NICs paid by employee	3c.16 Date NICs paid over to HMRC
Conversion of £1.00 convertible shares into £1.00 ordinary shares	Leave blank	£9,500	Yes	£1,216	Leave blank	01-02-2007	28-02-2007

**How to calculate amount liable to tax**

At acquisition the chargeable amount would be:

$(10,000 \times £1)$  less  $(10,000 \times £0) = £10,000$

At conversion the chargeable amount would be;

$(10,000 \times £3)$  less  $(10,000 \times £2 + £500) = £9,500$  using the formula:

CMVCS – (CMVERS + CC). See [ERSM 40090](#).

### 3.d. Discharge of notional loans

Complete this section where employment-related securities were acquired on or after 16 April 2003 and a notional loan is treated as discharged (creating a taxable amount) when the employment-related securities are disposed of other than to a connected person or an outstanding liability to pay for the securities released.

#### Example

On 1 January 2006 J Bloggs (NINO AB123456A) acquired 100,000 £1 ordinary shares in XYZ plc whose shares are listed on the London Stock Exchange (PAYE reference 106/A2006), his employer. The shares were acquired under the terms of the company's share incentive plan. The market value of the shares at the acquisition date was £7.00 each. J Bloggs paid £3.00 per share on 1 January 2006 and the terms of the plan require him to pay a further £4.00 per share on 1 January 2007.

The undervalue on acquisition was:

	100,000 X £7.00 =	£700,000
less	100,000 X £3.00 =	<u>£300,000</u>
	undervalue	<u>£400,000</u>

The original notional loan is £400,000. The cash equivalent of the benefit of the loan for the year ended 31 December 2006 assuming an official rate of interest of 5%, was £20,000. The benefit of this loan was included on form P11D for both 2005/6 & 2006/7 tax years. On 1 January 2007 the loan was discharged by the company with J Bloggs having to pay only half of the outstanding amount (£200,000). Form 42 would require the following entries in section 3d.

3d.01 Employee name	3d.02 National Insurance number	3d.03 Employer	3d.04 PAYE reference	3d.05 Number of securities	3d.06 Date of discharge	3d.07 Amount of notional loan outstanding immediately before discharge	3d.08 Has PAYE/NICs been operated (Yes/No)?
J Bloggs	AB123456A	XYZ Plc	106/A2006	10,000	1-01-2007	£200,000	Yes

#### How to calculate amount liable to tax

The amount of the notional loan initially outstanding is –

$$MV - DA, \text{ where}$$

MV is the market value of the employment-related securities at the time of the acquisition,

DA is the total of any deductible amounts.

$$MV = £700,000$$

$$DA = £300,000 + £200,000 = £500,000$$

$$\text{Chargeable amount} = £200,000$$

### 3.e. Receipt of other benefits from securities

Complete this section if an employee or a person connected with the employee has received a benefit not otherwise chargeable to income tax by reason of their ownership of employment-related securities and that benefit was received on or after 6 April 2006.

#### *Research Institute Spin Out Company*

If the shares acquired are in a spin out company, enter "spin-out relief" in column 3e.09 and leave the remaining columns blank.

#### *Example*

J Bloggs (NINO AB123456A) works for XYZ plc whose shares are listed on the London Stock Exchange (PAYE reference 106/A2006) and on 1 July 2006 he was awarded 10,000 £1 "B" shares in XYZ plc for no consideration. The "B" shares entitle J Bloggs to receive a free holiday to the value of £10,000 plus £10,000 spending money on 1 December 2006, 2007 and 2008. Form 42 would require the following entries in section 3e.

3e.01 Employee name	3e.02 National Insurance number	3e.03 Employer	3e.04 PAYE reference	3e.05 Description	3e.06 Date securities originally acquired	3e.07 Number of securities	3e.08 Date benefit received
J Bloggs	AB123456A	XYZ Plc	106/A2006	£1.00 "B" shares in XYZ plc	01-07-2006	10,000	01-12-2006

3e.09 Nature of benefit received	3e.10 Amount of MV of the benefit	3e.11 Nature of artificial reduction	3e.12 Has PAYE/NICs been operated (Yes/No)?
Holiday plus cash	£20,000	Leave blank	Yes

#### **How to calculate amount liable to tax**

The taxable amount is the amount or market value of the benefit.

Based on the above example, the taxable amount is £20,000, that is, the value of the holiday plus cash (spending money).

### 3.f. Securities sold for more than market value

Complete this section if the employee or a person connected with the employee has disposed of employment-related securities on or after 6 April 2006 for more than their market value at the time of disposal. In this case the consideration received on disposal of the employment-related securities less their market value and expenses incurred at the time of disposal is employment-related income of the employee.

#### Example

On 1 January 2005, J Bloggs (NINO AB123456A) was awarded 10,000 £1.00 ordinary shares in XYZ plc (under the terms of the company share incentive scheme) whose shares are listed on the London Stock Exchange (PAYE reference 106/A2006). The market value of the shares on acquisition was £50,000. Under the terms of the share incentive scheme, J Bloggs can dispose of his shares to the company's employee trust for the market value (at the time of acquisition) at any time during the first three years after the date of award.

On 1 July 2006 the market value of the shares had fallen to £40,000 and J Bloggs sold his shares to the company's employee trust for £50,000. Form 42 would require the following entries in section 3f.

3f.01 Employee name	3f.02 National Insurance number	3f.03 Employer	3f.04 PAYE reference	3f.05 Description	3f.06 Number of securities	3f.07 Date of disposal	3f.08 Consideration received on disposal
J Bloggs	AB123456A	XYZ Plc	106/A2006	£1.00 ordinary shares in XYZ plc	10,000	01-07-2006	£50,000

3f.09 Total MV of securities on disposal	3f.10 Nature of artificial reduction	3f.11 Expenses incurred on disposal	3f.12 Has PAYE/NICs been operated (Yes/No)?
£40,000		Nil	Yes

#### How to calculate amount liable to tax

The chargeable amount is –

$$CD - MV - DA, \text{ where}$$

CD is the amount of the consideration given on the disposal,

MV is the market value of the employment-related securities at the time of the disposal, and

DA is the amount of any expenses incurred in connection with the disposal.

There is an income tax charge for 2005-06 on £10,000, the excess of the consideration for the disposal over the market value of the shares.

$$CD = £50,000$$

$$MV = £40,000$$

$$DA = £0$$

$$\text{Chargeable amount} = £50,000 - £40,000 = £10,000$$

### 3.g. Artificial enhancement of market value

Complete this section if the market value of an employee's employment-related securities is increased by more than 10% in a relevant period by non-commercial actions and the date of the taxable event is on or after 6 April 2006, regardless of when the securities were acquired. The relevant period runs from the date securities are acquired to the earlier of the date of disposal **or** 5 April 2007. The date of the taxable event will be 5 April 2007 **or** the date the securities were disposed of **if** earlier.

#### Example

On 1 January 2005, J Bloggs (NINO AB123456A) acquired 6,000 £1.00 ordinary shares in a trading subsidiary of XYZ plc. (PAYE reference 106/A2006) and he paid £6,000 for the shareholding. This represented 30% of the share capital of the subsidiary who traded from the same premises as his employer however did not pay any rent. The market value rental was assessed at £10,000 p.a. so it is accepted that the arrangement will affect the value of 30% of the shares by £3,000 p.a. The market value of the shares was £5 each on 5 April 2007. For each relevant period there is an increased value caused by a thing done (no rent) otherwise than for genuine commercial purposes (the non-arms length transaction). Form 42 will require the following entries in section 3g.

3g.01 Employee name	3g.02 national insurance number	3g.03 Employer	3g.04 PAYE reference	3g.05 Description of securities originally acquired	3g.06 Date of original acquisition	3g.07 Number of securities	3g.08 Date of taxable event
J Bloggs	AB123456A	XYZ Plc	106/A2006	£1.00 ordinary shares in XYZ Ltd	01-01-2005	6,000	05-04-2007

3g.09 Total UMV on 5 April 2007 or, if earlier, the date of disposal	3g.10 Total UMV ignoring effect of artificial increase on date of taxable event	3g.11 Has PAYE/NICs been operated (Yes/No)?
£33,000	£30,000	Yes

Chargeable amount = IMV (increased market value) less MV

IMV = £33,000

MV = £30,000

Chargeable amount = £3,000

## Section 4 Participating Companies

If only one company is issuing employment-related securities to its employees, there is no need to complete this section. However, if this form is completed to cover a group of companies or organisations, please enter details below of the companies for whom the return applies.

4.01 PAYE reference	4.02 Corporation tax reference	4.03 Company registration number	4.04 ESSU reference number (if any)

## Section 5 Nil Return

If the scheme/plan was registered with the ESSU and there is no reportable event during the tax year, please enter 1 in the box.

## Section 6 Declaration

The Taxes Acts require that the Company Secretary or a person acting as the Company Secretary should complete the declaration. If a liquidator has been appointed they should complete the declaration.

In most cases, the employer, as one of the responsible persons, will usually make the report and complete the declaration. However, if the company has delegated the responsibility to make a report to another person, the person can make the report on behalf of the company.

## Some terms explained

### *By reason of employment*

These are securities and securities options which are:

- acquired because of employment, or
- deemed to have been acquired because of employment.

They are deemed to have been acquired because of employment when the opportunity to acquire them is made available to employees by an employer or a person connected with an employer.

### *Employment-related securities and securities options*

Securities and securities options include:

- shares in any body corporate (wherever incorporated) or in any unincorporated body constituted under the law of a country or territory outside the United Kingdom ,
- rights under contracts of insurance other than excluded contracts of insurance,
- debentures, debenture stock, loan stock, bonds, certificates of deposit and other instruments creating or acknowledging indebtedness,
- warrants and other instruments entitling their holders to subscribe for securities ,
- certificates and other instruments conferring rights in respect of securities held by persons other than the persons on whom the rights are conferred and the transfer of which may be effected without the consent of those persons,
- units in a collective investment scheme,
- options & futures, and
- rights under contracts for differences or contracts similar to contracts for difference (other than contracts of insurance).

For the purposes of Form 42, the following are **not** securities:

### *Cheques*

Cheques and other bills of exchange, bankers' drafts and letters of credit (other than bills of exchange accepted by a banker).

### *Cash and Account balances*

Money and statements showing balances on a current, deposit or savings account.

### *Property*

Leases and other dispositions of property and heritable securities.

## *Insurance*

Rights under contracts of insurance (within the meaning of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001) in relation to periods before 2 December 2004.

## *Death*

Securities cease to be “[employment-related securities](#)” immediately before the death of the employee.

### *Securities that cease to be employment-related - 7 Year Rule*

Securities cease to be “[employment-related securities](#)” seven years after the employee leaves employment with:

- the employer (in most cases this will be the company the employee worked for, or
- the company which issued the securities to the employee, or
- a person connected with the employer or the company which issued the securities to the employee.

## *Market value to be used*

For the purposes of completing Form 42 it is not necessary to have a formally agreed valuation of the securities. The market value to be shown should be the best available value at the time of the particular transaction.

Where the value you enter on the form differs from that on which PAYE and NICs was operated, you should attach a note to this form explaining the difference. If, after the submission of the form, you determine that a different value is more appropriate, then that revised value should be used in your Corporation Tax computation and by employees in their Self-Assessment Tax Returns. There is no need to send in a revised Form 42.

When we have received the completed Form 42 we may enquire into the valuation used and it may then be necessary for us to consult with Shares & Assets Valuation who may then contact you or your agent to check the valuation used. This check may show a different valuation but provided that the valuation reported on Form 42 is the best available at the time of the transaction, then the subsequent agreement of a different value, will not mean that the form is incorrect.

If, however, the valuation shown is not the best available and is, for example misleading, then we will regard the form as incorrect and penalties may be imposed.

## *Meaning of market value*

Market value has the same meaning as it has for the purposes of Taxation of Chargeable Gains Act 1992 in accordance with Part VIII of that Act.

Section 272(1) of TCGA 1992 defines market value in relation to any assets means the price which those assets might reasonably be expected to fetch on a sale in the open market.

For shares or securities quoted in the Stock Exchange Daily Official list, except where in consequence of special circumstances prices quoted in that list are by themselves not a proper measure of market value, the market value would be as follows:

- (a) the lower of the two prices shown in the quotations for the shares or securities in The Stock Exchange Daily Official List on the relevant date plus one-quarter of the difference between those two figures, or
- (b) halfway between the highest and lowest prices at which bargains, other than bargains done at special prices, were recorded in the shares or securities for the relevant date.

If the shares are not quoted on a “[recognised stock exchange](#)”, the market value is the price which the asset might reasonably be expected to fetch on a sale in the open market. For the above, it shall be assumed that in that market, there is available to any prospective purchaser of the shares all the information which a prudent purchaser might reasonably require if he were proposing to purchase it from a willing vendor by private treaty and at arm’s length.

#### *NICs Agreements*

Paragraph 3A(2) of Schedule 1 to Social Security Contributions and Benefits Act 1992 (SSCBA 1992) allows employees and employers to enter into agreements. These agreements allow employers to recover the whole or part of any secondary NICs payable in respect of gains treated as remuneration. If an agreement has been entered into, complete the relevant columns showing the amount of employer’s NICs paid by the employee.

#### *NICs Elections*

Paragraph 3B(1) of Schedule 1 SSCBA 1992 provides the basis for formal joint elections. The elections transfer the employer’s liability to NICs from the employer to the employees. If an election has been made, complete the relevant columns showing the amount of employer’s NICs paid by the employees.

#### *Non-commercial actions*

Non-commercial actions include anything done

- other than for a genuine commercial purpose
- as part of a scheme or arrangement designed to avoid tax and NICs
- between companies in a group of companies on terms other than would be expected from persons acting at arm’s length.

#### *Readily convertible assets (RCAs)*

Shares and certain securities are RCAs if:

- the securities can be sold or otherwise realised on a recognised investment exchange, such as the Stock Exchange, The New York Stock Exchange, etc, or
- trading arrangements are in place in respect of the shares at the time the taxable income is provided, or
- trading arrangements are likely to come into existence in accordance with arrangements or an understanding in place at the time the taxable income is provided.

From 10 July 2003, shares and other employment- related securities are deemed to be RCA’s and subject to PAYE and NICs, regardless of whether or not they fall within the above definitions, unless they are shares for which the company is entitled to a Corporation Tax deduction by reason of Schedule 23 to the Finance Act 2003.

The [flowchart](#) may help you decide whether or not PAYE is due.

## *Restricted Securities*

Employment-related securities are restricted securities if:

- (1) there is any contract, arrangement or condition which makes provision whereby a freedom or right, conferred by the employment-related securities, is restricted, including restrictions on the right of disposal or retention of the security or proceeds from its disposal, **and**
- (2) the market value of the employment-related securities is less than it would be but for that provision.

Employment-related securities are not restricted securities if the only reasons for which they would be restricted are:

1. the employment-related securities are unpaid or partly paid shares which may be forfeited for non-payment of calls and there is no restriction on the meeting of calls by the person by whom they are held, or
2. that person may be required to offer for sale or transfer the employment-related securities on the employee ceasing, as a result of misconduct, to be employed by the employer or a person connected with the employer.

Restrictions on securities can be divided into those described as “conditions of forfeiture” and other restrictions. A “forfeitable security” means one that may have to be surrendered and for which you may get back less than its then market value.

### *Restricted securities elections (for sections 1b, 1c & 2 (Security Types B, C and D))*

Where employment-related securities are restricted securities, the employer and employee may jointly elect:

- that the effect of any forfeiture condition should be ignored on acquisition, or
- for the relevant purposes their market value at the time of the acquisition is to be calculated as if they were not restricted, and
- sections 425 to 431 are not to apply to the employment-related securities.

An election will affect both when a charge arises and whether or not the charge arises on the unrestricted market value or the actual market value. It will also affect whether or not further chargeable events arise on the lifting of restrictions at later dates.

### *Restricted securities elections - Forms*

Approved forms of election for each of the three possible elections (sections 425(3), 430 & 431) can be found under [ERSM30450](#). There are both one part and two part forms to enable the employer to elect once for a number of employees or for both parties to complete the same form.

If there is a need to tailor an election to particular circumstances the Employee Share and Securities Unit will consider approving appropriate revised forms. In particular, some employers may wish to sign under seal, and/or require employees' signatures to be witnessed and we will be willing to consider such revisions as appropriate.

### *Responsible persons*

Responsible persons are the employer, any host employer, (that is, person treated as the employer), the person from whom securities or options were acquired and the person by whom securities were issued.

In most cases, the employer, as one of the responsible persons, will usually make the report and complete the declaration. However, if the company has delegated the responsibility to make a report to another person, for example an agent holding a current Form 64-8 for the company, the agent can make the report on behalf of the company.

### *Recognised stock exchange*

S841 ICTA defines a recognised stock exchange for tax purposes as the London Stock Exchange and any such stock exchange outside the UK as is approved by an Order of the Board of HMRC. Over the years, a large number of overseas exchanges have been recognised. The current list of recognised overseas exchanges is available on HMRC's website.