



# ***SHARE FOCUS***

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## **INTRODUCTION**

Share Focus seems to be like the number 25 bus, you don't see one for ages then they all appear at once! But seriously, we are producing this extra edition to update you on Budget issues and changes to our administrative procedures.

## **GENERAL**

### **Budget 2007 and Share Schemes**

A minor change to Enterprise Management Incentives will be made to allow the transfer of the qualifying trade of exploiting relevant intangible assets (RIAs) around a group of companies. If you wish to look at the detail of the proposed changes then please look at [Clause 60 of the Finance Bill 2007](#) and the corresponding [Explanatory Note](#). Both are accessible from the [HM Treasury's](#) website. On the other hand if you only want a summary then you may find it easier to read [Budget Note 14](#).

### **Online filing of Employee Share Schemes returns and information**

We know this appeared in the last issue but we thought it would be good to remind our customers of this new facility. It is a significant change for both us and our customers and we are keen for our customers to take advantage of it. We would also welcome any feedback you can give us, positive or negative.

Here is a [Press Release](#) that was published on the 6 April 2007 and some [Frequently Asked Questions](#) on the subject.

### **Share scheme returns - Failure to provide information and penalties**

There was a detailed article on this subject in [Share Focus 3](#). HMRC has been taking action before the Commissioners where companies have failed to submit their share scheme returns. The Commissioners have made declarations of failure to make Share Schemes returns and these cases are now waiting for penalties to be determined. We will continue to take action where companies continue to fail to submit their returns or make their return late.

## **TECHNICAL ISSUES**

### **Special Commissioners case – Chapter 3D – Company A v HMRC**

The first appeal hearing featuring the revised legislation in Schedule 22 FA 2003 came before the Special Commissioners in November 2006. Mr G, the Managing Director of Company A, acquired shares in the parent of that company at market value. The company had a single class of shares, all with identical rights. A

Shareholders' Agreement entered into a few days later provided that on a disposal of the group for more than a specified minimum value Mr G would be entitled to a greater share of the disposal proceeds than a pro rata allocation in line with his holding of shares. A disposal duly took place, and Mr G received his entitlement in accordance with the Shareholders' Agreement. HMRC successfully argued that Mr G had disposed of his shares for more than their market value, leading to an employment income charge on the excess under Chapter 3D, Part 7 ITEPA 2003. Company A has lodged an appeal, so the case is not yet final.

### **Share Incentive Plan – Civil Partnership regulation update**

Some practitioners have asked us whether companies need to submit for approval an amended partnership share agreement where the only change is to take account of the Civil Partnership Regulations. The answer is no.

### **Approved Share Option Schemes and market value**

Following discussions with our colleagues in Shares and Assets Valuation (SAV) we will accept, from 1 May 2007, that for the purpose of granting options under an approved Share Scheme market value (MV) may be determined as follows

#### *1. Shares listed on Daily Official List – London and New York and shares listed on any Recognised Investment/Stock Exchange (excluding AIM)*

MV can be established on:

- the date of grant/invitation or the immediately preceding day.
- an average over a maximum of 5 consecutive days (dealing days) immediately prior to the above dates.

MV can be defined by reference to (a) the middle market quotation or (b) the quarter up of the lower figure on the day. In practice SAV always recommend the mid-market quote.

If the Shares are listed and the Company wishes to establish the Option Exercise Price using an average of Market Values exceeding the maximum of 5 consecutive days then this must be agreed in advance with ESSU. For example, we will normally accept a longer period where this is a legal requirement of a particular country.

This change in practice applies only to establishing MV for the purpose of granting options and /or awarding shares. It is not intended to affect ESSU's procedures relating to (a) rollover of options and (b) adjustments to options following variation of share capital.

One effect of this change is that for shares that are listed on the Paris Stock Exchange we will accept that the MV of options can be set at the **higher** of

- a) the average share price over the 20 trading days prior to the date of grant and
- b) the closing price on the day immediately preceding the date of grant.

The valuation obtained by this method can be used for determining whether the £30,000 limit has been exceeded.

## 2. *Unlisted companies*

We recommend that MV should always be agreed in advance of any grant, ESSU cannot insist on this but it is recommended so that options are not, inadvertently, granted at less than MV. SAV will agree MV on a particular date (date of grant/invitation), which will stand for, usually 30 days. If the company fails to grant options within that period we would advise that it should seek a fresh valuation.

## 3 *Flotation's and similar transactions*

MV should always be agreed in advance of any grant with SAV.

## Share Incentive Plans and market value

We have been asked to clarify our guidance on how market value is to be determined where shares are acquired over several days. For example, a large tranche of shares may be acquired over several days, rather than in a same day transaction, to prevent price volatility. The SIP Code (at paragraph 92 Schedule 2 ITEPA 2003 – “Schedule 2”) states that the value is to be determined in accordance with Part VIII of the Taxation of Chargeable Gains Act 1992. The date on which the value must be taken is:

**Free Shares or Matching Shares\***: the date of award (paragraph 35(2) of Schedule 2);

**Partnership Shares with no accumulation period\***: the value at the acquisition date (paragraph 50(2));

**Partnership Shares with an accumulation period\***: the start of the accumulation period or the acquisition date, whichever produces the lowest value (paragraph 52(3));

*\*For this purpose Matching Shares and any linked Partnership Shares awarded by reference to the market value on the date of acquisition (paragraph 50(2) or 52(3)(b)) are treated as one award.*

**Dividend Shares**: the value at the date of acquisition (paragraph 66(3)).

Paragraph 92(3) of Schedule 2 provides for a different date or dates to be used if “an officer of HM Revenue & Customs and the trustees [of the plan]... agree”. In practice, this agreement (if any) is normally reached before a plan is approved and is reflected in the definition of market value in the plan rules.

If the shares are quoted on a recognised stock exchange (section 841 ICTA 1988) the plan rules may provide for the value to be determined without reference to SAV. If such a provision is used, it must state that Market Value on any day means

(a) if all the shares to be awarded on a particular occasion are purchased in the market over 5 or fewer consecutive dealing days ending either on the date of award or on the dealing day immediately preceding the date of award, the average purchase price of those shares; or

(b) if all the shares are not so purchased, a quoted market price on

- the date of award or acquisition date,
- the dealing day immediately preceding the date of the award, or
- an average of the prices on the 5 (or fewer) consecutive dealing days immediately preceding the award.

If the company decides to use one of these three choices, the value could be the mid-market price, quarter-up price or the closing price. It is not, however, acceptable for the company to have a choice of any of those options. It must decide at the outset which will apply and, if more than one method is specified, the plan should specify the circumstances in which each will be used.

If the shares are not quoted on a recognised stock exchange, the plan must provide for the value to be determined in accordance with Part VIII of the Taxation of Chargeable Gains Act 1992. Although it is not a statutory requirement, we recommend that the value (or the method of arriving at the value) is agreed in advance for the purposes of the plan with SAV.

### **Changes to Forms 34 & 35 for 2008**

As part of HMRC’s continuing commitment to ease the burden on business the annual return forms for Savings Related Shareschemes (SRS) and Company Share Option Plan (CSOP) are being reviewed for 2008.

All aspects of the forms have been reviewed to see whether or not all the information currently requested is actually required, particularly if the information is provided in another form.

For example, information in respect of option exchanges, variations of share capital, scheme amendments and participating companies generally require prior HMRC approval or are notified to ESSU after the event. As we generally have that information in advance of the completed returns we are considering removing these sections from each of the forms 34 & 35. Copies of the revised returns will be made available shortly.

*Form 34 – Section entitled “Options & replacement options exercised and chargeable to Income Tax”.*

The most common event on which an option holder will incur a charge to income tax is if the option is exercised within 3 years of the date of grant following a change of control, including by means of a scheme of arrangement. In these circumstances ESSU needs to be advised in order to approve the documentation to be used and to confirm that the scheme remains approved.

In addition, ESSU is often asked at the same time to approve an arrangement whereby the employer accounts for the income tax via the payroll on a voluntary basis. ESSU cannot comment on this arrangement and will pass details of the request to the appropriate PAYE district to consider. If the arrangement is acceptable the scheme organiser will have to provide a schedule of all participants who have had income tax accounted for under PAYE and also those participants who have declined to enter into this voluntary arrangement when submitting the form 34.

If, however, the scheme organiser provides the schedule of participants who have entered into the voluntary arrangement to account for any income tax through PAYE at the date of the change of control or shortly thereafter, it will no longer be necessary to report these details on Form 34 as we do not want to ask for the same information at the end of the year. Exercises by participants where income tax has not been accounted under the voluntary arrangement will still need to be reported on Form 34 along with any other exercises that incur a liability to income tax.

## **NICs Regulations 2007**

### *Social Security (Contributions) (Amendment No.2) Regulations 2007*

Payments to employees involving employment-related securities which avoid income tax and National Insurance contributions (NICs) are treated as employment income for tax purposes by provisions in Finance (No.2) Act 2005 and Finance Act 2006. The provisions in both Finance Acts are retrospective to the 2 December 2004. These Regulations ensure that the payments to employees are similarly retrospectively treated as earnings and create a National Insurance liability on those payments. The Regulations came into force on 6 April 2007. Other regulations which set out the rules for recording and collecting the retrospective

NICs liability and the effect of these NICs on benefits and pensions also came into force on 6 April 2007. If you wish to know more then we would suggest you visit the HMRC website: [www.hmrc.gov.uk/employers/nicbill05.htm](http://www.hmrc.gov.uk/employers/nicbill05.htm). The article below on 'Retrospective PAYE & NICs on avoidance options' will also be of interest to you.

### *Social Security (Contributions) (Amendment No.3) Regulations 2007*

These were laid on 5 April 2007 and require, as from 6 April 2007, that all joint NICs elections must include a statement stating that 'The joint election will not apply to any liability, or any part of any liability, to a contribution arising as a result of regulations being given retrospective effect by virtue of section 4B (2) of the Social Security Contributions and Benefits Act 1992' in order for formal approval to be given.

All new NICs elections that are sent to us for approval will need to have this statement included in the terms or scope of the election. Elections that have been approved and entered into with employees do not need to be altered. If an approved form of election is to be used for any further awards of shares or share options to employees then we advise the election is amended to include the additional statement and that you provide a copy of the amended election to us for information. It will not require re-approval if that is the only change made.

Revised one and two-part model elections have now been placed on our [website](#).

### **Retrospective PAYE & NICs on avoidance options**

Section 92 Finance Act 2006 retrospectively re-defined securities options used in avoidance as securities, backdated to 2 December 2004. The effect of this is that:

- Any restrictions are ignored through a deemed section 431(1) election imposed by section 431B.
- Because such "securities" convert on exercise into other securities they are within the convertible securities legislation and section 437(2) to (4) applies to deem their "entitlement to convert" as immediate and unconditional.
- If the "securities" have been acquired for less than their market value (taking into account the modifications above) section 446UA creates an immediate acquisition charge, which counts as employment income.
- PAYE is imposed through new section 698(1) (ea).

To collect the PAYE and NIC, the following regulations came into force on 6 April 2007:

- The Income Tax (Pay As You Earn) (Amendment) Regulations 2007 (No. 1077)
- The Social Security (consequential Provisions) Regulations 2007 (No. 1056)

- The Social Security (Contributions) (Amendment No. 2) regulations 2007 (No. 1057)
- The Finance Act 2006 (Section 94(5)) (PAYE: retrospective Notional Payments – Appointment of Substituted Date) Order 2007 (No. 1081)

Detailed explanatory memoranda were also published for the first three.

We know that these are not the snappiest of documents, so an employer's guide has been prepared and can be accessed on the HMRC website [here](#). The crucial dates to note are:

<b>6 April 2007</b>	All notional payments for 2006/7 and earlier years treated as being made on this day.
<b>19 June 2007</b>	PAYE & NIC payments due
<b>5 July 2007</b>	S222 benefit incurred by employee if PAYE not refunded to employer before this date ("before end of the period of 90 days beginning with the relevant date" – S222 (1) (c)).
<b>19 May 2008</b>	Last day for PAYE returns.

## **COMMUNICATIONS**

### **Employment Related Securities Manual (ERSM)**

Revised guidance on the application of Chapter 3C of Part 7 of ITEPA03 is due to be published on the HMRC Internet pages before the end of May. The current target date for publication is 24 May. The bulk of the changes involve expansion of the guidance on the application of the Chapter 3C rules to gains from securities and securities options made by internationally mobile employees.

### **Share Schemes web pages**

We are currently looking at our web pages with a view to re-designing and bringing them up to date. If you have any suggestions for improvements or what you would like us to include please email [shareschemes@hmrc.gsi.gov.uk](mailto:shareschemes@hmrc.gsi.gov.uk)

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