

# FINANCE ACT 2014

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## EXPLANATORY NOTES

### INTRODUCTION

#### *Section 52 Schedule 9: Employment-Related Securities Etc*

#### Summary

1. This section and Schedule implement a number of recommendations made by the Office of Tax Simplification (OTS) to simplify the tax rules in relation to employment-related securities (ERS) - such as employee shares - or ERS options awarded to employees. It changes the tax treatment of ERS and ERS options awarded to internationally mobile employees, introduces a new relief for certain ERS exchanges, simplifies the rules around nil-paid and partly-paid ERS and extends the corporation tax relief available to companies in relation to employee share acquisitions.

#### Details of the Schedule

##### **Part 1: Internationally mobile employees**

2. Paragraphs 1 to 5 amend Part 2 of ITEPA by substituting a new Chapter 5B (taxable specific income from employment-related securities etc: internationally mobile employees) for the current Chapter 5A (taxable specific income: effect of the remittance basis) and making consequential amendments to sections 6 and 10 of ITEPA. The new Chapter 5B comprises sections 41F to 41L, which set out new rules for the taxation of ERS and ERS options received by internationally mobile employees, and also contain provisions on the effect of the remittance basis on ERS income that are currently in Chapter 5A.
3. New sections 41F to 41L of ITEPA set out what income from ERS and ERS options (securities income) is to be subject to UK income tax, either on the normal 'arising' basis or the remittance basis where this applies. The effect of the remittance basis for those to whom this applies is that, broadly, income or gains in respect of foreign duties are only taxable in the UK to the extent that they are remitted to the UK. Income or gains are remitted to the UK when they are brought into, used in, or enjoyed in the UK.
4. New section 41F of ITEPA includes subsection (1) and (2), which set out the scope of the new rules. They apply when an amount counts as employment income under Chapters 2 to 5 of Part 7 of ITEPA (which provides rules for the taxation of ERS and ERS options) and at least one of the 'international mobility conditions' specified in subsection (2) are met. The rules at subsections (3) and (4) identify the amount of income from relevant employment for the tax year (securities income) that will be subject to income tax on the arising basis. These subsections provide that this amount should be established by deducting securities income that is 'foreign' from total securities income. Subsection (5) specifies that the amount of securities income that is foreign is the total of any 'chargeable foreign securities income' and any 'unchargeable foreign securities income', with reference to new sections 41H to 41L of ITEPA. Subsections (6) and (7) identify chargeable foreign securities income that is remitted to the UK as 'taxable specific income'. Subsections (8) and (9) make provision in relation

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to amounts remitted to the UK in a tax year and broadly reproduce certain provisions currently found in section 41A of ITEPA, concerning the effect of the remittance basis on taxable specific income from ERS.

5. New section 41G of ITEPA (at subsections (2) – (8)) defines the ‘relevant period’ for each type of ERS for the purposes of the international mobility conditions at new section 41F. This is the period over which securities income is to be apportioned between that which is subject to income tax in the UK, and that which is not. Where appropriate, the relevant periods broadly replicate those already in operation for the remittance basis of taxation at the current section 41B of ITEPA. The rules at subsection (2) to (8) are subject to an override (at subsection (9)) where the relevant period they provide is not just and reasonable.
6. New sections 41H to 41L of ITEPA determine how ‘unchargeable’ and ‘chargeable’ foreign securities income are to be calculated, for the purposes of establishing how much securities income is not to be subject to UK income tax, or subject to UK income tax only on the remittance basis. Where appropriate, these sections broadly replicate rules currently in sections 41C to 41E of ITEPA, which establish the amount of foreign securities income for the purposes of the remittance basis of taxation.
7. New section 41H of ITEPA sets out rules to determine whether ERS income is ‘chargeable or ‘unchargeable’ foreign securities income. Chargeable foreign securities income will be subject to UK income tax on the remittance basis. Subsection (2) provides that securities income is regarded as accruing equally on each day within the relevant period, as set out in new section 41G of ITEPA. Subsections (3) to (12) provide rules that apply for the calculation of chargeable and unchargeable foreign securities income in various cases. These include (at subsections (3), (4), (6) and (7)) the rules that apply for tax years within the relevant period during which: the remittance basis applies, an individual satisfies or does not satisfy the requirement for a 3-year period of non-residence in the UK at section 26A of ITEPA, or the duties of the relevant employment are performed wholly or partly outside the UK. Subsection (8) provides the rules that apply for tax years for which the individual is not UK resident. Subsection (9) sets out the rules that apply where any part of the relevant period is within the overseas part of a tax year that is a split year (where an individual either leaves the UK to live or work abroad or comes from abroad to live or work in the UK). Subsection (11) links the rules in this new section to new section 41J of ITEPA relating to the location of duties. Subsection 12 provides that the rules in this new section are subject to the rules on overseas Crown employment in new section 41K of ITEPA and to provisions on just and reasonable apportionment at new section 41L of ITEPA. Subsections (5) and (10) specify how new section 41H will interact with new section 24A ITEPA.
8. New section 41I of ITEPA limits the amount of securities income that is chargeable foreign securities income in various cases where an individual has associated employment (in addition to their relevant employment), which involves UK duties. Subsection (2) provides that the amount of chargeable foreign securities income for the period is limited to the amount that is just and reasonable with reference to the factors specified in this subsection.
9. New section 41J of ITEPA concerns the location of employment duties: UK duties which are incidental to overseas employment, duties on board a vessel or aircraft and employment on the continental shelf.
10. New section 41K of ITEPA provides for the treatment of securities income from overseas Crown employment.
11. New section 41L of ITEPA provides an override where the proportion of securities income that is chargeable or unchargeable foreign securities income, as determined under new section 41H, is not just and reasonable in all the circumstances.

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12. Paragraph 7 of the Schedule inserts a new subsection (A1) into section 418 of ITEPA. This requires Part 7 of ITEPA (concerning income from ERS and ERS options) to be read alongside the new Chapter 5B of Part 2 of ITEPA.
13. Paragraph 8 repeals section 421E of ITEPA which sets out the current residence provisions for the taxation of certain ERS.
14. Paragraphs 9, 11 and 12 amend sections 425, 430 and 431 of ITEPA to limit the availability of the elections available under these sections (which allow for the disapplication of certain provisions within Chapter 2 of Part 7 of ITEPA concerning restricted securities). They provide that these elections can only be made where at the time of the acquisition of the securities (or in the case of section 430 at the time of a chargeable event in relation to the securities), the charging provisions of Chapters 4 and 5 of Part 2 of ITEPA apply in relation to earnings from the relevant employment (or in cases where there are no earnings from that employment, would apply if there were any earnings). These charging provisions apply where an employee is UK resident, or performs duties in the UK.
15. Paragraph 10 amends section 428 of ITEPA. Sub-paragraph (2) updates section 428 of ITEPA, concerning the amount subject to income tax on the occurrence of a chargeable event in relation to restricted ERS. The amendment ensures that amounts previously charged to 'non-UK income tax' when the ERS were acquired by an internationally mobile employee can be a 'deductible amount' when calculating what value is subject to UK tax on the occurrence of a subsequent chargeable event in relation to these ERS. It also sets out various definitions for the purpose of these rules. This puts amounts that have been charged to UK income tax and amounts charged to income tax outside the UK on a broadly equal footing, for the purposes of this tax calculation.
16. Sub-paragraph (3) of paragraph 10 clarifies the treatment of income that would have been 'exempt income' in the UK had the internationally mobile employee been UK resident, or subject to the remittance basis of taxation, at the appropriate time. It provides that such amounts are to be treated for the purposes of the relevant calculation in the same way as income that was exempt in the UK – and are therefore not deductible amounts. This puts this income on a broadly equal footing for UK tax purposes, regardless of where the employee was based at the time that the relevant ERS were acquired.
17. Paragraphs 13, 15 and 27 provide the same clarification of the treatment of this 'exempt' income in other cases where it is necessary to establish an amount subject to tax in relation to ERS. These are the calculation of notional loan amounts outstanding in relation to ERS acquired for less than market at section 446T ITEPA; the amount subject to tax on the occurrence of a chargeable event in relation to ERS options; and amount that is taken to be consideration for the acquisition of restricted or convertible shares for the purposes of capital gains tax.
18. Paragraph 14 repeals section 474 of ITEPA which provides the current residence provisions for the taxation of ERS options.
19. Paragraph 16 amends section 540 of ITEPA which ensures that no charge arises under Chapter 3C from the exercise of options under the Enterprise Management Incentives scheme.
20. Paragraphs 17 to 20 amend various sections of ITEPA in consequence of the omission of sections 421E and 474 of ITEPA and the insertion of new Chapter 5B of Part 2 of ITEPA.
21. Paragraphs 21 to 26 and 28 to 33 amend section 700A of ITEPA and various provisions in the Taxation of Chargeable Gains Act 1992, the Corporation Tax Act 2009 (CTA 2009) and the Income Tax Act 2007 in consequence of changes made in this Schedule.

**Part 2: Restricted securities and securities acquired for less than market value: replacement and additional securities and rollover relief etc**

22. Part 2 of the Schedule provides rollover relief from income tax for certain cases in which restricted securities held by an employee are exchanged for other restricted securities. It also amends the rules at Chapter 3C of Part 7 of ITEPA concerning notional loans, under which tax may be chargeable in relation to nil-paid or partly-paid ERS.
23. Paragraph 35 amends section 421D of ITEPA concerning replacement and additional securities and changes in interests. Sub-paragraphs (2) and (3) address cases in which the value of ERS has been reduced by the issue of certain additional or replacement securities. The provision sets out that, in such cases, the amount of that reduction should be treated as a payment for the acquisition of these new securities for the purposes of Chapter 3C of Part 7 of ITEPA. Chapter 3C provides tax rules for ERS acquired for less than market value, including nil-paid and partly-paid ERS, and taxes certain amounts in relation to these ERS as notional loans.
24. Paragraph 36 inserts new section 430A of ITEPA, which introduces relief from income tax in certain cases where restricted securities held by an individual ('old securities') are exchanged for other restricted securities ('new securities'). Restricted securities are those which have restrictions which reduce their market value. Subsections (3) and (4) of new section 430A concern circumstances in which old securities are exchanged for new securities as well as other consideration, and provide that the new rollover relief will only be available on that part of the consideration that is new securities. That part of the consideration which is not new securities will give rise to a chargeable event on the disposal of the matching proportion of the old securities. Subsection (5) concerns cases in which the only consideration for the old securities is new securities, and provides that neither the disposal of the old securities nor the acquisition of the new securities will give rise to a tax liability and that Chapter 2 of Part 7 of ITEPA applies to the new securities as it applies to the old securities, subject to subsections (6) to (17).
25. Subsections (6) to (17) of new section 430A set out how the new securities are to be treated under Chapter 2 (concerning the taxation of restricted securities). Subsection (6) provides that sections 425 or 431 of ITEPA do not apply in relation to the new securities. Section 425 provides an income tax exemption on the acquisition of certain restricted securities, and sections 425 and 431 allow elections to be made disregarding that exemption and certain other provisions within Chapter 2. The tax arrangements for the old securities will, in certain respects, be transferred to the new securities. This includes (at subsection (7)) any elections to disapply certain provisions of Chapter 2 made in respect of the old securities under sections 430(1) or 431(1); and (at subsection (8) to (10)) the proportions used to calculate the amount of charge under section 428 of ITEPA, in the case of a subsequent chargeable event in relation to the new securities.
26. Subsections (11) to (14) of new section 430A apply where no tax was chargeable on acquisition of the old securities by virtue of section 425(2) of ITEPA, because the securities were 'forfeitable' within 5 years, and a forfeiture restriction still applies to the old securities at the time of the exchange. Broadly, on the occurrence of a chargeable event, income tax will apply in relation to these new securities in the same way as would have been the case for the old securities. Subsection (12) creates a chargeable event immediately after the acquisition of the new securities where the restriction on them is not a forfeiture restriction. Subsections (13) and (14) provide that where the new securities remain forfeitable more than 5 years after the acquisition of the old securities, the forfeiture restriction is treated as having been removed five years after the acquisition of the old securities, so that a chargeable event occurs at that time. Subsections (15) to (17) ensure that these rules apply in relation to subsequent exchanges of these new securities.
27. Paragraph 37 of the Schedule amends the rules at current section 446U of ITEPA concerning the discharge of notional loans, which apply for nil-paid and partly-paid ERS. Sub-paragraph (2) amends the circumstances in which the release of a liability

in respect of the ERS will result in a notional loan being treated as discharged. Sub-paragraph (3) removes certain disposals of these ERS from provisions in section 446U that would otherwise treat the outstanding notional loans as employment income subject to tax at that time. Sub-paragraph (4) provides that the notional loan in relation to these ERS is discharged without giving rise to an amount of employment income where these ERS are disposed of in certain circumstances.

28. Paragraph 38 consequentially amends section 554N of ITEPA.

### **Part 3: Corporation tax relief for employee share acquisitions**

29. Part 3 of the Schedule extends the circumstances in which corporation tax relief is available under Part 12 of CTA 2009 in relation to employee share acquisitions.
30. Paragraphs 40 and 41 modify certain interpretations and definitions used for the purposes of Part 12 of CTA 2009, consequential to changes made in this Part of the Schedule.
31. Paragraphs 42, 43, 45 and 46 introduce new sections 1007A, 1015A, 1015B, 1025A, 1025B, 1030A and 1030B of CTA 2009. These new sections concern cases where shares are acquired, or share options are obtained, where an individual is employed by a company not within the charge to corporation tax, and the individual either: (i) works for (but does not have employment with) a company within the charge to corporation tax (for example during a period of secondment); or (ii) takes up employment with such a company.
32. The new sections 1007A and 1015B of CTA 2009 concern employees of non-UK resident companies who work in the UK for (but do not have employment with) a host company that is within the charge to corporation tax - for example under secondment or similar arrangements. These new sections enable the host company to claim relief under Part 12 of CTA 2009 in relation to an acquisition of shares, subject to certain conditions. They provide (at subsection (2) of both new sections) that an individual is treated as having employment with the host company and (at subsection (4) of both new sections) that the shares or option in question are treated as having been acquired or obtained because of work for this host company. Subsection (3) of both new sections makes the application of subsection (4) dependent upon an amount of employment income being charged to tax under ITEPA in respect of the acquisition of the shares, because of work done for the host company. Subsection (6) of both new sections limits the relief available to the total amount of employment income charged to tax under ITEPA in relation to the acquisition.
33. The effect of these new sections is that, subject to certain conditions, the basic requirements for relief at sections 1007 and 1015 of CTA 2009 (concerning the employment of the individual and the employment in respect of which the shares are acquired or the option is obtained) can be satisfied in relation to overseas secondees or similar workers. Relief up to a specified maximum may therefore be available to the host company on the acquisition of the shares. Subsection (5) of both new sections means that relief may be available in relation to an acquisition of shares in the overseas employer. Subsection (7) of both new sections makes provision for cases in which there is more than one company to whom relief might be available in relation to the same acquisition of shares, and sets out that only one company may be given relief.
34. New section 1015A of CTA 2009 concerns share options obtained because of 'overseas employment' with non-UK resident companies, where the employee takes up 'UK employment' with a company within the charge to corporation tax. It provides at subsection (3) that where certain conditions are met, share options obtained because of the overseas employment are treated as if they were obtained because of the UK employment, for the purposes of the requirement at section 1015(1)(c) CTA 2009 (concerning the employment in respect of which the option is obtained).

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35. The effect of new section 1015A is that in certain circumstances relief may be available to a UK employer in relation to shares acquired by exercise of an option obtained because of overseas employment. Subsection (2) makes relief as a result of this new section dependent upon an amount of employment income being charged to tax under ITEPA in relation to the acquisition of the shares, because of the UK employment; or the acquisition of the shares taking place because of the UK employment. Subsection (5) limits the relief available to the total amount of employment income charged to tax under ITEPA in relation to the acquisition. Subsection (4) means that relief may be available in relation to an acquisition of shares in the overseas employer. Subsection (6) makes provision for cases in which there is more than one company to whom relief might be available in relation to the same acquisition of shares, and sets out that only one company may be given relief.
36. New section 1025A of CTA 2009 concerns the additional relief available under Chapter 4 of Part 12 CTA 2009 where there is a chargeable event involving restricted shares. It addresses cases in which restricted shares have been acquired because of 'overseas employment' with a non-UK resident company, and the employee either takes up 'UK employment' with a company within the charge to corporation tax, or works for such a company on a secondment or similar basis. Subsection (5) means that additional relief under Chapter 4 is available to a UK company, subject to certain conditions. These conditions include a requirement at subsection (1)(h) that, because of the UK employment or work, an amount of employment income is charged to tax under ITEPA in relation to the chargeable event. Subsection (9) limits the relief available to the total amount of employment income charged to tax under ITEPA in relation to this chargeable event. Subsection (8) explains how this new section interacts with other provisions of Part 12 that set out how relief is given. Subsection (10) sets out rules for cases in which there is more than one company to whom relief might be available in relation to the same chargeable event.
37. The new sections 1025B and 1030B of CTA 2009 concern the additional relief available under Chapters 4 and 5 of Part 12 CTA 2009 in relation to chargeable events and restricted shares or convertible securities. These new sections provide, subject to certain conditions, that this additional relief is available to the host company in the secondment or similar arrangements covered by new sections 1007A and 1015B of CTA 2009. Similarly, this relief may be available in cases covered by new section 1015A, where an employee of an overseas company takes up employment with a UK company. Subsection (2) of new sections 1025B and 1030B mean that a host company is treated as the employing company for the purposes of the relief. Provisions within these new sections limit the relief available to the total amount of employment income charged to tax under ITEPA in relation to the chargeable event. These new sections also include provision for cases in which there is more than one company to whom relief might be available in relation to the same chargeable event, and cases in which an employee has died. By virtue of subsection (3) of new section 1030B (concerning convertible securities), the chargeable event for which relief is available may be the conversion of securities into shares in the overseas employer.
38. New section 1030A of CTA 2009 concerns the additional relief available under Chapter 5 of Part 12 CTA 2009 where there is a chargeable event involving convertible securities. It addresses cases in which convertible securities have been acquired because of 'overseas employment' with a non-UK resident company, and the employee either takes up 'UK employment' with a company within the charge to corporation tax, or works for such a company on a secondment or similar basis. Subsection (5) means that additional relief under Chapter 5 is available to a UK company, subject to certain conditions. These conditions include a requirement at subsection (1)(h) that, because of the UK employment or work, an amount of employment income is charged to tax under ITEPA in relation to the chargeable event. Subsection (10) limits the relief available to the total amount of employment income charged to tax under ITEPA in relation to this chargeable event. Subsection (7) means that relief may be given in relation to shares in the overseas or UK company. Subsection (9) explains how this new section interacts

with other provisions of Part 12 that set out how relief is given. Subsection (11) sets out rules for cases in which there is more than one company to whom relief might be available in relation to the same chargeable event.

39. Paragraph 44 of the Schedule extends the availability of corporation tax relief under Chapter 3 of Part 12 CTA 2009 for shares acquired by exercise of a share option, and concerns shares acquired following a company takeover. It introduces new subsections 1(d) and (1A) to section 1016 CTA 2009, which sets out requirements in relation to the shares acquired. The addition of these subsections means relief will be available in relation to the acquisition of shares that – immediately prior to a company takeover – satisfied the requirements at paragraphs (a) to (c) of Condition 2 at section 1016(1), but no longer do so as a result of this takeover. This is subject to the shares in question being acquired within 90 days of the takeover, as well as an anti-abuse provision.

#### **Part 4: Commencement and transitional provision**

40. Part 4 specifies the commencement of those changes in the Schedule which do not take effect from Royal Assent, and provides for The Treasury to make transitional, consequential, supplementary or incidental provision in relation to certain changes made by this Schedule.

#### **Background Note**

41. Income tax is generally due where an employer awards shares or other ERS to employees, and tax may also be due on certain disposals of ERS and on the exercise of share options. The tax rules in this area are designed to ensure that the employment income paid in the form of ERS or options is subject to income tax as appropriate. In certain circumstances, corporation tax relief is available to companies in respect of employee share acquisitions.
42. The OTS published a report and recommendations on unapproved employee share schemes in January 2013. This identified a number of areas in which the current tax rules created undue complexity, and included recommendations for how these might be simplified.
43. The Government consulted on the recommendations being taken forward in this measure during summer 2013. A summary of responses to this consultation was published on 10 December 2013.
44. This measure supports the Government's objective to simplify the tax system. Sections 19 (Payments by employer on account of tax where deduction not possible) and 45 (Taxable specific income: effect on pension input amount for non-UK schemes) of this Act also form part of the overall package arising from the OTS recommendations in relation to unapproved employee share schemes.
45. This Finance Act also includes other simplification changes recommended by the OTS in relation to the Government's four tax advantaged employee share schemes – see section 51 (Employee share schemes) and Schedule 8.