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**NEW CLAUSE 2: RESTRICTION OF EXCEPTIONS FROM CHARGES**

To move the following Clause-

‘(1) Each of the provisions of Part 7 of the Income Tax (Earnings and Pensions) Act 2003 (c. 1) (employment income: securities) specified in subsection (2) (exception from charges for certain company shares) is amended in accordance with subsections (3) to (5).

(2) The provisions are—

- (a) section 429 (restricted securities),
- (b) section 443 (convertible securities),
- (c) section 446R (securities acquired for less than market value), and
- (d) section 449 (post-acquisition benefits from securities).

(3) In subsection (1) of each of those sections, after paragraph (b) (but before the word “and” where that word features at the end) insert—

“(ba) subsection (1A) is satisfied,”.

(4) After subsection (1) of each of those sections insert—

“(1A) This subsection is satisfied if the avoidance of tax or national insurance contributions 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.”

(5) In subsection (4) of sections 429, 443 and 446R, and in subsection (3) of section 449, for the words after “are not” substitute “employment-related securities.”; and accordingly omit section 429(5), 443(5), 446R(5) and 449(4).

(6) In Chapter 3A of that Part of that Act (securities with artificially depressed market value), after section 446I insert—

**“446IA Disapplication of exceptions from charges**

(1) Section 429 (exception from charge under section 426 for certain company shares) does not prevent section 426 (restricted securities: chargeable events) applying in relation to an event if section 446E or 446I(1)(a) would have effect in relation to the event.

(2) Section 443 (exception from charge under section 438 for certain company shares) does not prevent section 438 (convertible securities: chargeable events) applying in relation to an event if section 446G, 446H or 446I(1)(b) would have effect in relation to the event.

(3) Section 446R (exception from charge under Chapter 3C for certain company shares) does not prevent that Chapter (securities acquired for less than market value) applying in relation to employment-related securities if section 446B would have effect in relation to them.

(4) Section 449 (exception from charge under Chapter 4 for certain company shares) does not prevent that Chapter (benefits from securities) applying in relation to a benefit if section 446I(1)(e) would have effect in relation to the benefit.”

(7) In Chapter 3B of that Part of that Act (securities with artificially enhanced market value), after section 446N insert—

**“446NA Disapplication of exceptions from charges**

(1) None of the provisions specified in subsection (2) (exceptions from charges for certain company shares) apply in relation to employment related securities if the market value of the employment-related securities at the time of the acquisition has been increased by at least 10% by non-commercial increases within the period of 7 years ending with the acquisition.

(2) The provisions are—

(a) section 429 (restricted securities),

(b) section 443 (convertible securities),

(c) section 446R (securities acquired for less than market value), and

(d) section 449 (post-acquisition benefits from securities).

(3) If section 446L (market value on valuation date increased by more than 10% by non-commercial increases during relevant period) applies in relation to employment-related securities, section 429 does not subsequently apply in relation to the employment-related securities.”

(8) This section applies on and after 7th May 2004.’.

Mr Paul Boateng

**NEW CLAUSE 3: RESTRICTED SECURITIES WITH  
ARTIFICIALLY DEPRESSED VALUE**

To move the following Clause:—

‘(1) Section 446E of the Income Tax (Earnings and Pensions) Act 2003 (c. 1) (employee securities with artificially depressed market value: charge on restricted securities) is amended as follows.

(2) In subsection (1), after “on restricted securities),” insert—

“(aa) immediately before the employment-related securities are disposed of (in circumstances which do not constitute such an event) or are cancelled without being disposed of,”.

(3) For subsections (3) to (6) substitute—

“(3) “The relevant period” is the period beginning—

(a) if section 425(2) (no charge on acquisition of certain restricted securities or restricted interests in securities) applied in relation to the employment-related securities, 7 years before the acquisition, and

(b) in any other case, 7 years before the relevant date,  
and ending with the relevant date.

(4) “The relevant date” is—

- (a) in a case within subsection (1)(a), the date on which the chargeable event concerned occurs,
  - (b) in a case within subsection (1)(aa), the date on which the disposal or cancellation concerned occurs, and
  - (c) in a case within subsection (1)(b), the 5th April concerned.
- (5) Where this section applies in a case within subsection (1)(aa) or (b), a chargeable event within section 427(3)(a) (lifting of restrictions) is to be treated as occurring in relation to the employment-related securities on the relevant date.
- (6) In every case where this section applies, subsection (1) of section 428 (amount of charge on restricted securities) applies as if the reference in subsection (2) of that section to what would be the market value of the employment-related securities immediately after the chargeable event but for any restrictions were to what would be their market value at the appropriate time but for the matters to be disregarded.
- (7) “The appropriate time” is—
- (a) in a case within subsection (1)(a) or (b), the time immediately after the chargeable event concerned, and
  - (b) in a case within subsection (1)(aa), the time immediately before the chargeable event concerned.
- (8) “The matters to be disregarded” are—
- (a) any restrictions,
  - (b) the things done as mentioned in subsection (2), and
  - (c) if the employment-related securities are about to be disposed of or cancelled, that fact.
- (9) Where this section applies in a case within subsection (1)(aa), section 428(1) applies with the omission of the reference to OP.
- (10) Where this section applies in a case within subsection (1)(a) and the chargeable event concerned is within section

427(3)(c) (disposal for consideration), section 428 applies with the omission of subsection (9) (case where consideration is less than actual market value).”

(4) This section applies on and after 7th May 2004.

(5) But if the employment-related securities were acquired before that date, section 446E does not apply by virtue of the amendment made by subsection (2) of this section unless their market value would be artificially low immediately before the disposal or cancellation if the date on which the relevant period began were the later of—

(a) that on which it did begin, and

(b) 7th May 2004.’.

## **SUMMARY**

1. The two clauses make amendments to the anti-avoidance rules in Part 7 of the Income Tax (Earnings & Pensions) Act 2003 (ITEPA) dealing with employment-related securities.
2. The clauses ensure that certain relieving provisions in Part 7 of ITEPA do not apply if those securities form part of arrangements to avoid tax and/or National Insurance contributions. The changes include, but are not limited to, cases where the value of employment-related securities has been increased or decreased by things done otherwise than for genuine commercial purposes.
3. The clauses also insert new provisions into the anti-avoidance rules in Chapter 3A of Part 7 of ITEPA to ensure that artificially-depreciated restricted securities, disposed of or cancelled in a manner that would not otherwise create a charge, are brought within the restricted securities legislation in Chapter 2 of Part 7 of ITEPA.

## **DETAILS OF THE CLAUSES**

### **RESTRICTION OF EXCEPTIONS FROM CHARGES**

4. Sub-clause (1) amends the sections in Part 7 of ITEPA, referred to in sub-clause (2), that provide relief from income tax in certain circumstances.
5. Sub-clause (2) identifies the sections to be amended by this clause. They are section 429 (restricted securities), section 443 (convertible securities), section 446R (securities acquired for less than market value) and section 449 (post-acquisition benefits from securities). The main tests to be satisfied in order to obtain relief under each of these sections are that the securities are shares of a single class and either:
  - the company is employee-controlled through that class of share, or
  - the majority of those shares are not held by employees.
6. Sub-clause (3) inserts a new paragraph (ba) into subsection (1) of each of the four sections identified by sub-clause (2) above. This paragraph introduces a new condition that must be satisfied for relief to be available under the relevant section referred to in sub-clause (2). That condition is contained in a new subsection (1A) that is inserted by sub-clause (4) below.
7. Sub-clause (4) inserts a new subsection (1A), after subsection (1), into each of the 4 sections identified in sub-clause (2) above. This new subsection contains a condition that must be satisfied in order to obtain exemption from the charge to income tax under the relevant charging provisions referred to by the sections identified in sub-clause (2) above. The condition is satisfied only if the avoidance of tax and/or National Insurance contributions 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.
8. Sub-clause (5) amends subsection (4) of sections 429, 443 and 446R and subsection (3) of section 449, being the sections identified in sub-clause (2) above. It replaces the five conditions in each of those sections that have to be met for relief to be available with the simpler term “employment-related securities”. It also removes subsection (5) of sections 429, 443 and 446R and

subsection (4) of section 449, as they are no longer necessary to give effect to subsections (4) in sections 429, 443 and 446R and subsection (3) in section 449.

9. Sub-clause (6) inserts a new section 446IA – “Disapplication of exceptions from charges” – into Chapter 3A of Part 7 of ITEPA after section 446I. The new section disapplies sections 429, 443, 446R and 449 in cases where the value of employment-related securities is reduced in circumstances to which Chapter 3A applies, so that the exemptions these sections provide are unavailable.
10. Subsection (1) of new section 446IA ensures that section 429 does not operate to stop a charge under section 426 in relation to an event if:
- section 446E (charge on restricted securities with artificially depressed market value), or
  - section 446I(1)(a) (adjustment of consideration or benefit with artificially depressed market value)

would apply to that event. This provision deals with non-commercial value manipulation of restricted employment-related securities.

11. Subsection (2) of new section 446IA ensures that section 443 does not operate to stop a charge under section 438 in relation to an event if:
- section 446G (adjustment of market value: consideration for entitlement to convert),
  - section 446H (adjustment of market value: charge on conversion), or
  - section 446I(1)(b) (consideration for disposal of convertible securities or release of entitlement to convert or benefit received in respect of entitlement to convert),

would apply to that event. This provision deals with non-commercial value manipulation of convertible employment-related securities.

12. Subsection (3) of new section 446IA ensures that section 446R does not operate to stop a charge under Chapter 3C in relation to employment-related securities acquired for less than market value, if section 446B (charge on acquisition of securities with artificially depressed market value) would apply to them. This provision deals with non-commercial value manipulation of employment-related securities acquired for less than their market value.

13. Subsection (4) of new section 446IA ensures that section 449 does not operate to stop a charge under Chapter 4 (post-acquisition benefits from securities) in relation to employment-related securities if section 446I(1)(e) (adjustment of artificially depreciated benefit) would apply to them. This provision deals with non-commercial value manipulation where a benefit is received by virtue of owning employment-related securities.
14. Sub-clause (7) inserts a new section 446NA – “Disapplication of exceptions from charges” – into Chapter 3B of Part 7 of ITEPA after section 446N. The new section disapplies sections 429, 443, 446R and 449 in cases where the value of employment-related securities is increased, either before or after they are acquired by reason of an employment, so that the relief those sections provide is not available.
15. Subsection (1) of new section 446NA disapplies the sections identified in new subsection (2) if the market value of employment-related securities has been increased by more than 10% as a result of anything done otherwise than for genuine commercial purposes in the period of 7 years ending with their acquisition.
16. Subsection (2) of new section 446NA identifies the sections disapplied by new subsection (1). They are:
  - section 429 (restricted securities),
  - section 443 (convertible securities),
  - section 446R (securities acquired for less than market value), and
  - section 449 (post-acquisition benefits from securities).
17. Subsection (3) of new section 446NA disapplies section 429 once section 446L has applied to employment-related securities to charge non-commercial increases in the market value at a valuation date. This means that the relief under section 429 will not be available to stop a charge under Chapter 2 if restrictions are lifted or varied, or the securities are disposed of with restrictions still applying to them, at any time in the future.
18. Sub-clause (8) specifies that the amendments to ITEPA provided by this Clause apply on and after 7<sup>th</sup> May 2004.

**RESTRICTED SECURITIES WITH ARTIFICIALLY  
DEPRESSED VALUE**

19. Sub-clause (1) introduces amendments to section 446E ITEPA which deals with restricted employment-related securities, the market value of which is reduced by things done otherwise than for genuine commercial purposes.
20. Sub-clause (2) inserts a new paragraph (aa) into subsection (1) of section 446E. New paragraph (aa) specifies an additional occasion on which the market value of employment-related securities is to be considered for the purposes of the section. That is, immediately before the employment-related securities are disposed of, in circumstances not within paragraph (a) of subsection (1) or immediately before they are cancelled in circumstances that would not constitute a disposal and before the 5<sup>th</sup> April following acquisition.
21. Sub-clause (3) replaces subsections (3) to (6) of section 446E with new subsections (3) to (10) to cater for the different times at which market values need to be considered for the three paragraphs in subsection (1).
22. New subsection (3) of section 446E effectively replaces section 446E(6), which interacted with section 446(5) to specify the period during which things done otherwise than for genuine commercial purposes are considered. The new subsection specifies the relevant period referred to in section 446E(2). In the case of forfeitable employment-related securities, to which section 425(2) (no charge on acquisition of certain restricted securities or restricted interests in securities) applied, that period begins 7 years before acquisition. In any other case it begins 7 years before the relevant date referred to in new subsection (4). The period ends on the relevant date in new subsection (4). Generally the relevant period is 7 years, except where section 425(2) applied, in which case it can be up to five years longer due to the way in which section 425(2) operates.
23. New subsection (4) of section 446E effectively replaces section 446E(5), which interacted with section 446E(6). It specifies the date on which the relevant period for subsection (2) ends for each of paragraphs (a), (aa) and (b) of subsection (1). Those are:
  - the date on which a chargeable event under section 426 occurs;
  - the date on which the securities are otherwise disposed of, or cancelled;
  - 5<sup>th</sup> April following their acquisition.

24. New subsection (5) of section 446E effectively replaces section 446E(4). It deems all restrictions to be lifted, triggering a chargeable event under section 427(3)(a), where new paragraph (aa) or existing paragraph (b) of section 446E(1) applies. This would be where the securities are disposed of, or cancelled, otherwise than in circumstances that give rise to a charge under section 426 or, if earlier, at 5<sup>th</sup> April following their acquisition. New subsection (6) then acts to disregard the effect of any things done otherwise than for genuine commercial purposes within the relevant period defined for subsection (2).
25. New subsection (6) of section 446E effectively replaces section 446E(3) which modifies the meaning of market value for the purposes of the formula in section 428(1) that applies when a chargeable event arises in respect of restricted employment-related securities. This new subsection requires the market value to be measured at "the appropriate time" defined in new subsection (7) and disregarding matters referred to in new subsection (8).
26. New subsection (7) of section 446E defines "appropriate time" which is used in new subsection (6) to determine the time at which the market value of restricted employment-related securities is to be established in a case within section 446E. In the case of events within paragraphs (a) or (b) of subsection (1) that time is immediately after the event concerned. In the case of events within new paragraph (aa) of subsection (1) it is immediately before the event of disposal or cancellation.
27. New subsection (8) of section 446E defines "matters to be disregarded" for the purposes of arriving at the market value of the employment-related securities for the purposes of section 428(1) in cases where section 446E(6) applies. Previously, effect was given to the requirement to disregard these matters through the wording of old section 446E(3).
28. New subsection (9) of section 446E omits any reference to OP (Outstanding Proportion) in the formula in section 428 in cases where section 446E applies by virtue of new paragraph (aa) of subsection (1). This puts beyond doubt that all remaining untaxed proportions of restricted securities are taxed where the securities have been cancelled.
29. New subsection (10) of section 446E prevents section 428(9) from applying to reduce the chargeable amount in certain cases if non-

commercial things have been done to reduce the market value during the relevant period specified in section 446E(2). This ensures that full effect is given to the adjustments required by this anti-avoidance section.

30. Sub-clause (4) specifies that the amendments to ITEPA provided by this Clause apply on and after 7<sup>th</sup> May 2004.
31. Sub-clause (5) modifies the operation of S446E in cases where the employment-related securities were acquired before the date specified in sub-clause (4) if the event which triggers a charge under section 426 is one within new paragraph (aa) of section 446E(1). In such cases the relevant period referred to in section 446E(2) is modified such that it begins no earlier than 7<sup>th</sup> May 2004.

### **BACKGROUND NOTE**

32. Part 7 of Income Tax (Earnings and Pensions) Act 2003 (ITEPA), which was amended by Finance Act 2003 to make the regime fairer, provides the income tax rules in cases where securities, interests in securities or securities options are acquired in connection with employment.
33. The amendments made by the Finance Act 2003 were designed to ensure that all of the value received by way of remuneration in the form of shares or other securities, is subject to income tax and National Insurance contributions at an appropriate time. The rules provide flexibility in respect of the timing of the charges. For example, the employer and employee can jointly elect to pay tax and National Insurance on a higher proportion when the shares are acquired, leaving future commercial growth in value of the shares in the capital gains tax regime.
34. The Inland Revenue has become aware of schemes that use employment-related securities subject to restrictions in order to pass value to employees in a way that attempts to circumvent the anti-avoidance provisions in Chapters 3A and 3B.
35. The provisions in Chapters 3A and 3B were put in place to counter known avoidance schemes using artificial arrangements to manipulate the value of securities.

36. The rules in Part 7 also widen the definition of securities to cover various kinds of financial products that have been or may be used in avoidance schemes and strengthen the reporting requirements.
37. The changes proposed by the two clauses will block avoidance schemes using employment-related securities by ensuring that provisions in Part 7 of ITEPA designed to provide relief in certain bona fide cases do not apply where the transactions are part of a scheme or arrangement to avoid tax or National Insurance contributions.