These notes refer to the Income Tax (Earnings and Pensions) Act 2003 (c.1) which received Royal Assent on 6th March 2003

INCOME TAX (EARNINGS AND PENSIONS) ACT 2003

EXPLANATORY NOTES

1. These explanatory notes relate to the Income Tax (Earnings and Pensions) Act 2003 which received Royal Assent on 6 March 2003. They have been prepared by the Tax Law Rewrite project at the Inland Revenue in order to assist readers of the Act and to help inform debate on it. They do not form part of the Act.

2. The notes need to be read in conjunction with the Act. They are not, and are not meant to be, a comprehensive description of its contents. So if a section or part of a section does not seem to require explanation or comment, none is given.

SUMMARY

3. The main purpose of the Income Tax (Earnings and Pensions) Act 2003 is to rewrite tax legislation relating to income from employment, pensions and social security so as to make it clearer and easier to use.

4. The Act also makes some minor changes to the legislation. These are within the remit given to the Tax Law Rewrite project and the Parliamentary process for the Act.

BACKGROUND

The Tax Law Rewrite Project

5. In December 1995 the Inland Revenue presented a report to Parliament on the scope for simplifying the UK tax system (*The Path to Tax Simplification*). The main recommendation was that UK direct tax legislation should be rewritten in clearer, simpler language.

6. This recommendation was warmly welcomed, both in Parliament and in the tax community. After further work on important practical issues and a period of

preliminary consultation, the then Chancellor of the Exchequer (the Rt Hon Kenneth Clarke MP, QC) announced in his November 1996 Budget statement that the Inland Revenue would propose detailed arrangements for a major project to rewrite direct tax legislation in plainer language.

7. The project team was given the task of rewriting almost all of the United Kingdom's existing primary direct tax legislation. The aim is that the rewritten tax law should use simpler language and structure than legislation that it replaces. The members of the project are from different backgrounds, including Inland Revenue employees, private sector tax professionals and parliamentary counsel including (as head of the drafting team) a senior member of the Office of the Parliamentary Counsel.

Steering Committee

8. The work of the project is overseen by a Steering Committee, chaired by Lord Howe of Aberavon CH, QC. The membership of the Steering Committee as at February 2003 is:

- Rt Hon the Lord Howe of Aberavon CH, QC (Chairman)
- Ian Barlow
- Adam Broke
- David Hartnett
- The Rt Hon Michael Jack MP
- Dr John Avery Jones CBE
- Rachel Karp
- Professor Frank Kidd
- James Plaskitt MP
- The Rt Hon Lord Mustill
- David Swaine

Consultative Committee

9. The work is also reviewed by a Consultative Committee, representing the accountancy and legal professions and the interests of taxpayers. Its members as at February 2003 were:

– Peter Michael CBE	Chairman
– Graham Aaronson QC	Revenue Bar Association
– Derek Brownlee	Institute of Directors
– Adam Broke	Special Committee of Tax Consultative Bodies
– Colin Campbell	Confederation of British Industry

– Russell Chaplin	London Chamber of Commerce
– Malcolm Gammie	The Law Society of England and Wales
– Terry Hopes	Institute of Chartered Accountants in England and Wales
– Isobel d'Inverno	Law Society of Scotland
– Elizabeth Lathwood	Chartered Institute of Taxation
– Simon McKie	Institute of Chartered Accountants in England and Wales
– Cunnie Rankin	Institute of Chartered Accountants of Scotland
– Mavis Sargent	Association of Chartered Certified Accountants
– Simon Sweetman	Federation of Small Businesses
– Wreford Voge	Chartered Institute of Taxation
– Professor David Williams	Office of the Social Security Commissioners
– Mervyn Woods	Confederation of British Industry

Consultation

10. The work produced by the project has also been subject to public consultation. This has allowed all interested parties an opportunity to comment on draft clauses. This consultation has taken the form of a series of Exposure Drafts which publish clauses in draft. The relevant ones for this Act are numbers 6, 11 and 12. They were published in May 1999, January 2001 and December 2001 respectively. A draft Bill was published for further consultation in July 2002. Those who responded to one or more of those documents include:

- Cardiff Law School, Cardiff University
- Chartered Institute of Taxation
- City of London Law Society
- Confederation of British Industry
- Construction Industry Joint Taxation Committee
- Deloitte & Touche
- Ernst & Young
- Global Employment Solutions
- Holborn Law Society
- ideasUK
- Institute of Chartered Accountants in England and Wales
- Institute of Chartered Accountants of Scotland
- Institute of Directors
- Institute of Payroll and Pensions Management
- John Jeffrey-Cook

- KPMG
- Law Society of England and Wales
- London Society of Chartered Accountants
- London Tax Study Group
- Low Incomes Tax Reform Group
- Mayer Brown Rowe and Maw
- Share Scheme Lawyers Group
- Special Committee of Tax Law Consultative Bodies

Note: this table excludes those who asked that their responses be treated in confidence.

A brief history of the taxation of employment income

11. Income tax was introduced in 1799; Schedules A to E first appeared in 1803; and the income tax legislation of the Napoleonic period was given its final shape in an Act of 1806. That Act was also drafted in terms of the five Schedules A to E. Schedule E related to every public office or employment of profit; and the general rule was that income tax was to be "detained and stopped" at the public office. The Napoleonic wars ended in 1815, and income tax was then abolished.

12. Income tax was reintroduced in 1842, in an Act agreed to have been modelled on the 1806 Act, and the five Schedules accordingly reappeared. Income tax has been in continuous existence ever since.

13. Some provisions in the income tax legislation relating to Schedule E, therefore, now have a considerable history. One of these is the central provision concerning the deductibility of expenditure, with its requirement that the expenditure should be expended "wholly, exclusively and necessarily" in the performance of the duties of the employment (see section 336 in Part 5 of this Act). For well over a century this provision also included a reference to keeping and maintaining a horse in order to enable the employee to perform the duties of the employment; and only in 1998 was this reference removed.

14. In the years following 1842 the charge to income tax under Schedule E applied only if the office or employment held or exercised was of a public nature. If it was not, income tax was charged under Schedule D (the residual Schedule). There were fewer public offices than some had thought: in Great Western Railway Co - v - Bater (1922) 8 TC 231, [1922] 2 AC 1, the House of Lords, undoing the accepted practice of decades, placed a railway clerk in Schedule D and not in Schedule E. But the charge to income tax under Schedule E was widened by section 18 of FA 1922, which provided that profits or gains arising from employments chargeable under Schedule D, "other than the profits or gains chargeable under Case V of Schedule D", should be transferred to Schedule E. The profits or gains from some employments

accordingly continued to be chargeable under Schedule D Case V; but that possibility disappeared when section 10 of FA 1956 provided that all income from employments was to be chargeable under Schedule E, and divided Schedule E into three Cases.

15. The twentieth century saw major increases in the revenue obtained from income tax, in the rates of that tax, and in the importance of income tax to central finance. It became a matter of major operational importance, therefore, (and not least during the Second World War) that employees should account for income tax on their earnings. The result was the Pay As You Earn (PAYE) system. The developments leading to the introduction of that system are discussed in greater detail in the introductory explanatory notes for Part 11 of this Act; and that Part deals with the primary legislation relating to the PAYE system.

16. Since the Second World War both earnings and income tax rates have been very high by historical standards; and national insurance contributions may well make further demands on both employer and employee.

17. Against this background, it might well be worthwhile for employers and employees to try to arrange for payments and benefits to be received in a way that minimises income tax – and for the Inland Revenue to contest those arrangements. There are, accordingly, numerous cases in which the Inland Revenue has alleged, and the taxpayer has denied, that the receipt of a particular advantage was within the ambit of the Income Tax Acts. Hochstrasser - v - Mayes (1959) 38 TC 673, [1960] AC 376 is one example that may represent others. And against this same background it was also to be expected that the legislation relating to income tax charged under Schedule E would become more extensive and more complicated.

18. One legislative consequence related to the subject described in Part 3 of this Act as "the benefits code" – and dealt with in that Part. Legislation on this subject featured in FA 1948, and has been extended in other Finance Acts since – not least in FA 1976.

19. A second legislative consequence was that the charge to income tax under Schedule E was extended to receipts with characteristics specified in the legislation in question. The first, and very important, example was the legislation relating to payments and benefits received on the termination of an employment, originally enacted in FA 1960. In this Act these provisions may be found in Chapter 3 of Part 6. The provisions of that Part do not deal with earnings from an employment, charged to income tax under Schedule E by virtue of paragraph 1 of section 19(1) of ICTA 1988, but with other payments and benefits specifically charged to income tax under Schedule E by virtue of paragraph 5 of section 19(1). In this Act this income is referred to as "specific employment income", and it is distinguished, very carefully, from "general earnings" (see section 6(1) of this Act).

20. A third legislative consequence concerned share-related income, dealt with in Part 7 of this Act. Companies might well wish to reward employees by allowing them to acquire shares on advantageous terms – including arrangements designed to minimise income tax. The income tax legislation on this matter accordingly consists in part of legislation designed to counteract schemes that have been in existence at various times, and in part of legislation designed to promote share schemes with meritorious characteristics. These matters are discussed in greater detail in the introductory explanatory notes for Part 7 of this Act. That Part is extensive. It occupies 138 sections and four Schedules with a total of 245 paragraphs (and there is further material in Schedule 6 dealing with consequential amendments). Some of this material is very recent: of the provisions just mentioned 43 of the sections and 159 of the paragraphs in the Schedules derive from legislation on topics first dealt with in FA 2000.

Employment income, pensions and social security

21. As mentioned above, employment income is taxed under Schedule E in ICTA. During the course of the work leading up to the production of this Act, it became apparent that it would be more sensible to rewrite the whole of Schedule E, rather than just picking out those parts relevant to employment income.

22. The grouping of employment income, pensions and social security income represents income within Schedule E as set out in section 19 of ICTA. Rewriting the charging provisions for these categories of income makes possible a repeal of Schedule E as a whole.

23. In order to have all the charging provisions relating to pensions in one place, Part 9 of the Act also includes some pensions within Schedule D as set out in section 18 of ICTA.

THE ACT

24. The Act has 725 sections and eight Schedules.

25. The sections are arranged as follows:

Part 1 (Overview) sets out what is covered in the Act and where to find abbreviations and definitions.

Part 2 (Employment income: charge to tax) introduces the concept of "the employment income Parts" to cover Parts 2 to 7 and sets out the charging provisions for employment income.

Part 3 (Employment income: earnings and benefits etc. treated as earnings) deals with the general earnings element of employment income, setting out what kinds of income and benefits should be brought into account.

Part 4 (Employment income: exemptions) gives details of a number of exemptions from various kinds of income that would otherwise be chargeable to tax under the employment income Parts.

Part 5 (Employment income: deductions allowed from earnings) sets out various deductions that may be allowed from earnings in computing taxable earnings.

Part 6 (Employment income: income which is not earnings or share-related) covers payments to and benefits from non-approved pension schemes and payments and benefits on termination of employment etc.

Part 7 (Employment income: share related income and exemptions) contains provisions about share-related remuneration and the various share option schemes and incentive plans.

Part 8 (Former employees: deductions for liabilities) sets out that certain deductions may be made from a former employee's total income.

Part 9 (Pension income) contains the charging provisions for pension income, including any exemptions from those charging provisions.

Part 10 (Social security income) contains the charging provisions for taxable social security benefits including any exemptions from those charging provisions.

Part 11 (Pay As You Earn) sets out the framework for the operation of PAYE and provides for the making of PAYE regulations.

Part 12 (Payroll giving) sets out the rules for the payroll deduction scheme for charitable donations.

Part 13 (Supplementary provisions) contains provisions that have effect across the other Parts of the Act.

26. The Schedules are:

Schedule 1: Abbreviations and defined expressions

Schedule 2: Approved share incentive plans

Schedule 3: Approved SAYE option schemes

Schedule 4: Approved CSOP option schemes

Schedule 5: Enterprise management incentives

Schedule 6: Consequential amendments

Schedule 7: Transitionals and savings

Schedule 8: Repeals and revocations

COMMENTARY ON SECTIONS

27. At the end of the commentary there is more detailed supporting material in three annexes.

28. *Annex 1* contains details of the minor changes in the law made by the Act.

29. *Annex 2* gives notes on technical points of interpretation of the sections. These notes concentrate on points where it may not be immediately apparent that the Act preserves the effect of the existing law.

30. *Annex 3* contains a table of destinations for the Extra-Statutory Concessions to which this Act gives statutory effect.

Glossary

31. The commentary uses a number of abbreviations. They are listed below.

APS	approved profit sharing
CAA 2001	the Capital Allowances Act 2001
CSOP	company share option plan
CTSA	Corporation Tax Self Assessment
EMIs	enterprise management incentives
ESC	extra-statutory concession
FA 1971	Finance Act 1971 (and similarly FA 1985 and so on)
F(No.2)A	Finance (No. 2) Act
ICTA	the Income and Corporation Taxes Act 1988
ICTA 1970	the Income and Corporation Taxes Act 1970
ITA 1918	the Income Tax Act 1918 (and similarly ITA 1945)
NIC	National Insurance contributions
PAYE	Pay As You Earn
PSA	PAYE settlement agreement
SAYE	Save As You Earn
SE manual	the Inland Revenue's Schedule E manual – references to paragraphs in the manual take the form SE 12345
SI 1993 No 744	the Income Tax (Employments) Regulations 1993 ("the PAYE regulations")
SIPs	share incentive plans
TCGA 1992	the Taxation of Chargeable Gains Act 1992
TMA 1970	the Taxes Management Act 1970
VAT	value added tax

32. There is a list of abbreviations used in the Act at the start of Schedule 1 to this Act.

Part 1: Overview

Section 1: Overview of contents of this Act

33. This section summarises the charges to tax and other matters covered in the Act. It also provides, in *subsection (2)*, the link to the general charge to income tax in section 1(1) of ICTA. It is new.

Section 2: Abbreviations and defined expressions

34. This is another new section. It provides information on where to find lists of the various abbreviations and defined expressions used in this Act.

Part 2: Employment income: charge to tax

Chapter 1: Introduction

Section 3: Structure of employment income Parts

35. This section sets out what is in Parts 2 to 7 of this Act and provides "the employment income Parts" as a collective label for them. It is new.

Section 4: "Employment" for the purposes of the employment income Parts

36. This section is new. It casts some light on what is meant by "employment". It is not an attempt to delineate the boundary between employment and self-employment. That boundary depends on fact and the degree to which a number of indicators exist. This section is simply intended to confirm that employments that are clearly nowhere near that boundary are squarely within this Act, by providing a non-exhaustive definition.

37. This change of approach is explained in detail in *Note 1* in Annex 2.

Section 5: Application to offices and office-holders

38. This section sets out that the employment income Parts apply to offices and office-holders in the same way as they apply to employments and employees.

39. *Subsection (3)* provides a non-exhaustive definition of the term "office". It is based on guidelines derived from case law. This change in approach is explained in detail in *Note 1* in Annex 2.

Chapter 2: Tax on employment income

Section 6: Nature of charge to tax on employment income

40. This section provides in *subsection (1)* that the charge to tax on employment income under Part 2 is split into a charge to tax on "general earnings" and "specific employment income". The labels "employment income", "general earnings" and "specific employment income" are new, and are explained in section 7.

41. *Subsection (2)* provides a signpost to section 9 which sets out how to work out the amount of general earnings or specific employment income that is charged to tax in a particular tax year.

42. *Subsection (3)* is a pointer to Chapters 4 and 5 which derive from the Cases of Schedule E. Those Chapters set out the rules relating to residence, domicile etc that apply to general earnings. Those Chapters have no application to "specific employment income".

43. *Subsection (4)* provides a signpost to section 13 which in turn makes clear who is liable for tax under this Part.

44. Subsections (1) to (4) are new, although subsection (1) derives in part from paragraphs 1 and 5 of section 19(1) of ICTA.

45. *Subsection (5)* provides the one exception to the basic rule that employment income is charged to tax on income from employments. This Act replaces all charges to tax under Schedule E, but there is one category of income from employment that is not charged to tax under Schedule E. The employment duties of specified types of divers and diving supervisors are treated as if they constitute a trade and are charged to tax under Schedule D. Subsection (5) of this section reflects the effect of section 314(1) of ICTA in removing the income from employment of those divers and diving instructors from the scope of Schedule E.

Section 7: Meaning of "employment income", "general earnings" and "specific employment income"

46. This section sets out the definitions of these terms introduced in the preceding section. It is new. See *Notes 2* and *3* in Annex 2.

47. Those Notes explain in full why it is necessary to distinguish between the two elements to the employment income charged in this Part. The first element is "general earnings", which relate to "emoluments" brought into charge by paragraph 1 of section 19(1) of ICTA. The basis of assessment for "general earnings" depends on the residence, ordinary residence and domicile status of the employee. The second element, "specific employment income", relates to the free-standing charges under Schedule E, chargeable under paragraph 5 of section 19(1) of ICTA. The basis of assessment for "specific employment income" is blind to issues of residence, ordinary residence and domicile.

Section 8: Meaning of "exempt income"

48. This section provides the definition of exempt income for the purposes of the employment income Parts. It is new.

Chapter 3: Operation of tax charge

Section 9: Amount of employment income charged to tax

49. This is a new section that explains what amounts are charged to tax for each stream of employment income. *Subsection (2)* sets out that for earnings, the amount charged to tax is "net taxable earnings" – this is another new label. It describes the amount of income from the employment that has been allocated to a particular tax year by reference to the timing rules as determined by the Cases of Schedule E in section 19(1) of ICTA (now contained in Chapters 4 and 5 of this Part), less any available deductions.

50. *Subsection (3)* explains where to find the mechanics of how to calculate net taxable earnings in the following provisions of Part 2.

51. *Subsection (4)* sets out that, for specific employment income, the amount charged to tax is "net taxable specific income" – this is another new label. It is the amount allocated to that year by the relevant provisions less any available deductions.

52. *Subsection (5)* explains where to find the mechanics of how to calculate net taxable specific income in the following provisions of this Chapter.

53. *Subsection (6)* makes it clear that tax may only be charged under this Chapter for a particular year on taxable earnings and taxable specific income. *Paragraph (a)* derives from the closing words of paragraph 1 of section 19(1) of ICTA. *Paragraph (b)* is new.

Section 10: Meaning of "taxable earnings" and "taxable specific income"

54. "Taxable earnings" and "taxable specific income" are two more new labels to help identify income at the various stages from when it arises to when it becomes chargeable to tax in a particular tax year. This section explains each of those terms, setting out where to find the other provisions that set out particular rules for arriving at either "taxable earnings" or "taxable specific income".

Section 11: Calculation of "net taxable earnings"

55. *Subsection (1)* sets out how to calculate "net taxable earnings" in a tax year.

56. This explicit explanation of the calculation is new. See *Note 4* in Annex 2.

57. The definition of "DE" is a pointer to the comprehensive list of all deductions available from earnings which appears in the opening Chapter of the Part dealing with deductions.

58. *Subsection (3)* is a signpost to what happens in the exceptional case that loss relief is available.

59. *Subsection (4)* gives effect to the general proposition that deductions may only be made from the earnings of the employment to which they relate. For example, section 198(1) says:

> (1) If the holder of an office or employment is obliged to incur and defray out of the emoluments of the office or employment
>
> (a) qualifying travelling expenses, or
>
> (b) any amount (other than qualifying travelling expenses) expended wholly, exclusively and necessarily in the performance of the duties of the employment,
>
> (c) there may be deducted from the emoluments to be assessed the amount so incurred and defrayed.

60. It is clear from such wording that in order to arrive at "net taxable earnings" where there is more than one employment, there must be a separate calculation for each employment.

Section 12: Calculation of "net taxable specific income"

61. This section performs a similar function to section 11 but in respect of specific employment income, and so uses different letters of the alphabet to designate the two elements of the calculation. Like section 11, it is new. See *Note 4* in Annex 2.

Section 13: Person liable for tax

62. This section identifies the person liable for tax on the various kinds of employment income, and the various circumstances in which that tax charge arises. *Subsections (1)* to *(3)* are new. See *Note 5* in Annex 2.

63. Although the idea of identifying the person liable for tax on employment income is new, it does not change the current position where the employer has the primary liability to deduct tax under the PAYE provisions. Under ICTA employees *are* liable for the tax, but are entitled to pay only the net amount after taking off payments on account and deductions at source (see section 59B of TMA 1970).

64. *Subsections (4)* and *(5)* set out who is liable for tax on earnings received or remitted to the United Kingdom after the employee's death. They derive from section 202A(3) of ICTA.

Chapter 4: Taxable earnings: rules applying to employee resident, ordinarily resident and domiciled in UK

Overview

65. This Chapter sets out how to work out the amount of general earnings from an employment which are charged to tax in a particular tax year if the employee is resident, ordinarily resident and domiciled in the United Kingdom. Under ICTA such employees come within Case I of Schedule E.

66. This category of employees represents the vast majority of the people who are taxed in the United Kingdom on their employment income. All the rules relating to such employees appear together in one Chapter, leaving all the provisions for cases involving a non-UK element, such as non-resident employees or income representing chargeable overseas earnings ("foreign emoluments" in the language of ICTA), to be covered in Chapter 5. This means that the bulk of employees and their advisers will have to read no further than Chapter 4 of this Part to determine the amount of general earnings charged to tax in a year.

67. This approach does mean that some of the supplementary rules (for example about the meaning of receipt of money earnings) appear in both Chapters 4 and 5. The aim is that the reader will only have to look at one chapter to be able to work out what are the taxable earnings in any given year for any given employment.

Section 14: Taxable earnings under this Chapter: introduction

68. This introductory section sets out how the Chapter deals with the calculation of the taxable earnings in a year for an employee who is resident, ordinarily resident and domiciled in the United Kingdom. It is new.

Section 15: Earnings for year when employee resident, ordinarily resident and domiciled in UK

69. This section sets out the basic rule that the taxable earnings in such a year are all general earnings received in that year. It derives from Case I of Schedule E as set out in paragraph 1 of section 19(1) and section 202A(1) of ICTA.

70. *Subsection (3)* sets out the rule that the receipts basis is not affected by the fact that earnings may relate to a different tax year to that in which they are received or to a year when the employment is not held. It derives from section 202A(2) of ICTA.

Section 16: Meaning of earnings "for" a tax year

71. This section explains what is meant by earnings "for" a tax year. It is a new section in response to requests made during the consultation leading up to this Act which suggested that it would be a good idea to have this kind of clarification about what earnings are "for" a tax year. See *Note 6* in Annex 2.

72. *Subsection (2)* identifies the period that the earnings are "for", and *subsections (3)* and *(4)* explain how to work out the tax year that the earnings are "for" on the basis of the period determined in subsection (2). If the period spans more than one tax year then the earnings for that period should be apportioned between those years on a just and reasonable basis.

73. Some of the provisions in Part 3 that operate to treat income as earnings specify the year "for" which the income should be so treated. *Subsection (5)* makes it clear that section 16 does not displace the effect of those provisions in Part 3.

Section 17: Treatment of earnings for year in which employment not held

74. This section sets out how earnings from an employment should be treated if they would otherwise be considered as earnings for a year before or after that employment is held. It derives from paragraph 4A of section 19(1).

75. The rule in section 17 applies only to "general earnings", ie emoluments or amounts treated as emoluments, thus subject to the Cases of Schedule E as set out in paragraph 1 of section 19(1) of ICTA.

76. Where the Schedule E legislation provides that an amount shall be treated as an emolument of an employment only if provided in a year when the employment is held, this Act reproduces that limitation. The sections in the benefits code make it clear that such amounts or benefits will only be treated as earnings if they are paid/provided in a year in which the employment is held. If they are paid/provided at any other time they will not be treated as earnings and will be outside the "general

earnings" to which section 17 applies. *Subsection (4)* makes it clear that this section does not apply in connection with determining amounts to be treated as earnings under the benefits code. See *Note 7* in Annex 2.

Section 18: Receipt of money earnings

77. This section sets out the rules for determining when money earnings should be treated as received, providing for the first time a single rule for all money earnings. It derives from the first half of section 202B of ICTA. See also *Change 1* in Annex 1.

78. *Subsection (3)* provides the definition of "director" used for this purpose. It derives from section 202B(5) of ICTA.

Section 19: Receipt of non-money earnings

79. This section sets out the rules for determining when non-money earnings should be treated as received, excluding any money earnings. The section derives from section 202B (7) to (11) of ICTA. The exclusion of money earnings is new. See also *Change 2* in Annex 1.

Chapter 5: Taxable earnings: rules applying to employee resident, ordinarily resident or domiciled outside UK

Overview

80. This Chapter sets out, in cases not covered by Chapter 4, how to determine what general earnings from an employment are within the charge to UK tax in any particular year. The rules are set out for each category of employee in succession.

81. The residence, ordinary residence or domicile status and the place of and, in some cases, nature of duties are all relevant in determining the tax treatment of earnings. In the Schedule E legislation these factors and their consequences are somewhat condensed and do not appear in any logical order. This Chapter is organised so that an employee can easily see which sections apply to the earnings for a year because they all contain in the heading a description of which residence, ordinary residence or domicile conditions apply and (if applicable) what type of earnings the section applies to.

Section 20: Taxable earnings under this Chapter: introduction

82. This introductory section sets out how the Chapter deals with the calculation of taxable earnings in a year when the employee is resident, ordinarily resident or domiciled *outside* the United Kingdom, showing which section applies in which combination of circumstances. For example, an employee who is resident and ordinarily resident, but not domiciled, in the United Kingdom, can see from *subsection (1)(a)* and *(b)* that sections 21 and 22 are the sections to use in calculating taxable earnings for the year. The list in subsection (1) also makes it clear that there are separate rules in separate sections to deal with chargeable overseas earnings, UK-based earnings and foreign earnings. Each of these terms is defined in the section dealing with that kind of earnings. This introductory material is new.

Section 21: Earnings for year when employee resident and ordinarily resident, but not domiciled, in UK, except chargeable overseas earnings

83. This section deals with those earnings that are, under the Schedule E legislation, still within Case I because they are not excepted from it as "foreign emoluments" by the operation of section 192 of ICTA. The label "overseas earnings" replaces "foreign emoluments" to describe earnings for a year in which the employee is resident and ordinarily resident but not domiciled in the United Kingdom that are from an employment with a foreign employer where the duties are all performed outside the United Kingdom.

84. This section derives from section 202A(1) of ICTA and appears as a separate category for the first time here. See *Note 8* in Annex 2.

85. *Subsection (3)* sets out the rule that the receipts basis is not affected by the fact that earnings may relate to a different tax year to that in which they are received or to a year when the employment is not held. It derives from section 202A(2) of ICTA.

86. *Subsection (4)* is a signpost to section 23 which describes how to calculate the amount of *chargeable* overseas earnings to be excluded from this section.

Section 22: Chargeable overseas earnings for year when employee resident and ordinarily resident, but not domiciled, in UK

87. This section deals with those earnings that the Schedule E legislation excepts from Case I as "foreign emoluments" by virtue of section 192 of ICTA.

88. *Subsections (1)* and *(2)* explain that, where this section applies, "taxable earnings" are the full amount of overseas chargeable earnings that are remitted to the UK. See *Note 9* in Annex 2.

89. *Subsection (3)* sets out the rule that the remittance basis is not affected by the fact that the earnings may relate to a different tax year to that in which they are remitted or to a year when the employment is not held. It derives from section 202A(2) of ICTA. It also includes a signpost to possible relief under section 35 in the cases of delayed remittances.

90. *Subsection (4)* is a signpost to section 23 which describes how to calculate the amount of chargeable overseas earnings within this section.

91. Normally, any deductions available would be subtracted from taxable earnings, under section 11 to give "net taxable earnings" – the amount chargeable to tax in that year. However, deductions have already been taken off in arriving at the amount of "chargeable overseas earnings" according to the calculation set out in section 23. *Subsection (5)* sets out that deductions taken off in arriving at "chargeable overseas earnings" should not be taken off again in arriving at the "net taxable earnings" relating to those chargeable overseas earnings.

92. Those deductions are, however, still available to set against any taxable earnings that remain subject to section 21. See *Note 8* in Annex 2.

Section 23: Calculation of "chargeable overseas earnings"

93. This section sets out what overseas earnings are and how to calculate "chargeable overseas earnings". It derives from the description of "foreign emoluments" set out in section 192 of ICTA.

94. Section 192(5) of ICTA says that the *amount* of the excepted emoluments is the amount remaining after any capital allowance and after any deductions under a series of listed provisions. Those listed provisions do not include all the provisions under which deductions could be allowed if one were simply computing an amount of taxable income. It is not clear why some provisions are mentioned and others not.

95. Section 192(5) has therefore been rewritten in section 23(3) of the Act to allow a person's "overseas earnings" to be reduced by *any* deductions. See *Change 3* in Annex 1. An example may serve to illustrate the effect of this change:

96. Suppose a taxpayer has foreign emoluments (overseas earnings) of £1,000, and deductions within the section 192(5) list of £200 plus other deductions of £100.

97. Under section 192(5) of ICTA the amount of foreign emoluments excluded from Case I would be £800, leaving £200 chargeable under Case I against which £200 of the taxpayer's total £300 deductions can be set. The net result is Case I charge = Nil, Case III charge = £800.

98. Under the rewritten legislation the amount of chargeable overseas earnings within section 22 would be £700, leaving £300 within section 21 against which all of the taxpayer's total £300 deductions can be set. The net result is section 21 charge = Nil, section 22 charge = £700.

99. The outcome is clearly in the taxpayer's favour.

Section 24: Limit on chargeable overseas earnings where duties of associated employment performed in UK

100. This section contains the anti-avoidance rules for earnings from associated employments. They derive from paragraph 2 of Schedule 12 to ICTA.

101. The effect of these rules is to limit the amount of overseas earnings taxed on the remittance basis because of the operation of sections 22 and 23 in cases where there are associated employments. The reference in *subsection (3)* to "section 23(3)" means that this section adopts the same approach as described in paragraph 95. See *Change 3* in Annex 1.

102. Where this section does apply a limit to the amount of general earnings computed under section 23 to be within section 22, any excess of the overseas earnings above that limit falls within section 21. This is set out in *subsection (7).*

Section 25: UK-based earnings for year when employee resident, but not ordinarily resident, in UK

103. This section sets out how to calculate the taxable earnings in a year when the employee is resident but not ordinarily resident in the UK, and whose earnings are in respect of duties performed in the UK or from overseas Crown employment subject to UK tax (defined in section 28).

104. These rules derive from paragraph 1 of section 19(1) (Case II of Schedule E), section 132(4)(a) and section 202A(1)(a) of ICTA. See also *Note 10* in Annex 2.

105. *Subsection (3)* sets out the rule that the receipts basis is not affected by the fact that the earnings may relate to a different tax year to that in which they are received or to a tax year when the employment is not held. It derives from section 202A(2) of ICTA.

Section 26: Foreign earnings for year when employee resident, but not ordinarily resident, in UK

106. This section sets out how to calculate the taxable earnings in a year when the employee is resident but not ordinarily resident in the United Kingdom, when those earnings are neither in respect of duties performed in the United Kingdom nor from overseas Crown employment subject to UK tax, and so not within section 25.

107. These rules derive from paragraph 1 of section 19(1) (Case III of Schedule E) and section 202A(1)(b) of ICTA. See also *Note 9* in Annex 2.

108. *Subsection (3)* sets out the rule that the remittance basis is not affected by the fact that the earnings may relate to a different tax year to that in which they are remitted or to a year when the employment is not held. It derives from section 202A(2) of ICTA.

Section 27: UK-based earnings for year when employee not resident in UK

109. This section sets out what earnings are taxable earnings in a year when the employee is not resident in the United Kingdom. These rules derive from paragraph 1 of section 19(1) (Case II of Schedule E), section 132(4)(a) and section 202A(1)(a) of ICTA. See also *Note 10* in Annex 2.

110. *Subsection (3)* sets out the rule that the receipts basis is not affected by the fact that the earnings may relate to a different tax year to that in which they are received or to a tax year when the employment is not held. It derives from section 202A(2) of ICTA.

Section 28: Meaning of "general earnings from overseas Crown employment subject to UK tax"

111. This section explains what is meant by "qualifying earnings from overseas Crown employment subject to UK tax" in sections 25 to 27. It derives from section 132(4)(a) of ICTA. See also *Note 10* in Annex 2.

112. *Subsections (5)* to *(8)* derive from ESC A25. That concession operates to remove from the scope of UK income tax locally engaged low paid staff employed overseas by the Crown, in accordance with long-standing practice and in keeping with international treaty obligations. See *Change 4* in Annex 1.

Section 29: Meaning of earnings "for" a tax year

113. This section explains what is meant by earnings "for" a tax year. It is a new section in response to requests made during the consultation leading up to this Act which suggested that it would be a good idea to have this kind of clarification about what earnings are "for" a tax year. See *Note 6* in Annex 2. The counterpart to this section in Chapter 4 is section 16.

114. *Subsection (2)* identifies the period that the earnings are "for", and *subsections (3)* and *(4)* explain how to work out the tax year that the earnings are "for" on the basis of the period determined in subsection (2). If the period spans more than one tax year then the earnings for that period should be apportioned between those years on a just and reasonable basis.

115. Some of the provisions in Part 3 that operate to treat income as earnings specify the year "for" which the income should be so treated. *Subsection (5)* makes it clear that section 29 does not displace the effect of those provisions in Part 3.

Section 30: Treatment of earnings for year in which employment not held

116. This section sets out how earnings from an employment should be treated if they would otherwise be considered as earnings for a year before or after that employment is held. It derives from paragraph 4A of section 19(1) of ICTA. Its counterpart in Chapter 4 is section 17.

117. Where the Schedule E legislation provides that an amount shall be treated as an emolument of an employment only if provided in a year when the employment is held, this Act reproduces that limitation. The sections in the benefits code make it clear that such amounts or benefits will only be treated as earnings if they are paid/provided in a year in which the employment is held. If they are paid/provided at any other time they will not be treated as earnings and will be outside "general earnings" to which section 30 applies. *Subsection (4)* makes it clear that this section does not apply in connection with determining amounts to be treated as earnings under the benefits code. See *Note 7* in Annex 2.

Section 31: Receipt of money earnings

118. This section sets out the rules for determining when money earnings should be treated as received, providing for the first time a single rule for all money earnings. It derives from the first half of section 202B of ICTA. See also *Change 1* in Annex 1. Its counterpart in Chapter 4 is section 18.

Section 32: Receipt of non-money earnings

119. This section sets out the rules for determining when non-money earnings should be treated as received, excluding any money earnings. The section derives from section 202B(7) to (11) of ICTA. The exclusion of money earnings is new. See *Change 2* in Annex 1. The counterpart to this section in Chapter 4 is section 19.

Section 33: Earnings remitted to the UK

120. This section deals with the remittance of general earnings to the United Kingdom. This is relevant for general earnings charged under section 22 (chargeable overseas earnings for year when employee resident and ordinarily resident, but not domiciled, in the United Kingdom) and general earnings charged under section 26 (foreign earnings for year when employee resident, but not ordinarily resident, in the United Kingdom).

121. *Subsection (2)* derives from section 132(5) of ICTA. Apart from using the term "remitted to" in place of "received in", the conditions are expressed in the same language. General earnings are treated as remitted to the United Kingdom if they are paid, used or enjoyed in the United Kingdom, or transmitted or brought to the United Kingdom in any manner or form.

122. Section 132(5) also contains a cross-reference to certain anti-avoidance measures contained in section 65(6) to (9) of ICTA dealing with constructive remittances to the United Kingdom that would not otherwise fall to be taxed under the general rule.

123. Instead of a cross-reference to those provisions, section 65(6) to (9) of ICTA have specifically rewritten, as they apply to remittances of general earnings, in *subsections (3)* to *(7*) of this section, and in section 34.

124. The provisions are concerned with anti-avoidance measures to counter the practice of taking out loans in the United Kingdom and subsequently arranging for the debt (or interest on the debt) to be repaid abroad out of unremitted general earnings. They also apply to loans taken out outside the United Kingdom, where the money borrowed is subsequently received in the United Kingdom. The provisions only apply if the taxpayer is ordinarily resident in the United Kingdom.

125. *Subsection (3)* states that the general earnings of a person who is ordinarily resident in the United Kingdom will be treated as remitted to the United Kingdom at the time when the general earnings are used outside the United Kingdom in or towards satisfying a UK-linked debt.

126. *Subsection (4)* explains what is meant by this new label "UK-linked debt". It is: (a) a debt for money lent to the employee in the United Kingdom, or for the interest on money so lent; (b) a debt for money lent to the employee outside the United Kingdom and received in the United Kingdom or (c) a debt incurred satisfying a debt falling within (a) or (b).

127. *Subsection (5)* states that, for debts falling within subsection (4)(b) or (c), it is immaterial whether the money lent is received into the United Kingdom before or after the general earnings are used to repay the debt. But, in the case of money received into the United Kingdom after the general earnings are used to repay the debt, the general earnings will not be treated as being remitted to the United Kingdom until the money lent is received there.

128. *Subsection (6)* extends the meaning of the reference to money being "received" in the United Kingdom in subsections (4) and (5) to include money being "brought to" the United Kingdom.

129. *Subsection (7)* is a pointer to the provisions of section 34, which also concern UK-linked debts.

Section 34: Earnings remitted to the UK: further provisions about UK-linked debts

130. This section contains more provisions about UK-linked debts.

131. *Subsection (2)* sets out the rules for determining when a person, defined as the "borrower", will be treated for the purposes of the section as using the earnings towards satisfying a debt. Two conditions must be met, Conditions A and B.

132. Condition A is that the earnings are so dealt with that the lender holds money or property representing the earnings in such a way that the money or property is available to the lender to satisfy, or reduce, the debt. This is set out in *subsection (3).*

133. *Subsection (4)* sets out Condition B, that there is an arrangement between borrower and lender such that the quantum of the outstanding debt or the timing of the repayment of the debt depends on the amount or value the lender holds as mentioned in subsection (3).

134. *Subsection (5)* explains when a debt for money lent can be treated as incurred towards satisfying another debt.

135. *Subsection (6)* extends the meaning of lender to include any person for the time being entitled to repayment and *subsection (7)* extends the meaning of "satisfy" (also for the purposes of section 33) to mean satisfy wholly or in part.

Section 35: Relief for delayed remittances

136. This section provides relief for employees whose earnings are taxable when remitted to the United Kingdom and who have been unable to remit their earnings in an earlier year because of local law or the impossibility of obtaining currency that could be transferred to the United Kingdom.

137. It derives from section 585 of ICTA.

138. *Subsection (1)* allows a claim for relief for delayed remittances. The claim may be for all or part of the delayed remittances. See *Change 5* in Annex 1.

139. *Subsection (2)* defines "delayed remittances" as earnings which are taxable when remitted to the United Kingdom, were received in an earlier year but remitted to the United Kingdom in a later year and which could not have been remitted before that later year.

140. Section 585 refers to income "arising". This becomes "income received" in this section to reflect the receipts basis used for Schedule E. See *Change 6* in Annex 1.

141. In section 585(1)(c) the third condition for a claim to be made is that the inability to transfer the income to the United Kingdom "was not due to any want of reasonable endeavours" on the part of the employee. This condition has been omitted in rewriting this subsection. See *Change 5* in Annex 1.

142. The final condition in section 585(1)(b) is the impossibility of obtaining foreign currency in that territory. "Foreign currency" has been rewritten in subsection 2(c)(iii) as "currency other than the currency of that country or territory". See *Note 11* in Annex 2.

143. In rewriting that same condition the words "that could be transferred to the United Kingdom" have been added. See *Change 5* in Annex 1.

144. *Subsection (3)* explains the result of the claim for relief. The amount chargeable for the tax year in which the delayed remittances are received in the United Kingdom is reduced and the amount of the reduction becomes chargeable for an earlier year. The amount allocated to earlier years is in accordance with either subsection (4) or an election under section 36 (election in respect of delayed remittances).

145. *Subsection (4)* sets out the allocation to tax years if no election is made. In cases where the employment income of only one year cannot be remitted the amount of the income remitted in a later year is treated as if it had been remitted in the year in

which it was received. The same applies when there is more than one year in which the income was received.

Section 36: Election in respect of delayed remittances

146. This section sets out in detail how the election allowed by section 35(3)(b) operates. It is new. See *Change 7* in Annex 1.

147. *Subsection (1)* explains that the section applies when a claim is made and the claimant has blocked earnings.

148. *Subsection (2)* defines "blocked earnings".

149. *Subsection (3)* allows the claimant to decide to which year the delayed remittances are to be allocated.

150. *Subsection (4)* places a restriction on the tax year to which the income can be allocated.

151. *Subsection (5)* requires the amount to be allocated to a particular year to be specified in the election if more than one year is specified.

152. *Subsection (6)* requires that the amounts allocated to an earlier year must not exceed the amount of earnings which could not be remitted in that year.

153. *Subsection (7)* makes the election part of the claim and irrevocable.

154. *Subsection (8)* ensures that personal representatives are able to make the election.

Section 37: Claims for relief on delayed remittances

155. This section sets out the administrative provisions regarding the claim under section 35.

156. It derives from section 585 of ICTA.

157. *Subsection (1)* sets out the time limit within which the claim must be made.

158. *Subsection (2)* allows tax adjustments to be made for earlier years to implement the claim and election.

159. *Subsection (3)* overrides anything in the Income Tax Acts which would otherwise prevent the adjustments from being made, such as time limits.

160. *Subsection (4)* allows the claim to be made by the personal representatives of someone who would have been entitled to make it.

161. *Subsection (5)* provides for the collection and repayment of tax in the case of someone who has died. The personal representatives are liable in respect of the tax which has become chargeable for an earlier year. This is the case, because of subsection (3), even where that year is otherwise time-barred.

162. *Subsection (6)* provides for additional tax to be assessed on the personal representatives and to be a debt of the estate.

Section 38: Earnings for period of absence from employment

163. The place where the duties of an employment are performed is relevant in determining which section in Chapter 5 applies for the purposes of calculating the taxable earnings for the year. This section sets out how to treat earnings for a period of absence from the employment, when there are, of course, no duties performed. It derives from section 132(1) of ICTA.

Section 39: Duties in UK merely incidental to duties outside UK

164. This section sets out that if the duties of the employment are performed outside the United Kingdom but there are some incidental duties performed in the United Kingdom, then those incidental duties are to be treated as being performed outside the United Kingdom. This section does not apply to employees claiming a deduction from seafarer's earnings, for which a separate rule appears in the Chapter dealing with that deduction. This section derives from section 132(2) and (3) of ICTA.

Section 40: Duties on board vessel or aircraft

165. This section sets out the rules for deciding where duties should be treated as being performed if they take place on a vessel or an aircraft. It derives from section 132(4)(b) of ICTA. Subsections (3) to (6) set out the rule for the treatment of seafarers carrying out duties on a ship. This derives from paragraph 5 of Schedule 12 to ICTA.

166. "Ship" takes its everyday meaning, subject to the exception in respect of an "offshore installation" as provided by the Mineral Workings (Offshore Installations) Act 1971. Further guidance on the meaning of those terms is given in the Inland Revenue Schedule E manual at paragraphs SE 33221 to 33222.

Section 41: Employment in UK sector of continental shelf

167. This section sets out that earnings from certain activities performed in the United Kingdom sector of the continental shelf are to be treated as earnings from duties performed in the United Kingdom. It derives from section 830(5) of ICTA.

Chapter 6: Disputes as to domicile or residence

Overview

168. The two sections 42 and 43 provide the means for an appeal against a decision by the Board of Inland Revenue concerning a person's ordinary residence or domicile status in the United Kingdom. The sections derive from section 207 of ICTA.

Section 42: Board to determine dispute as to domicile or ordinary residence

169. *Subsection (1)* introduces the purpose of the section. The phrase "is or has been" caters for the possibility that the dispute may relate to the person's domicile or residence status in a tax year prior to the dispute arising.

170. *Subsection (2)* provides the means to start the process of reconciling a disagreement about the status of the employee. Either side can ask for reference to the Board of Inland Revenue. A ruling would then be issued giving the Board's decision on the matter.

171. *Subsection (3)* lists the provisions which rewrite paragraph 1 of Schedule E – and section 192 of ICTA. In rewriting Schedule E a structure has been applied which uses residence, domicile and place of performance of duties to identify the basis of chargeability and year of charge. The term "foreign emoluments" is not used, nor an equivalent to that label, as used in section 192 of ICTA. Instead a full description of the status of employer and employee is given, which leads to certain earnings being excluded from chargeability. This subsection includes a list of all those provisions which rewrite or are dependent on "foreign emoluments" as well as those which rewrite the Cases of Schedule E. Three of the provisions based on section 192(1) of ICTA also contain a reference to "ordinary residence" which is not derived from that section, nor from paragraph 1 of Schedule E.

172. Disputes relating to all these provisions will now be covered by section 42. See *Change 8* in Annex 1.

Section 43: Appeal against Board's decision on domicile or ordinary residence

173. This section provides an appeal procedure where someone is aggrieved by the ruling of the Board of Inland Revenue made under section 42. Under section 207 of ICTA an application may be made for the question to be heard and determined by the Special Commissioners in "like manner as an appeal".

174. On the grounds that similar processes should be the same (ie they should all be appeals), *subsection (1)* gives the right of appeal to a person who has received notice of the Board's decision. This allows the person in question to take the matter further. The change to a straightforward appeal procedure is intended to simplify matters. Section 48(2) of TMA 1970 provides that various provisions of that Act as regards proceedings before the Commissioners apply to "appeals other than appeals against assessments" and to "proceedings…to be heard and determined in the same way as an appeal". There is no real difference in law or practice between provisions that refer to an appeal and those that refer to proceedings where the Special Commissioners shall "hear and determine the matter in like manner as an appeal". See *Change 9* in Annex 1.

Chapter 7: Application of provisions to agency workers

Overview

175. In broad terms, workers must normally be engaged under either a contract of service (in which case they are employed) or a contract for services (in which case they are self-employed). However, some workers may be contracted to an agency to perform duties for the agency's client. This Chapter, deriving from section 134 of ICTA, provides that the remuneration of such agency workers is treated as if it is employment income.

176. The rules have been restructured into four sections. There is an increased focus in *subsection (2)(a)* of section 44 on the agency contract (defined in section 47) under which the services provided to the client are treated as duties of an employment held by the worker with the agency. The agency pays the remuneration in a normal case.

Section 44: Treatment of workers supplied by agencies

177. This section derives from section 134(1), (4) and (5) of ICTA.

178. The conditions are set out in *subsection (1)*. These have been set out in more colloquial English (personally providing services instead of rendering personal services) and in the case of subsection (1)(c), it has been made more obvious that the person supervising the manner of the work is not specified.

179. If all of the conditions in this Chapter are satisfied, then it operates so that:

- the services provided by the worker under an agency contract are treated as the performance of the duties of an employment with the agency; and
- the remuneration receivable is treated as earnings from that employment.

180. The words in brackets in s*ubsection (2)(b)*, which provide that the remuneration which is treated as earnings of an employment includes any remuneration paid by the client, derive from section 134(4) of ICTA.

181. The extra focus on the agency contract is achieved by the definition of this being taken to section 47 and more significantly by the words "with the agency" in the last part of section 44(2)(a). The duties (the services provided to the client) are the deemed duties of an employment held with the agency. See *Change 10* in Annex 1.

Section 45: Arrangements with agencies

182. This derives from section 134(5), (the reference to "excluded services"), and from section 134(6) of ICTA. The provision is aimed at remuneration paid by the agency while an agency worker is on their books, for a period in which the worker is not assigned to any particular client.

183. This section refers to "a third person ("the agency")" in place of the phrase "another person" used in ICTA. See *Change 11* in Annex 1.

Section 46: Cases involving unincorporated bodies etc.

184. This section ensures that the agency rules apply in circumstances where the worker is a partner or member of an unincorporated body. They also apply in the situation in which the worker is a member of the agency itself, eg a professional association.

185. It derives from section 134(2) and (3) of ICTA.

Section 47: Interpretation of this Chapter

186. This section provides definitions of terms used in this Chapter. The agency contract is defined in terms deriving from section 134(1)(a) and (b). The scope of excluded services is set out in *subsection (2)* and derives from section 134(5) of ICTA.

187. There is a definition of remuneration in *subsection (3)* which derives from section 134(7) of ICTA. This section draws on the language of section 62, which defines earnings in relation to an employment, but with its reference to "every form of payment" the scope appears wider. The section 62 definition is limited to money or money's worth. The definition here is restricted, however, by the words of subsection (3)(a). This makes it clear that the purpose is to capture remuneration that would have been taxed had the worker been an employee of the agency or the client, but no more than that.

188. As with section 62 the language of this definition has been modernised, for example removing the word "perquisites", while retaining the import of the source legislation.

Chapter 8: Application of provisions to workers under arrangements made by intermediaries

Overview

189. The provisions in this Chapter are commonly known as the "service company provisions".

190. The material in this Chapter derives from Schedule 12 to FA 2000 and follows much the same order as that Schedule. References in the notes on this Chapter to paragraphs are all references to paragraphs of Schedule 12 to FA 2000 unless otherwise stated.

191. This Chapter does not include anything in respect of paragraphs 17 or 18, which concern the computation of profits of the intermediary and are to be dealt with in the rewrite of the trading income provisions.

192. This Chapter also excludes the material from paragraph 23, which is a transitional provision.

Section 48: Scope of this Chapter

193. *Subsection (1)* of this section provides for the Chapter to have effect where the services of a worker are provided through an intermediary.

194. *Subsection (2)* sets out that Chapter 7 of this Part, treatment of workers supplied by agencies, and section 555 of ICTA, payments to non-resident entertainers or sportsmen, both have priority over this Chapter. It derives from paragraphs 6 and 24.

Section 49: Engagements to which this Chapter applies

195. *Subsection (1)* sets out when the provisions of the Chapter apply. It derives from paragraph 1(1). There are three elements to be satisfied in order for the Chapter to apply:

- an individual ("the worker") personally performs, or is under an obligation to perform, services for the purposes of a business carried on by another person ("the client")

- the services are provided not under a contract directly between the client and the worker but under arrangements involving a third party ("the intermediary"), and

- the circumstances are such that, if the services were provided under a contract directly between the worker and the client, the worker would be regarded for income tax purposes as an employee of the client.

196. *Subsection (2)* expands on the interpretation of "business" given in section 61 for the purposes of subsection (1)(a). That interpretation only extends to trades, professions, vocations and Schedule A businesses. This would not normally include the activities of, say, a Government Department delivering public services, so subsection (2) is needed to bring in the other instances where individuals provide services through intermediaries. It derives from paragraph 1(2).

197. *Subsection (3)* expands on the meaning of "third party" used in subsection (1)(b). If the intermediary is a partnership, the worker would be a member of that partnership – subsection (3) is needed to make sure that such a partnership (or other unincorporated association) counts as a third party for the purposes of subsection (1)(b). This material derives from the paragraph 1(1)(b).

198. *Subsection (4)* ensures that the wide phrase "the circumstances" used in subsection (1)(c) can include the terms on which the services are provided and the contractual arrangements under which they are provided throughout the whole chain of relationships between worker and client, rather than focusing only on the contract to which the worker is a party. This provision is drawn from paragraph 1(4).

199. This Chapter does not include the material in paragraph 1(5). That sub-paragraph said:

> The fact that the worker holds an office with the client does not affect the application of this Schedule.

200. Even without such a statement, the fact that a worker holds an office with the client has no relevance to the operation of these provisions. See *Note 12* in Annex 2.

201. *Subsection (5)* brings forward the explanation of the label "engagement to which this Chapter applies". In Schedule 12 to FA 2000 the equivalent term is not explained until paragraph 21(1), although it is used several times in the early paragraphs of that Schedule.

Section 50: Worker treated as receiving earnings from employment

202. *Subsection (1)* describes what happens when all the relevant conditions (as set out in sections 51, 52 and 53) are met and the provisions of the Chapter apply. Where there is, in any tax year, a payment (or right to receive such payment) for services in circumstances as set out in section 49, and that payment is not chargeable to tax as employment income, then the intermediary is treated as making a deemed payment to the worker. That deemed payment is chargeable to income tax as earnings. (Later sections in this Chapter explain how to calculate the deemed payment).

203. The most notable change in this subsection from its source in paragraph 2(1) of Schedule 12 to FA 2000 is the new name for what was "the deemed Schedule E payment", which has been shortened in common usage of that legislation to "the deemed payment". To chime in with the language of Chapter 2 of this Part, this is now "the deemed employment payment".

204. *Subsection (2)* sets out that a single deemed employment payment is treated as being made in respect of all engagements in relation to which the intermediary is treated as making a payment to the worker during the year. This derives from paragraph 2(3).

205. *Subsection (3)* sets out when the single payment mentioned in subsection (2) should be treated as being made. This derives from paragraph 2(2).

206. *Subsection (4)* introduces the label "relevant engagements", which means any engagements in relation to which the intermediary is treated as making a payment to the worker during the year. This derives from paragraph 2(3).

Section 51: Conditions of liability where intermediary is a company

207. As suggested by the heading, this section is only of interest if the intermediary is a company. It derives from paragraph 3.

208. *Subsection (1)* sets out one negative condition and two alternative positive conditions. The negative condition is that the intermediary should not be an associated company of the client. If the intermediary is associated with the client then this Chapter will not apply.

209. *Subsection (2)* sets out a special test for whether the company is associated with the client for the purposes of this paragraph. It derives from paragraph 3(2).

210. It incorporates a minor change to the law. The normal meaning of "associated company" is given in section 416 of ICTA. That definition says that two companies are associated if one has control of the other, or if they are both controlled by the same person or persons. It is imported for the purposes of this Chapter by section 61. But paragraph 3(2) only envisages common control under a maximum of two people - the worker and another person. This subsection widens the definition of "associated company" for the purposes of section 51 to include companies that are under the common control of the worker together with more than one other person. See *Change 12* in Annex 1.

211. One of the positive conditions mentioned in subsection (1) is that the worker has a material interest in the company. This catches the most obvious cases where a company is being used as an intermediary, where the worker has some say in the operation of the company. *Subsection (4)* sets out the definition of "material interest" for this purpose. That definition includes a reference to "a participator", a term which is defined in *subsection (5).*

Section 52: Conditions of liability where intermediary is a partnership

212. As suggested by the heading, this section is only of interest if the intermediary is a partnership. It derives from paragraph 4.

213. *Subsection (2)* sets out the situations where liability may arise because the worker has a say in the operation of the partnership, whether that is because:

- the worker (alone or with relatives) is entitled to more than 60% of the profits of the partnership;

- most of the profits of the partnership come from one client (or that client's associates) in respect of services provided by the worker to which this Chapter applies; or

- the worker is a member of the partnership whose share of partnership profits is based on the amount of income generated by his/her provision of services to which this Chapter applies.

214. The alternative test set out in *subsection (3)* is designed to catch the cases where the worker is not paid as a member of the intermediary partnership, but rather as an individual. This condition looks at what is actually going on between the

worker, the intermediary and the client. It is satisfied if the worker receives (or is entitled to receive) direct from the intermediary something that can reasonably be taken to be remuneration for services provided to the client.

Section 53: Conditions of liability where intermediary is an individual

215. This section is only of interest where the intermediary is an individual. It is drawn from paragraph 4. The condition looks at what is actually going on between the worker, the intermediary and the client. It is satisfied if the worker receives (or is entitled to receive) direct from the intermediary something that can reasonably be taken to be remuneration for services provided to the client.

Section 54: Calculation of deemed employment payment

216. *Subsection (1)* sets out a method statement to show how to calculate the deemed employment payment. It derives from paragraph 7.

217. *Steps 1* and *2* contain a cross-reference to section 55, so that readers know where to find out what amount should be taken into account in respect of any benefits.

218. After *Step 2*, all the remaining steps deduct various amounts. *Step 3* contains a statement to the effect that if the result of that, or any later step, is nil or a negative amount, then there is no deemed employment payment.

219. *Step 3* also contains a cross-reference to the deductions provisions in Chapters 1 to 5 of Part 5 so that the reader can see where to look to find out what kind of expenses may be deducted.

220. *Step 8* of the method statement explains the operations involved in deducting the notional national insurance contributions.

221. The method statement concludes with a statement that the result represents the deemed employment payment.

222. *Subsection (2)* explains what to include in *Step 1* of the calculation of the deemed payment if the intermediary has received amounts under deduction of tax because of the operation of section 559 of ICTA (sub-contractors in the construction industry). It is drawn from paragraph 8.

223. *Subsection (3)* provides that amounts deducted at *Step 3* of the method statement may include certain reimbursed expenses. This derives from section 38(2) of FA 2002.

224. *Subsection (4) and (5)* provide that mileage allowance relief may be included in amounts deducted at *Step 3* of the method statement. This derives from paragraph 7B as introduced by section 38(2) of FA 2002.

225. *Subsection (6)* is new. It applies for the purposes of working out the amount to be deducted at *Step 3* of the method statement in respect of travel expenses. Entitlement to travel expenses depends on whether or not a workplace is "temporary" and where the worker is based over the course of the employment. Subsection (6) allows such travel expenses to be deducted at *Step 3* as would have been available during the combined period of all the relevant engagements as if that combined period was a continuous employment with the intermediary. This new rule is a minor change to the law. See *Change 13* in Annex 1.

226. *Subsection (7)* allows for mileage allowance payments or passenger payments to be deducted at *Step 7* of the method statement. This derives from paragraph 7B as introduced by section 38(2) of FA 2002.

227. It is quite likely that the intermediary will receive payments from the client to cover the services of more than one worker or to cover the services of a worker and other things (such as materials, reimbursed fees to third parties etc). *Subsection (8)* sets out that in such a case any apportionment required to arrive at the amount attributable to the services of a single worker should be on a just and reasonable basis. It derives from paragraph 9.

Section 55: Application of rules relating to earnings from employment

228. This section explains how to arrive at the amounts to be used in the various steps of the method statement outlined in section 54(1). It derives from paragraph 10. Broadly it specifies that the normal rules for computing employment income should apply when working out the amounts to go into the method statement.

229. One place where paragraph 10 departs slightly from the normal rule for employment income is in sub-paragraph (5), which deals with the time that a payment or benefit should be treated as received. This reads:

> (5) A payment or benefit is treated as received-
>
> (a) in the case of a payment or cash benefit, when payment is made of or account of the payment or benefit;
>
> in the case of a non-cash benefit, when it is used or enjoyed.

230. *Subsection (5)* of this section provides a more detailed explanation of when a non-cash benefit should be treated as received. This is a minor change to the law. See *Change 14* in Annex 1.

Section 56: Application of Income Tax Acts in relation to deemed employment

231. This section ensures that the deemed employment payment is treated in exactly the same manner as if it were an actual payment of salary made by the intermediary, as employer, to the worker as employee. It derives from paragraph 11.

Section 57: Earlier date of deemed employment payment in certain cases

232. As set out in section 50(3) the basic timing rule for the deemed payment is that it is treated as being made at the end of the tax year in question. This section sets out what earlier date should be taken for payment of the deemed payment if there is a break in the worker-intermediary relationship during the tax year in question. It derives from paragraph 12, as amended by section 38(3) of FA 2002.

233. *Subsection (1)* sets the scene and says that where there is such a break (relevant event), then the deemed payment is treated as being made immediately before it, or before the first of them if there are more than one.

234. *Subsection (2)* lists the kinds of break in the worker-intermediary relationship that count as relevant events if the intermediary is a company. *Subsections (3)* and *(4)* list the kinds of break in the worker-intermediary relationship that count as relevant events where the intermediary is a partnership and where the intermediary is an individual.

235. *Subsection (5)* emphasises that this section only affects the time at which the deemed payment is treated as being made. It does not affect the calculation of the deemed payment, which is still based on amounts received in the tax year.

Section 58: Relief in case of distributions by intermediary

236. Where the intermediary is a company, it may pay distributions to the worker if the worker is a shareholder in the company. Since April 1999, UK companies have not had to pay ACT on distributions made. But the recipient of any distributions is taxable on them under Schedule F. So there is a possibility of double taxation in that the worker might have to pay tax under Schedule E on the deemed payment as well as on the actual amount of any distributions received. This section allows an intermediary that is a company to make a claim for relief to remove the possibility of double taxation. It derives from paragraph 13.

237. *Subsection (2)* describes how a claim to relief under this section should be made. It includes a statement of the time limit for such a claim. There is no specified time limit for making the claim in Schedule 12. This means the default time limit for claims (in section 43 of TMA 1970) applies, so that the claim must be made not more than five years following the 31 January following the tax year during which the distribution is made. That time limit is reproduced here to save users having to refer to another Act.

238. *Subsection (3)* describes the method of delivery of the relief claimed. It allows the Inland Revenue to direct that the relief be given by whatever means appears appropriate.

239. *Subsection (4*) makes it clear that in a case where there is a distribution and a deemed employment payment, it is the distribution that is reduced, by setting the employment income payment against it.

Section 59: Provisions applicable to multiple intermediaries

240. There may be a chain of intermediaries between the worker and the client.

241. *Subsections (2)* and *(3)* contain provisions derived from paragraph 16 concerning the intermediaries' responsibility to operate PAYE on deemed payments made to the worker. Subsection (2) makes all the relevant intermediaries involved in the same relevant engagement jointly and severally liable for amounts due as a result of the operation of PAYE on the deemed payment in respect of the engagement common to all the intermediaries, plus (if applicable) any other relevant engagements. Subsection (3) provides a get-out for any intermediaries who have not received any payments or benefits in respect of the common relevant engagement or any other relevant engagement.

242. *Subsections (4)* and *(5)* prevent any double counting of amounts when calculating the deemed payments of the intermediaries where there is more than one intermediary. It applies where there has been some kind of payment (or benefit provided) from one relevant intermediary to another in respect of a relevant engagement. In such a case, a reduction is made in the amount to be taken into account at *Steps 1* and *2* of the deemed payment calculation. This material derives from paragraph 15.

243. *Subsection (6)* says that, subject to subsections (2) to (5), the Chapter applies to each intermediary separately. *Subsection (7)* explains the label "relevant intermediary", used in this section. These two subsections derive from paragraph 14.

Section 60: Meaning of "associate"

244. This section deals with the meaning of "associate". This term is used in sections 50(1)(b), 51(3)(a) and (b) and 52(2)(b)(ii). It derives from paragraph 19.

245. The definition of an employee benefit trust now appears in Chapter 11 of Part 7.

Section 61: Interpretation

246. This interpretative section derives from paragraph 21.

247. *Subsection (1)* points out where the various terms used in the Chapter are defined.

248. *Subsection (2)* ensures that any payments or benefits received or receivable from a partnership or unincorporated association include any that a person is or may be entitled to receive in his capacity as a member of that partnership or association.

249. *Subsection (3)* treats anything done by or in relation to an associate of an intermediary as if it were done by or in relation to the intermediary. It also treats anything provided to an individual's family or household as if it were provided to the individual.

250. *Subsection (4)* treats (for the purposes of this Chapter) a man and a woman who live together as husband and wife as if they were married to each other. This extends into the definition of "associate" (defined in section 60(1) as having the same meaning as in section 417(3) and (4) of ICTA).

Part 3: Employment income: earnings and benefits etc. treated as earnings
Chapter 1: Earnings
Section 62: Earnings

251. This section sets out what constitutes the primary ingredient of employment income: earnings. It derives from section 131 of ICTA. The "money's worth" principle incorporated in *subsection (2)* derives from long-established case law. See *Note 13* in Annex 2.

252. The definition of earnings incorporates several suggestions received during the consultation process leading up to this Act to bring the language more up to date. In particular "emolument" does not now appear until subsection (2)(c).

Chapter 2: Taxable benefits: the benefits code
Overview

253. Before 1948 there was no legislation specific to benefits. Benefits were only chargeable to tax if they fell within the definition of emoluments, that is if they were "perquisites and profits whatsoever".

254. It was established by case law in Tennant v Smith (1892) 3 TC 158 that a non-cash benefit given by an employer to an employee because of the employment would only be a chargeable emolument if it was "money's worth".

255. Finance Act 1948 brought in the first charge based on the cost of provision of benefits. Over the years that followed many additional provisions were introduced dealing with specific benefits, plus a number of ESCs and statements of practice. Many of the benefits provisions apply only to those with annual earnings of £8,500 or more.

256. The benefits code, set out in Chapters 2 to 11 of this Part, provides a coherent structure for all those provisions. There is now only a minority of employees earning less than £8,500. Accordingly, it seems more logical to apply the rules to everyone and then to exclude the "lower-paid".

- Chapter 2 provides the introduction to the benefits code
- Chapters 3 to 9 contain the provisions that identify a specific type of benefit and explain how to calculate the appropriate taxable amount.
- Chapter 10 is a "sweep-up" provision, bringing in anything not in Chapters 3 to 9.

- Chapter 11 identifies employees who count as "lower-paid" and explains which chapters do not apply to them.

257. The introduction of a coherent benefits code, applying to all except the "lower-paid" is new.

258. The sections of ICTA which treat amounts as emoluments and from which Chapters 3 – 10 and sections 222 and 223 of this Act derive make no mention of the year "for" which they are so treated other than in section 162(5) and section 162(6). Instead a variety of terms are used. In Chapter 2 of Part 5 of ICTA the term is "treated as an emolument and accordingly chargeable to income tax under Schedule E". In those sections which are not in Chapter 2 of Part 5 the terms used are "treated as having received an emolument" – sections 141 and 142, "assessable to income tax under Schedule E" – section 144A and "treated for the purposes of Schedule E as being in receipt of an emolument" – sections 145 and 146.

259. All of these terms provide the route into the Cases of Schedule E, so that either the receipts or remittance basis applies to the emoluments. The structure of Chapter 3 of Part 2 of this Act requires identification of what are general earnings for a tax year so that the provisions of Chapter 4 or 5 of Part 2 can be used to find the tax year in which the earnings are received or remitted.

260. What is implicit in the relevant sections of ICTA has been made explicit in this Act by stating for which year the amounts are treated as earnings in the following provisions:-

- Section 72 (Sums in respect of expenses treated as earnings)
- Section 81 (Benefit of cash voucher treated as earnings)
- Section 87 (Benefit of non-cash voucher treated as earnings)
- Section 94 (Benefit of credit-token treated as earnings)
- Section 102 (Benefit of living accommodation treated as earnings)
- Section 120 (Benefit of car treated as earnings)
- Section 149 (Benefit of car fuel treated as earnings)
- Section 154 (Benefit of van treated as earnings)
- Section 175 (Benefit of taxable cheap loan treated as earnings)
- Section 188 (Release or writing off of loan treated as earnings)
- Section 193 (Application of section 175 to notional loan)
- Section 203 (Cash equivalent of benefit treated as earnings)
- Section 222 (Payments by employer on account of tax)
- Section 223 (Payments on account of director's tax)

261. This change in approach is described more fully in *Note 7* in Annex 2.

Section 63: The benefits code
262. This section explains which chapters of this Part come together to form the benefits code. It is new.

Section 64: Relationship between earnings and benefits code
263. This section provides a rule for the case where two amounts would otherwise be treated as earnings in respect of the same benefit, one under section 62 (earnings) of this Act and the other under the benefits code.

264. *Subsections (1)* and *(2)* derive from Inland Revenue practice, as set out in SE 21640. See *Change 15* in Annex 1.

265. *Subsections (3)* to *(5)* deal with the exceptions to the rule in subsections (1) and (2), giving the provisions which apply within the relevant chapters of the benefits code.

Section 65: Dispensations relating to benefits within provisions not applicable to lower-paid employment
266. This section, in defined circumstances and subject to certain conditions being met, disapplies the provisions of the benefits code for specified payments, benefits or facilities provided for employees. That reduces the administrative burden on the person responsible for dealing with the payroll aspects of the employee's employment and on the Inland Revenue. It also means that less information needs to be included in the employee's self-assessment return. This section derives from section 166 of ICTA.

267. This section is in Chapter 2 of Part 3, which is headed "Taxable benefits: the benefits code". That is an appropriate location because a dispensation is closely linked with the benefits code and is only applicable to an employee who is not lower-paid.

268. In *subsection (1)* the reference to "the inspector" in the source legislation has been replaced by the reference to "the Inland Revenue". See *Change 158* in Annex 1.

269. *Subsection (1)(a)* has the words "to or" inserted before "for", in relation to payments made to employees. That reflects how the Inland Revenue apply the source legislation, even though it is not quite so worded.

270. *Subsection (4)* uses the term "dispensation" for the notice that the Inland Revenue gives to the person who has sought it, to authorise the application of this section to the specified payments, benefits or facilities. The section also characterises the dispensation as a notice, which, by virtue of the definition of that word in section 832(1) of ICTA, means that it must be in writing. Taken together these two changes formalise the common name for the authorisation given and confirm the current practice that it must be in writing. See *Change 16* in Annex 1.

271. *Subsection (6)* has a minor change to the process for the revocation of a dispensation that has been given. Instead of requiring notice of the change to be

"served" on the person to whom the dispensation was given the provision now requires it to be "given". See *Change 16* in Annex 1.

Section 66: Meaning of "employment" and related expressions
272. This section sets out the meaning of "employment" and related expressions for the purposes of the benefits code. It derives from section 168(2) of ICTA.

Section 67: Meaning of "director" and "full-time working director"
273. This section provides definitions of "director" and "full-time working director" for the purposes of the benefits code. It derives from section 168(8) to (10) of ICTA.

Section 68: Meaning of "material interest" in a company
274. This section provides the definition of "material interest" in a company for the purposes of the benefits code. It derives from section 168(11) of ICTA.

Section 69: Extended meaning of "control"
275. This section provides the definition of "control" for the purposes of the benefits code. It derives from section 168(12) of ICTA.

Chapter 3: Taxable benefits: expenses payments
Overview
276. This Chapter deals with the charge to tax on expenses as taxable benefits. The Chapter applies to any employee other than those excluded under Chapter 11 of Part 3 of this Act.

Section 70: Sums in respect of expenses
277. This section derives from section 153 of ICTA and gives the two occasions when the charge to tax on sums paid in respect of expenses applies.

278. *Subsection (1)*, which derives from section 153(1), deals with the first occasion. It states that this Chapter applies to a sum paid in respect of expenses to an employee in a tax year. The sum must be paid "by reason of the employment". That expression is defined in section 71 of this Act.

279. *Subsection (2)*, which derives from section 153(3), deals with the second occasion. It states that this Chapter applies when a sum is "paid away" by an employee in a tax year where the conditions set out in paragraphs (a), (b) and (c) apply. The condition under (c) refers to the fact that the sum is paid away "in respect of expenses". See *Change 17* in Annex 1.

280. If all or part of the sum which is put at the disposal of the employee in respect of expenses is paid away, but not in respect of expenses, the tax charge may be as earnings in section 62 of this Act or as an amount treated as earnings by virtue of Chapter 10 of Part 3 of this Act (Taxable benefits: residual liability to charge).

281. *Subsections (3)* and *(4)* apply for the purposes of sums paid under subsection (1) or paid away under subsection (2). They make it explicit that, if the employment is held at some time in the tax year in which the sum is paid to the employee or paid away by the employee, it is immaterial whether or not the employment is held at the time of payment. Subsection (4) further clarifies this proposition by stating that references to an employee may therefore include a former or a prospective employee. These provisions derive from and clarify the meaning of the words "where in any year a person is employed" found in section 153(1). See *Note 14* in Annex 2.

282. *Subsection (5)* derives from the words in section 153(1) "apart from this section, are not chargeable to tax as his income". The most likely charge will be as earnings by virtue of section 62 of this Act. An example of this is a round sum expenses allowance.

Section 71: Meaning of paid or put at disposal by reason of the employment

283. This section derives from section 168(3) of ICTA. It provides a definition of the words "by reason of the employment" for the purposes of this Chapter.

Section 72: Sums in respect of expenses treated as earnings

284. This section derives from section 153(1) and (2) of ICTA.

285. *Subsection (1)* derives from part of section 153(1). In addition, the tax year for which the sums are treated as earnings is specified here. See *Note 7* in Annex 2.

286. *Subsections (2)* and *(3)* derive from section 153(2) and indicate that deductions allowed by the provisions listed in subsection (3) may be claimed in respect of the sums treated as earnings.

Chapter 4: Taxable benefits: vouchers and credit-tokens

Overview

287. This Chapter sets out the amount charged on the benefit of certain cash vouchers, non-cash vouchers and credit-tokens which are provided by reason of an employee's employment. The cash equivalent of the benefit is treated as earnings from the employment.

288. The sections in this Chapter derive from sections 141 to 144 of ICTA.

289. Chapter 6 of Part 4 of this Act contains a number of exemptions from the charge on the benefit of vouchers and credit-tokens.

290. This Chapter is not listed in section 216 of this Act (provisions not applicable to lower-paid employments). Lower-paid employees are therefore not excluded from the charge.

Section 73: Cash vouchers to which this Chapter applies
291. This section sets out the cash vouchers to which this Chapter applies. It derives from section 143(1) of ICTA.

292. If an employer who is an individual provides such a voucher for personal reasons, it is not regarded as provided by reason of the employment. The disregard of vouchers provided by an individual for personal reasons is a minor change to the law. See *Change 18* in Annex 1.

293. *Subsection (3)* determines the time of receipt for a cash voucher appropriated to the employee. This is particularly relevant for the operation of PAYE.

Section 74: Provision for, or receipt by, member of employee's family
294. This section extends provision for or receipt by the employee of a cash voucher to provision for or receipt by a member of the employee's family. It derives from section 144(4) of ICTA.

295. "Members of the employee's family" is defined in section 721(4) of this Act.

Section 75: Meaning of "cash voucher"
296. This section defines "cash voucher" for the purposes of this Chapter. It derives from section 143(3) of ICTA.

297. *Subsection (1)* sets out the definition. It does not require a cash voucher to be exchangeable wholly for cash. The amount of cash must be "not substantially less than" the cost to the employer. "Substantially" is not defined.

298. The section makes it explicit that the "voucher" provided at the expense of the person bearing the cost includes a "stamp or similar document". This is implicit in ICTA by virtue of section 143(3). See *Note 15* in Annex 2.

299. *Subsection (2)* further clarifies what is or is not a cash voucher for the purposes of this Chapter. A voucher which is not a "cash voucher" may be a "non-cash voucher" to which section 82 of this Act applies.

Section 76: Sickness benefits-related voucher
300. This section modifies the meaning of "cash voucher" where the expense incurred by the provider of the voucher includes costs of providing sickness benefits and the sum of money for which the voucher can be exchanged is substantially less than the total cost to the provider. It derives from section 143(4) of ICTA.

301. The modification effectively removes the sickness benefits element when testing whether the voucher is a cash voucher.

302. *Subsection (1)* sets out the circumstances in which the section applies.

303. *Subsection (2)* provides two formulae to be used in determining whether the voucher is a cash voucher. The use of the formulae is best illustrated by examples:-

Example 1
The exchange sum E is £60.
The provision expense PE is £150
The cost of providing the sickness benefits is £90.
£150(PE) – £60(E) = £90
The cost of providing the sickness benefits is £90, so D = £90.
Putting these values into the formula: £150(PE) – £90(D) = £60
£60(E) = £150(PE) – £90(D), so the voucher is a cash voucher.

Example 2
The exchange sum E is £60.
The provision expense PE is £150
The cost of providing the sickness benefits is £85.
£150(PE) - £60(E) = £90
The cost of providing the sickness benefits is £85, so D = £85
Putting these values into the formula: £150(PE) – £85(D) = £65
£60(E) is not substantially less than £65, so the voucher is a cash voucher.

Example 3
The exchange sum E is £50
The provision expense PE is £150
The cost of providing the sickness benefits is £60.
£150(PE) – £50(E) = £100
The cost of providing the sickness benefits is £60, so D = £60.
Putting these values into the formula: £150(PE) – £60(D) = £90
£50(E) is substantially less than £90, so the voucher is not a cash voucher.

304. *Subsection (3)* defines "sickness benefits" for the purposes of the section.

Section 77: Apportionment of cost of provision of voucher
305. This section provides a rule for apportionment of the expense incurred by the provider where vouchers are provided for two or more employees. It derives from section 144(3) of ICTA.

306. As in section 75 of this Act, this section makes explicit that the "voucher" provided at the expense of the person bearing the cost includes a "stamp or similar document". See *Note 15* in Annex 2.

Section 78: Voucher made available to public generally
307. This section excepts a cash voucher from the application of this Chapter where the voucher is made available to the public generally and the employee (or family member) does not get it on preferential terms.

308. This exception is a minor change to the law. See *Change 18* in Annex 1.

Section 79: Voucher issued under approved scheme
309. This section excepts a cash voucher from the application of this Chapter where an employee receives the voucher under an Inland Revenue approved scheme. Such

an approved scheme provides for deduction of income tax under PAYE. The practical effect of approval of a scheme is that tax is deducted when the voucher is exchanged instead of when it is received. This section derives from section 143(5) of ICTA.

310. The section reflects existing administrative practice when it refers to approval by the "Inland Revenue" rather than "the Board". This is a minor change in the law. See *Change 158* in Annex 1.

Section 80: Vouchers where payment of sums exempt from tax

311. This section derives from section 143(3) of ICTA which provides that certain vouchers are not included in cash vouchers. This section prevents the application of any provisions of this Chapter to such vouchers. In *paragraph (a)* of this section the words in section 143(3)(a) which say the sum intended to be obtained is "mentioned in the document" have been omitted as unnecessary since, if it is "intended to enable the person to obtain", it must be mentioned in the document.

Section 81: Benefit of cash voucher treated as earnings

312. This section provides the means of charging the benefit of the voucher to income tax. It derives from section 143(1) of ICTA.

313. *Subsection (1)* treats the cash equivalent of that benefit as earnings from the employment. Amounts treated as earnings under this Chapter are employment income charged under Part 2 of this Act. They are earnings for the tax year in which the voucher is received – see *Note 7* in Annex 2. For the purposes of Chapters 4 and 5 of Part 2 they are treated as received in that year – see sections 19(2) and 32(2) of this Act.

314. *Subsection (2)* defines "cash equivalent" as the sum of money for which the voucher may be exchanged.

Section 82: Non-cash vouchers to which this Chapter applies

315. This section sets out the non-cash vouchers to which this Chapter applies. It derives from section 141 of ICTA.

316. If an employer who is an individual provides such a voucher for personal reasons, it is not regarded as provided by reason of the employment. The disregard of vouchers provided by an individual for personal reasons is a minor change to the law. See *Change 18* in Annex 1.

Section 83: Provision for, or receipt by, member of employee's family

317. This section extends provision for or receipt by the employee of a non-cash voucher to provision for or receipt by a member of the employee's family. It derives from section 144(4) of ICTA.

Section 84: Meaning of "non-cash voucher"

318. This section defines "non-cash voucher" for the purposes of this Chapter. It derives from section 141(7) of ICTA.

319. *Subsection (1)* sets out the definition in terms of three types of voucher, but excludes a cash voucher.

320. *Subsection (2)* further clarifies what is a non-cash voucher for the purposes of this Chapter.

321. *Subsection (3)* defines "transport voucher". The definition of a "transport voucher" reflects the fact that it may only have to be shown, rather than exchanged, to obtain services.

322. *Subsection (4)* defines "cheque voucher" as a cheque intended for use in payment for goods and services. It describes a particular type of cheque which is limited in its purpose. The distinction is made between that and non-cash vouchers to prevent any argument that the type of voucher which required completion of the amount, and perhaps a signature as well, did not fall within the definition of non-cash voucher. That definition of non-cash voucher is extended by the definition of cheque voucher to include such deviations from the norm.

Section 85: Non-cash voucher made available to public generally

323. This section excepts a non-cash voucher from the application of this Chapter where the voucher is made available to the public generally and the employee (or family member) does not get it on preferential terms.

324. This exception is a minor change to the law. See *Change 18* in Annex 1.

Section 86: Transport vouchers under pre-26th March 1982 arrangements

325. This section excepts a transport voucher from the application of this Chapter where it is provided, under arrangements in operation on 25 March 1982, to enable an employee (or family member) to obtain cheap or free travel provided by their employer or another passenger transport undertaking. It derives from section 141(6) of ICTA.

326. Where a transport voucher, such as a season ticket, is provided other than under such arrangements, the benefit of the voucher is chargeable to tax.

327. Paragraph 27 of Schedule 24 to F A 1994 provided for the exception to continue for employees of British Rail transferred to new rail franchises following privatisation. Paragraph 224 of Part 2 of Schedule 6 to this Act makes consequential amendments to those provisions.

Section 87: Benefit of non-cash voucher treated as earnings

328. The section provides the means of charging the benefit of the voucher to income tax. It derives from section 141 of ICTA.

329. *Subsection (1)* treats the cash equivalent of that benefit as earnings from the employment. Amounts treated as earnings under this Chapter are employment income charged under Part 2 of this Act. They are earnings for the tax year in which the voucher is received – see *Note 7* in Annex 2. For the purposes of Chapters 4 and 5 of Part 2 they are treated as received in the tax year mentioned in section 88 of this Act - see sections 19(3) and 32(3) of this Act.

330. *Subsection (2)* defines "cash equivalent" as the net cost of provision after deducting the amount made good by the employee.

331. *Subsections (3)* and *(4)* define "cost of provision".

332. *Subsection (5)* provides an apportionment rule.

Section 88: Year in which earnings treated as received

333. This section gives the timing rules for the receipt of the amount treated as earnings. It derives from section 141(1) and (2) of ICTA.

334. *Subsection (1)* deals with non-cash vouchers other than cheque vouchers. In most cases the cost of provision will have been incurred before the voucher is received. The earnings will therefore be treated as received in the year in which the employee receives the voucher. If that is not the case and the cost of provision is incurred at a later time, the amount will not be known. That may cause a particular problem if the amount cannot be ascertained until a tax year after the voucher is received. This section defines the receipt for the purposes of sections 19 and 32 of this Act as being at the time the cost is known.

335. *Subsections (2)* and *(3)* are provisions specific to cheque vouchers which provide a similar rule to that for other non-cash vouchers.

Section 89: Reduction for meal vouchers

336. This section excepts, subject to the conditions of the exception, 15 pence for each working day on which a meal voucher is provided to an employee. It derives from ESC A2 ("luncheon vouchers"), but adapts the ESC to meet the terms of this Chapter.

337. *Subsection (3)* excludes an overlap with the exemption in section 266(3) of this Act for a non-cash voucher, equivalent to the exemption for direct provision in section 317 of this Act (subsidised meals).

338. Legislating ESC A2 is a minor change to the law. See *Change 19* in Annex 1.

Section 90: Credit-tokens to which this Chapter applies
339. This section sets out the credit-tokens to which this Chapter applies similarly to the provisions in section 73 of this Act for cash vouchers and in section 82 of this Act for non-cash vouchers. It derives from section 142(1) of ICTA.

340. Where an employer who is an individual gives such a credit-token for personal reasons, it is not regarded as provided by reason of the employment.

341. The disregard of credit-tokens provided by an individual for personal reasons is a minor change to the law. See *Change 18* in Annex 1.

Section 91: Provision for, or use by, member of employee's family
342. This section extends provision for or use of a credit-token by the employee, to provision for, or use by a member of the employee's family. It derives from section 144(4) and (4A) of ICTA.

Section 92: Meaning of "credit-token"
343. This section defines "credit-token" for the purposes of this Chapter.

344. *Subsection (1)* provides the definition. It derives from section 142(4) of ICTA.

345. *Subsections (2)* and *(3)* amplify the definition for particular circumstances.

346. *Subsection (4)* excludes cash and non-cash vouchers from the definition.

Section 93: Credit-token made available to public generally
347. This section excepts a credit-token from the application of this Chapter where the credit-token is made available to the public generally and the employee (or family member) does not get it on preferential terms.

348. This exception is a minor change to the law. See *Change 18* in Annex 1.

Section 94: Benefit of credit-token treated as earnings
349. This section provides the means of charging the benefit of the token to income tax. It derives from section 142(1) of ICTA.

350. *Subsection (1)* treats the cash equivalent of that benefit as earnings from the employment. Amounts treated as earnings under this Chapter are employment income charged under Part 2 of this Act. They are earnings for the tax year in which the credit-token is used – see *Note 7* in Annex 2. For the purposes of Chapters 4 and 5 of Part 2 they are treated as received in that year – see sections 19(2) and 32(2) of this Act.

351. The timing rule for receipt of the cash equivalent of credit-tokens is different from that for non-cash vouchers. The focus is on when the token is used. This is because expense is incurred each time a credit-token is used, even if it is not paid at

that time. Regardless of when the provider of the credit-token pays for the goods or services, the amounts treated as earnings for the tax year in which the credit-token is used are treated as received in that year.

352. *Subsection (2)* defines "cash equivalent" as the net cost of provision after deducting any amount made good by the employee.

353. *Subsection (3)* defines "cost of provision".

354. *Subsection (4)* provides an apportionment rule equivalent to that in sections 77 and 87(6) of this Act.

355. Section 91 of this Act, along with this section, extends the charge to treat the benefit of use of a credit-token by a member of the employee's family as earnings of the employee.

Section 95: Disregard for money, goods or services obtained

356. This section eliminates any charge on the money or money's worth or cost of the goods or services received in exchange for vouchers, or through the use of a credit-token, where the cash equivalent of the benefit is treated as earnings under this Chapter (or would be, but for a dispensation under section 96) of this Act.

357. It derives from sections 141(1)(b), 142(1)(b) and 143(1)(b) of ICTA.

358. *Subsection (1)* sets out the circumstances in which this section operates. The addition of subsection (1)(b) prevents the goods and services obtained by use of the voucher being within Chapter 10 of Part 3 of this Act if a dispensation is given. This is a minor change to the law. See *Change 20* in Annex 1.

359. *Subsection (2)* provides that the money, goods or services obtained are disregarded for the purposes of the Income Tax Acts.

360. That disregard extends to goods or services obtained through use of a cash voucher. Normally, a cash voucher is exchanged for a sum of money and tax is charged on that sum. If goods or services are provided, tax will not be charged on the value of those goods or services.

361. Extending that disregard to goods and services obtained by use of a cash voucher is a minor change to the law. See *Change 20* in Annex 1.

362. The disregard has been extended to things obtained by the use of vouchers and tokens in certain cases where the benefit thus obtained itself is exempt and that exemption depends on the goods and services obtained by the use of the vouchers or tokens themselves being exempt if obtained direct. (The exemptions in question are those given by section 266(1)(a) or (e) of this Act (exemption of non-cash voucher where used to obtain parking provision or third party entertainment), section 267 of

this Act where subsection (2)(a) or (f) of that section applies (exemption of credit-token where used to obtain parking provision or third party entertainment) and section 268 of this Act (exemption of non-cash voucher or credit-token where used for incidental overnight expenses)). It is simpler to extend the disregard in this way than to allow the things obtained by the use of these vouchers and tokens to fall into other charging provisions, only to be exempted by the exemptions that apply in those cases.

363. *Subsection (3)* ensures that deductions available under sections 362 and 363 of this Act (deductions where non-cash voucher or credit-token provided) are not affected by the disregard.

364. *Subsection (4)* clarifies the application of the disregard for transport vouchers.

Section 96: Dispensations relating to vouchers or credit-tokens

365. This section provides for the Inland Revenue to give a notice (commonly called a dispensation) where they are satisfied that no additional tax is payable under the provisions of this Chapter. The section also provides for such notices to be revoked and for the tax charge to apply accordingly.

366. This section derives from section 144(1) and (2) of ICTA.

367. *Subsection (1)* sets out when the section applies, which is when a person applies for a dispensation. The reference to the Inland Revenue replaces references to the inspector. See *Change 158* in Annex 1.

368. *Subsection (2)* requires the Inland Revenue to give a dispensation if they are satisfied that no additional tax would arise in the particular circumstances from the application of this Chapter.

369. *Subsection (3)* defines "dispensation". That term is the commonly used name for the written notification that the Inland Revenue gives the employer to authorise the application of the provisions in this section to the benefit of vouchers and credit-tokens. The section also characterises the dispensation as a notice which, by virtue of the definition of that word in section 832(1) of ICTA, means that it must be in writing. These two changes to formalise the common name for the authorisation given and to require that it must be in writing are minor changes to the law. See *Change 16* in Annex 1.

370. *Subsection (4)* sets out the effect of a dispensation.

371. *Subsections (5)* to *(8)* authorise the Inland Revenue to revoke a dispensation "if in their opinion there is reason to do so", and set out the consequences of such a revocation. The consequences depend on the date from which the revocation has effect (which may be as far back as the date the dispensation was given).

372. A notice revoking a dispensation is "given" rather than "served". This is in line with current practice and consistent with the usage for notices in CAA 2001. This is a minor change to the law. See *Change 16* in Annex 1.

Chapter 5: Taxable benefits: living accommodation

Overview

373. This Chapter deals with the benefit which arises from the provision of living accommodation. It begins by defining in what circumstances the Chapter applies. It then sets out the circumstances in which it does not apply, so that anyone who falls within the exceptions does not need to go any further. The Chapter then deals with the method of calculating the cash equivalent of the benefit. It derives from sections 145, 146 and 146A of ICTA.

Section 97: Living accommodation to which this Chapter applies

374. This section sets out the general statement to indicate that when living accommodation is provided for an employee this Chapter applies.

375. *Subsection (2)* prevents a charge arising on family and household members living at home who are employed by the home-owner who is an individual. It also covers the case where the living accommodation is not the family home, and the employer is providing the accommodation in a capacity other than as employer.

376. This section derives from sections 145(1), (6), (7), 146(1)(a) and (10) of ICTA.

Section 98: Accommodation provided by local authority

377. This section provides for an exception to prevent a charge where a local authority employee is provided with accommodation and the conditions are met.

378. It derives from sections 145(7)(b) and 146(10) of ICTA.

Section 99: Accommodation provided for performance of duties

379. This section sets out two exemptions from the charge on provided living accommodation. The exemptions derive from sections 145(4)(a) and (b) of ICTA.

380. These exemptions apply to directors only if the conditions set out in *subsections (3)* to *(5)* are met. This rider to the exemptions derives from section 145(5) and (8) of ICTA.

381. When the exemptions in this section or that in section 98 of this Act apply, there are further exemptions which may be available by virtue of sections 314 and 315 in Part 4 of this Act.

Section 100: Accommodation provided as result of security threat
382. This section ensures that living accommodation provided because of a special threat to an employee does not give rise to a charge to tax. It derives from section 145(4)(c) of ICTA.

Section 101: Chevening House
383. This section provides an exemption from a charge to tax on provided living accommodation for a nominated person occupying Chevening House. It derives from section 147 of ICTA.

Section 102: Benefit of living accommodation treated as earnings
384. This section makes the cash equivalent of the benefit of the living accommodation chargeable to tax, by treating it as earnings. It derives from sections 145(1) and 146(1) of ICTA.

385. *Subsection (1)* sets out the year for which the cash equivalent is to be treated as earnings. See *Note 7* in Annex 2.

386. The period for which the cash equivalent is calculated is given the label "the taxable period". See *Note 16* in Annex 2.

Section 103: Method of calculating cash equivalent
387. This is a signpost section, introducing sections 104 to 106. It also sets out where to find the meaning of various terms used throughout this Chapter. It is new.

Section 104: General rule for calculating cost of providing accommodation
388. This section sets out the method for determining whether the cost of providing the accommodation exceeds £75,000. It contains material deriving from section 146(4), (5) and (11) of ICTA.

Section 105: Cash equivalent: cost of accommodation not over £75,000
389. This section sets out how to calculate the cash equivalent of the benefit of provided living accommodation costing no more than £75,000. It derives from section 145(1) and (2) of ICTA.

Section 106: Cash equivalent: cost of accommodation over £75,000
390. This section sets out how to calculate the cash equivalent of the benefit of provided living accommodation costing more than £75,000 by means of a method statement as set out in *subsection (2)*. It derives from section 146(1) to (5) and (11) of ICTA.

391. *Step 1* calculates the basic charge under section 105 of this Act. This includes taking into account any sums made good by the employee, as provided for in section 105(5).

392. *Step 2* calculates the additional yearly rent of the accommodation based on the extent to which the cost of providing the property exceeds £75,000.

393. *Step 3* reduces the additional yearly rent to that for "the taxable period".

394. *Step 4* brings together the results of *Steps 1* and *3* and also allows any excess of rent paid to be brought into account.

395. *Subsection (3)* defines excess rent and sets out the circumstances in which it can be taken into account at *Step 4*.

Section 107: Special rule for calculating cost of providing accommodation

396. If a property has been owned for some time before the year in which the benefit of provided living accommodation arises, the value of the property may have risen significantly. This section substitutes market value for cost in certain circumstances. It derives from section 146(4) to (6) and (11) of ICTA.

397. This rule applies only for the purposes of the calculation in section 106 of this Act, and does not have any application to accommodation within section 105 of this Act.

398. *Subsection (3)* sets out how to calculate the cost of providing the accommodation. Consultation leading up to this Act has resulted in the addition in paragraph (a) to the definition of P in respect of payments made. See *Change 21* in Annex 1.

399. Section 146(8) of ICTA provides that section 146(6) does not apply if the employee first occupied the property before 1983. Due to the length of time since that date the provision is now in paragraph 21(1) of Schedule 7 to this Act.

Section 108: Cash equivalent: accommodation provided for more than one employee

400. This section allows an apportionment of the cash equivalent when the accommodation is provided for more than one employee. It derives from ESC A91A. See *Change 22* in Annex 1.

Section 109: Priority of this Chapter over Chapter 1 of this Part

401. This section applies in the event that there is a possibility of a charge both under Chapter 1 and under this Chapter in respect of the same living accommodation.

402. This section ensures that the charge under this Chapter takes precedence. If the amount of earnings that would be chargeable by virtue of section 62 of this Act is less than the amount of the cash equivalent under this Chapter, then the cash equivalent applies. If the earnings exceed the cash equivalent, only the excess is treated as earnings. The section derives from section 146A of ICTA.

Section 110: Meaning of "annual value"

403. This section defines "annual value" for the purposes of this Chapter. It derives from section 837 of ICTA which in turn draws on section 23 of the General Rate Act 1967 (although that Act was repealed in 1988).

404. This section does not affect the Inland Revenue practice of using the gross rateable value as a proxy for "annual value". That practice will continue. The main use of this section is to provide guidance on how to arrive at the annual value of properties for which rent is not paid and in practice is only needed in cases where no gross rateable value can be found.

405. *Subsection (1)* defines "annual value". Section 837(1) refers to "rates and taxes" on the premises. This section includes a fuller and more updated description of domestic property charges: "taxes, rates or charges". See *Change 24* in Annex 1.

406. The following subsections set out the adjustments to make in order to arrive at the rent to be used for living accommodation. They derive from section 23 of the General Rate Act 1967 which was repealed in 1988. As a consequence of that repeal the reference to that Act in section 837(2) has not been included in this section. Instead the general thrust of the rules has been rewritten here. See *Change 23* in Annex 1.

407. *Subsection (2)* applies in relation to subsection (1). It ensures that the annual value does not include the cost of anything which is not provided in the case of unfurnished property. This is important in cases where the only available comparisons are rents paid for fully furnished and serviced properties. If, in considering what the rent of the accommodation would be, the nearest comparison is rent for a property for which services are provided at an inclusive rent, in order to reduce the rent to that for unfurnished, non-serviced accommodation the cost of the services provided are deducted. This means that if there is a profit element in the provision of the services it is treated as rent in arriving at the annual value.

408. *Subsections (3) and (4)* extend the process of comparison and adjustment. They follow the thrust of section 23(3) and (4) of General Rate Act 1967 which ensured that when a property is valued by reference to comparative rents of similar properties the value was not distorted by the existence (in the comparative case) of separate payments for services in addition to what one might call the basic rent. In particular it added the separate payments to the rental payments and allowed for certain deductions to be made. It did not allow any deduction in computing the value based on a comparative rent for amounts paid in respect of repairs, insurance or maintenance of other property belonging to or occupied by the landlord. In the case of payments for other types of services only the cost element of them was deducted. These subsections follow that method of comparison and adjustment.

409. *Subsection (5)* has the effect that the services whose cost of provision may be deducted are those which are not normally met by a landlord in the provision of

unfurnished property. Again, the wording is not derived directly from section 23 of the General Rate Act 1967 but follows the general thrust of provisions of that section.

410. This section does not affect the limited exemption in section 315 which applies to the amount of earnings or the amount treated as earnings based on the cost of certain services

Section 111: Disputes as to annual value
411. This section sets out the procedure for resolution of disputes about the annual value of accommodation for the purposes of this Chapter. It derives from section 837(3) of ICTA.

Section 112: Meaning of "person involved in providing the accommodation"
412. This definition makes it clear that it is necessary to look beyond the employer and the apparent owner of an interest in the accommodation. This is anti-avoidance legislation to counter schemes which depress the cost to the employer by using intermediate owners of interests. It derives from section 146(7) of ICTA.

Section 113: Meaning of "the property"
413. This section simply confirms that "the property" means the living accommodation in question. It derives from section 146(11) of ICTA.

Chapter 6: Taxable benefits: cars, vans and related benefits
Overview
414. Employees may be taxable on the benefit of the availability for private use of a car or van, or car fuel that their employers provide. If so, the cash equivalent of the benefit is taxed as the employee's earnings.

415. This Chapter contains the rules to calculate the cash equivalent of that benefit.

416. Sections 114 to 119 set out the basic principles of the car, car fuel and van benefit rules.

417. Sections 120 and 121 provide for the cash equivalent of the car benefit to be taxed as earnings and the method for calculating that cash equivalent.

418. Sections 122 to 148 give detailed rules in support of the calculation of the cash equivalent of the car benefit.

419. Sections 149 to 153 deal likewise with car fuel benefits.

420. Sections 154 to 166 deal likewise with van benefits.

421. Sections 167 and 168 give special rules that apply to pool vehicles.

422. Section 169 deals with situations where the same employer employs more than one member of a family or household.

423. Section 170 provides for the Treasury to make orders relating to provisions in this Chapter.

424. Sections 171 and 172 give definitions.

Section 114: Cars, vans and related benefits

425. This section sets out the scope of this Chapter and gives signposts to the groups of provisions dealing with the various aspects of the car, car fuel and van benefit rules. The section derives from sections 157(1) and 159AA(1) of ICTA.

426. *Subsection (1)* states when this Chapter applies.

427. *Subsection (1)(b)* avoids the use of the phrase "the employee's employment". Section 66(2)(a) of this Act identifies for this (and for other sections) the employee to whose employment the legislation applies.

428. *Subsection (2)* gives signposts to the groups of provisions applying to car, fuel and van benefits.

429. *Subsection (3)* prevents a double tax charge arising on car, car fuel or van benefits.

430. *Subsection (4)* gives signposts to provisions providing exceptions to the main rules.

Section 115: Meaning of "car" and "van"

431. This section defines "car" and "van" and related terms for the purposes of this Chapter. The section derives from parts of sections 168(5) and 168(5A) of ICTA.

432. *Subsection (1)* defines "car" and "van".

433. *Subsection (2)* defines terms relevant only to the definitions of "car" and "van", so that all such terms are located together.

Section 116: Meaning of when car or van is available to employee

434. It is the availability to an employee of a car or van for private use that may give rise to a tax charge. This section explains what a car or van being available to an employee means. The section derives from sections 168A(12), 168AA(4), 168B(8), 168C(3) and 168F(10), paragraph 10 of Schedule 6 and paragraph 12 of Schedule 6A to ICTA.

435. *Subsection (1)* extends the meaning of a car or van being available to an employee to include its being made available to members of the employee's family or household.

436. *Subsection (2)* defines when such cars first became available at all and when they are last available in the year.

437. *Subsection (3)* provides that this section does not apply to section 138 of this Act. That section therefore applies only to an employee who is disabled and not to members of that employee's family or household as well.

Section 117: Meaning of car or van made available by reason of employment

438. To give rise to a tax charge, the car or van must be made available to the employee by reason of the employment. This section provides that a car or van made available by an employer is regarded as made available by reason of the employment unless the circumstances in paragraphs (a) and (b) apply. The section derives from part of section 168(6) of ICTA.

Section 118: Availability for private use

439. This section explains what is meant by availability for private use of a car or van. The section derives from parts of section 168(5), 168(5A), and 168(6) of ICTA.

440. *Subsection (1)* provides that the car or van is regarded as available for private use unless the circumstances in paragraphs (a) and (b) apply.

441. *Subsection (2)* defines "private use".

Section 119: Where alternative to benefit of car offered

442. This section identifies the relationship between this Chapter and the provisions in Chapter 1 of Part 3 of this Act. The section derives from section 157A of ICTA.

Section 120: Benefit of car treated as earnings

443. This section provides that the cash equivalent of the benefit arising from the provision of a car is treated as an employee's earnings. The section derives from part of section 157(1) of ICTA.

444. *Subsection (1)* brings the cash equivalent of the car benefit into charge as part of the employee's earnings. The rewrite of the source legislation has clarified the timing of the charge. See *Note 7* in Annex 2.

445. *Subsection (2)* allows concise expression in this Chapter of the link between the employee and the taxable benefit.

Section 121: Method of calculating the cash equivalent of the benefit of a car

446. This section states how to calculate the cash equivalent of the car benefit. The section derives from sections 157(2) and 168G(1) and paragraph 1 of Schedule 6 to ICTA.

447. *Subsection (1)* sets out the steps involved in the calculation by using a method statement.

448. *Subsection (2)* gives signposts to two special cases when the calculation is modified.

449. *Subsection (3)* gives a signpost to the reduction that may be made when employees share a car.

Section 122: The price of the car

450. This section states what is meant by "the price of the car" and, in particular, introduces the concept of "the notional price" for the case where a car has no list price. It links to other provisions for the calculation of the cash equivalent of the car benefit. The section derives from part of section 168A(1) of ICTA.

Section 123: The list price of a car

451. This section deals with the most common case where there is a published list price for a car. The section derives from section 168A(2) and part of section 168A(9) of ICTA.

452. *Subsection (1)* defines "list price" by referring to the characteristics of an ordinary retail sale.

453. The phrase "(as the case may be)", from section 168A(2), is retained as the simplest way of determining whose list price is to be taken. The user looks first to the manufacturer, secondly to the importer and thirdly to the distributor to find a list price.

454. *Subsection (2)* makes it clear that "list price" includes delivery charges and taxes.

Section 124: The notional price of a car with no list price

455. This section deals with the less common case where there is no published list price within section 123. The legislation then falls back on the concept of the "notional price". The section derives from section 168A(8) and part of section 168A(9) of ICTA.

456. *Subsection (1)* defines the "notional price" of a car and the assumptions to be made in determining it. Those assumptions reflect the circumstances listed in section 123(1) where there is an actual list price.

457. *Subsection (2)* makes it clear that a notional price must, like a list price, include delivery charges and taxes.

Section 125: Meaning of "accessory" and related terms

458. This section defines "accessory". The section derives from parts of sections 168A(9), (10) and (11), 168AB(1) and (4), 168B(8), 168C(3), 168D(5) and 168F(9) of ICTA.

459. *Subsection (1)* defines "qualifying accessory".

460. *Subsection (2)* lists certain items that are not treated as accessories.

461. *Subsection (3)* states an exception to one item in subsection (2).

462. *Subsection (4)* distinguishes between a "standard accessory" and a "non-standard accessory". The term "equivalent to" in the definition of "standard accessory" does not mean "identical to". It accommodates slight changes to the specification of particular models of cars, which manufacturers may make from time to time but which do not result in changes to their published prices.

Section 126: Amounts taken into account in respect of accessories

463. This section identifies the types of accessories for which the prices are added at *Step 2* of the calculation in section 121(1) of this Act. The section derives from parts of sections 168A(1), (4), (5), (6) and (7), 168B(1), (2) and (3), and 168C(1), (2) and (4) of ICTA.

464. Section 168A(3) of ICTA (which deals with a car to which only standard accessories were fitted at the time it was first made available to the employee) has not been rewritten. It seems unnecessary given that standard accessories (as defined in section 168A(9)(c)) are necessarily taken into account when ascertaining the list price of the car under section 168A(2). The structure of the new method statement in section 121 is such that, having ascertained the list price of the car under *Step 1*, *Step 2* is only concerned with adding on the price of accessories not included in that price.

465. *Subsection (1)* states the basic rule and introduces the terms "initial extra accessory" and "later accessory".

466. *Subsection (2)* defines "initial extra accessory".

467. *Subsection (3)* defines "later accessory".

468. *Subsection (4)* identifies the price of the accessory as the list price or, if there is no list price, a notional price. This follows the same approach as for the car in section 122 of this Act.

469. *Subsection (5)* gives a signpost to a modifying rule that applies when accessories are replaced.

Section 127: The list price of an accessory
470. This section defines the list price of an accessory. The section derives from parts of sections 168A(4), (5), (6) and (7), 168B(2) and 168C(2) of ICTA.

471. *Subsection (1)* gives the rule when the accessory is an "initial extra accessory". The list price is the published price of either the manufacturer, importer or distributor of the car or, when there is no such published price, the published price of the manufacturer, importer or distributor of the accessory in a normal, retail sale.

472. *Subsection (2)* gives the rule when the accessory is a "later accessory". The list price is the published price of the manufacturer, importer or distributor of the accessory.

Section 128: Accessory: published price of the car manufacturer etc.
473. This section states how to arrive at the price of an accessory, when it is derived from the published price of the manufacturer, importer or distributor of the car. The section derives from parts of section 168A(4) and (9) of ICTA.

474. *Subsection (1)* gives the main definition. As in section 123 of this Act (see paragraph 453) the phrase "(as the case may be)" from the source legislation is retained.

475. *Subsection (2)* defines "inclusive price". Car tax is excluded from the "relevant taxes" to be taken into account in arriving at the price of the accessory in subsection (2)(b). That is because it is clear from the context of section 168A that, when applied to an accessory, the reference in section 168A(9) to "any car tax" is irrelevant when considering the "inclusive price" of the accessory as defined in section 168A(9)(a).

Section 129: Accessory: published price of the accessory manufacturer etc.
476. This section states how to arrive at the price of an accessory when it is derived from the published price of the manufacturer, importer or distributor of the accessory. The section derives from parts of section 168B(4), (6) and (7) and section 168C(4) of ICTA.

477. *Subsection (1)* defines the "published price of the manufacturer, importer or distributor of the accessory". As in section 123 of this Act (see paragraph 453), the phrase "(as the case may be)" from the source legislation is retained.

478. *Subsection (2)* defines "inclusive price". Car tax is excluded from the "relevant taxes" to be taken into account in arriving at the price of the accessory in subsection (2)(b). That reproduces the effect of section 168B(7)(b), which differs from section 168A(9) in that respect.

479. *Subsection (2)(c)* contrasts with section 128(2)(c) in identifying the person by whom the fitting charge is made. That reflects section 168B(6).

480. *Subsection (3)* states an interpretation rule for this section about timing. The reference to "time" here (and in subsection (1)(e) to which it relates) contrasts with the reference to "day" in section 128(1)(e). That reflects the distinction between section 168A(9)(b), which refers to "day" and section 168B(4), which refers to "time". A brand new car is generally on sale prior to its first registration. The act of registration often results in an immediate loss in value. This is equally true of an optional accessory provided with the car by the car manufacturer. The legislation adopts the price of such an accessory in relation to the day immediately before first registration as it does for the car itself (see section 123(1)(e) of this Act). In the case of an accessory that is made by someone other than the car manufacturer that may not be appropriate. That is because the accessory might be attached to the car only on the first day the accessory goes on sale. So this section refers to a particular time rather than a particular day.

Section 130: The notional price of an accessory

481. This section defines the "notional price" of an accessory. It applies when an accessory does not have a list price. The section derives from section 168B(5), (6) and (7) and section 168C(4) of ICTA.

482. *Subsection (1)* defines the notional price of the accessory by setting out the assumptions to be made in determining it. Those assumptions reflect the circumstances listed in section 129(1) where there is an actual list price.

483. *Subsection (2)* defines "inclusive price" to reflect what is referred to in section 129(2) when there is an actual list price.

484. *Subsection (2)(c)* follows section 129(2)(c) in identifying the person by whom the fitting charge is made. That reflects section 168B(6).

485. *Subsection (3)* follows the timing rule in section 129(3).

Section 131: Replacement accessories

486. This section sets out the rules for calculating the cash equivalent of a replacement accessory. The section derives from the Income Tax (Car Benefits) (Replacement Accessories) Regulations 1994 (SI 1994 No 777). Those Regulations were made under powers provided by section 168E of ICTA. As there is no longer any reason to retain those powers, section 168E has not been rewritten.

487. *Subsection (1)* states when the section applies.

488. *Subsection (2)* applies when the new accessory is not superior to the old accessory.

489. *Subsection (3)* applies when the new accessory is superior to the old accessory and the conditions in subsection (4) are met.

490. *Subsection (4)* states the conditions referred to in subsection (3).

491. *Subsection (5)* states what is meant by "superior" in this section.

492. *Subsection (6)* states what is meant by the "price of an accessory" in this section.

Section 132: Capital contributions by employee

493. This section provides for the deduction that can be made at *Step 3* of section 121(1) of this Act in calculating the cash equivalent of the car benefit. The section derives from section 168D(1), (2), (3) and (4) of ICTA.

494. *Subsection (1)* states when the section applies. That is when the employee contributes to the capital cost of the car or its qualifying accessories.

495. *Subsection (2)* states for which tax years the deduction can be made.

496. *Subsection (3)* states the maximum deduction that can be made under this section for any tax year.

Section 133: How to determine the "appropriate percentage"

497. This section is the first of a group of ten defining "the appropriate percentage" to be used in *Step 6* of section 121(1) of this Act to calculate the cash equivalent of the car benefit. The "appropriate percentage" depends on the type of car involved, when it was first registered, what fuel or fuels it uses and whether it has a CO_2 emissions figure. The section derives from paragraph 2 of Schedule 6 to ICTA.

498. *Subsection (1)* identifies the date of the car's first registration as the initial governing factor.

499. *Subsection (2)* applies different provisions to cars first registered after 31 December 1997, depending on whether or not they have a CO_2 emissions figure and/or whether they are diesels. It gives signposts to the relevant provisions in each case.

500. *Subsection (3)* gives a signpost to the provision that applies if the car was first registered before 1 January 1998.

Section 134: Meaning of car with or without a CO_2 emissions figure

501. This section determines whether a car is a car with or without a CO_2 emissions figure for the purposes of these provisions. The section derives from parts of paragraphs 3(1) and (2), 5 and 5C(1) of Schedule 6 to ICTA.

502. *Subsection (1)* defines a "car with a CO_2 emissions figure" by reference to its date of first registration and other sections that specify a CO_2 emissions figure for the particular combination of car type and date of first registration.

503. *Subsection (2)* defines a "car without a CO_2 emissions figure" by reference to its date of first registration, not being a car within subsection (1).

Section 135: Car with a CO_2 emissions figure: pre-October 1999 registration

504. This section gives a rule to determine the CO_2 emissions figure for certain cars first registered after 31 December 1997 and before 1 October 1999. The section derives from parts of paragraph 3(1) and (2) of Schedule 6 to ICTA.

505. *Subsections (1)* and *(2)* define a CO_2 emissions figure by reference to the appropriate European or United Kingdom certification schemes that were in place at the time of a first registration that occurred on or after 1 January 1998 and before 1 October 1999.

506. *Subsection (3)* makes this section subject to a further rule that applies to the provision of an automatic car for an employee who is disabled.

Section 136: Car with a CO_2 emissions figure: post-September 1999 registration

507. This section gives a rule to determine the CO_2 emissions figure for certain cars first registered after 30 September 1999. The section derives from parts of paragraph 3(1) and (2) of Schedule 6 to ICTA.

508. *Subsections (1)* and *(2)* define the CO_2 emissions figure by reference to the appropriate European or United Kingdom certification schemes that were in place at the time of a first registration on or after 1 October 1999.

509. *Subsection (3)* makes this section subject to further rules that apply to the provision of a car capable of running on more than one type of fuel or of an automatic car for an employee who is disabled.

Section 137: Car with a CO_2 emissions figure: bi-fuel cars

510. This section gives a CO_2 emissions figure for bi-fuel cars (cars capable of running on more than one type of fuel) first registered after 31 December 1999. Such cars will have at least two CO_2 emissions figures. The section derives from paragraph 5 of Schedule 6 to ICTA.

511. *Subsection (1)* refers to the CO_2 emissions figures of a bi-fuel car by reference to the appropriate European or United Kingdom certification schemes that were in place at the time of a first registration after 31 December 1999.

512. *Subsection (2)* determines which figure must be used.

513. *Subsection (3)* makes this section subject to a further rule that applies to the provision of an automatic car for an employee who is disabled.

Section 138: Car with a CO_2 emissions figure: automatic car for a disabled employee

514. This section gives a special rule for identifying the CO_2 emissions figure for an automatic car provided for a disabled employee. The section derives from paragraph 5A(1), (2), (3) and (4) of Schedule 6 to ICTA.

515. The CO_2 emissions figure for an automatic car is generally higher than for its manual equivalent. So as not to penalise a disabled employee whose disablement means that the car he or she drives must have an automatic gearbox, this section provides that the CO_2 emissions figure to be used is that of the nearest equivalent manual version of the car.

516. *Subsection (1)* states when the section applies. This subsection refers to the employee as "E" to avoid repeated use of the word "employee".

517. *Subsection (2)* provides for the substitution of the CO_2 emissions figure of the manual equivalent of the automatic car if it is lower.

518. *Subsection (3)* defines "equivalent manual car".

519. *Subsection (4)* defines a car with automatic transmission. This subsection incorporates a suggestion made during the process of consultation leading up to this Act. The definition turns on the central idea that an automatic car is a car that does not have a clutch needing to be operated by some physical action by the driver.

520. *Subsection (5)* avoids the use of the phrase "the employee's employment". This provision contrasts with section 116(1) of this Act in that it only applies to a car made available to the employee personally and not to members of the employee's family or household.

Section 139: Car with a CO_2 emissions figure: the appropriate percentage

521. This section identifies the "appropriate percentage" to be used at *Step 6* in section 121(1) of this Act to calculate the cash equivalent for a car that has a CO_2 emissions figure. The section derives from paragraphs 3(3), (4) and (5), and 4(1) and (3) of Schedule 6 to ICTA.

522. *Subsection (1)* states the starting point for arriving at the appropriate percentage, which is the car's CO_2 emissions figure.

523. *Subsection (2)* gives the appropriate percentage if the car's CO_2 emissions figure is no higher than "the lower threshold". This is the "basic percentage", initially set at 15%.

524. *Subsection (3)* gives the appropriate percentage if the car's CO_2 emissions figure is higher than "the lower threshold". The basic percentage is increased by one percentage point for each additional (full) five grams per kilometre of CO_2 emitted, up to a maximum appropriate percentage of 35%. The reference in paragraph 3(4) to "the basic percentage increased by 1%" is rewritten as "the basic percentage increased by one percentage point". That makes the intention of the legislation clearer, as it avoids any suggestion that the "minimum percentage" must be increased by 1% of itself (to 15.15%).

525. *Subsection (4)* states what is "the lower threshold" for different tax years.

526. *Subsection (5)* provides for the rounding down of the car's CO_2 emissions figure to the nearest multiple of five. Its effect is that the basic percentage is increased under subsection (3)(a) by one percentage point only for every additional full five grams per kilometre of CO_2 emitted.

527. *Subsection (6)* makes the section subject to other provisions relating to diesel cars and to Treasury powers to amend the amounts involved.

Section 140: Car without a CO_2 emissions figure: the appropriate percentage

528. This section gives the "appropriate percentage" to be used at *Step 6* in section 121(1) of this Act to calculate the cash equivalent for a car first registered after 31 December 1997 that does not, for whatever reason, have a CO_2 emissions figure. The section derives from paragraphs 5C(2), (3) and (4) and 5G of Schedule 6 to ICTA.

529. *Subsection (1)* applies the section to determine the appropriate percentage for cars without a CO_2 emissions figure. They include, for example, electrically propelled cars and cars with an internal combustion engine that does not have one reciprocating piston or more.

530. *Subsection (2)* applies to cars with an internal combustion engine that does have one reciprocating piston or more. The appropriate percentage increases with engine size.

531. *Subsection (3)* gives the appropriate percentage for cars not within subsection (2).

532. *Subsection (4)* defines an "electrically propelled vehicle" for the purposes of this section.

533. *Subsection (5)* makes the section subject to other provisions relating to diesel cars and to any regulations made under Treasury powers to amend the amounts involved.

Section 141: Diesel cars: the appropriate percentage

534. This section gives the "appropriate percentage" to be used at *Step 6* in section 121(1) to calculate the cash equivalent for a diesel car. The section derives from paragraph 5D(1), (2) and (4) of Schedule 6 to ICTA.

535. *Subsection (1)* states to which cars the section applies, namely diesel cars first registered after 31 December 1997.

536. *Subsection (2)* uses a method statement to set out the steps in the calculation of the appropriate percentage.

537. *Subsection (3)* defines "diesel car" for the purposes of this section.

538. *Subsection (4)* makes the section subject to any regulations made under Treasury powers to amend the amounts involved.

Section 142: Car first registered before 1st January 1998: the appropriate percentage

539. This section gives the "appropriate percentage" to be used at *Step 6* in section 121(1) of this Act to calculate the cash equivalent for a car registered before 1 January 1998. Such cars are less likely to have a recognised CO_2 emissions figure, so a different and consistent basis is used for all such cars. The section derives from paragraphs 5F(1), (2) and (3) and 5G of Schedule 6 to ICTA.

540. *Subsection (1)* states to which cars the section applies, namely those first registered before 1 January 1998.

541. *Subsection (2)* applies to cars with an internal combustion engine that has one reciprocating piston or more. The appropriate percentage increases with engine size. For cars driven by an internal combustion engine with one reciprocating piston or more the "appropriate percentage" is the same, irrespective of the fuel used.

542. *Subsection (3)* gives the appropriate percentage for cars not within subsection (2).

543. *Subsection (4)* defines an "electrically propelled vehicle" for the purposes of this section.

Section 143: Deduction for periods when car unavailable

544. This section quantifies a deduction that can be made at *Step 7* of section 121(1) of this Act in calculating the cash equivalent, because a car is not available at some time during the tax year. The section derives from part of paragraph 6 and paragraph 9 of Schedule 6 to ICTA.

545. *Subsection (1)* provides for the deduction.

546. *Subsection (2)* defines the periods of non-availability. They cover the period from the beginning of the tax year involved to the date on which the car first became available and the period from the date when the car ceased permanently to be available to the end of the tax year. There can also be one or more periods of temporary non-availability for each period of continuous non-availability of 30 days or more. Such periods can span two tax years, ie the 30 days or more do not have to fall wholly within one tax year.

547. *Subsection (3)* gives a formula to calculate the appropriate deduction.

548. *Subsection (4)* makes this section subject to a further provision that applies if the car is temporarily replaced.

Section 144: Deduction for payments for private use

549. This section provides for a deduction to be made in calculating the cash equivalent at *Step 8* of section 121(1) of this Act, to take account of the employee having paid for private use of the car. The section derives from paragraph 7 of Schedule 6 to ICTA.

550. *Subsection (1)* states when the section applies. That is when, as a condition of the car being made available for private use, the employee is required to pay, and does pay, for that private use.

551. The words "(whether by way of deduction from earnings or otherwise)" have been retained as they remove a potential area of doubt about whether a deduction from earnings can amount to a payment. The same approach is used in sections 159(1)(a) and 165(1)(a) of this Act.

552. *Subsections (2)* and *(3*) provide for the deduction of the appropriate amount at *Step 8* of the calculation in section 121(1).

553. *Subsection (4)* extends the section to private use of a car by a member of the employee's family or household.

554. *Subsection (5)* makes this section subject to a further provision that applies if the car is temporarily replaced.

Section 145: Modification of provisions where car temporarily replaced

555. This section modifies the effect of the two previous sections if a car is temporarily replaced. The section derives from the Income Tax (Replacement Cars) Regulations 1994 (SI 1994 No 778). Those Regulations were made under powers provided by paragraph 8 of Schedule 6 to ICTA. As there is no longer any reason to retain those powers, that paragraph has not been rewritten.

556. *Subsections (1)* to *(3)* deal with the conditions to be met for the section to apply. Condition A in *subsection (2)* relates to the quality of the replacement car as

compared with the car it replaces. This Act uses a slightly different form of wording from the source legislation. See *Change 25* in Annex 1.

557. *Subsection (4)* makes the necessary modifications to sections 143 and 144 of this Act when this section applies.

558. *Subsection (5)* defines "materially better". The possible introduction of a numerical measure of improvement (a maximum percentage increase above the interim sum, for example) to remove the inherent uncertainty of "materially" was considered but rejected. That approach might produce "hard cases". It is better to retain the flexibility that a common sense interpretation of "materially" allows.

Section 146: Cars that run on road fuel gas

559. This section provides for a deduction to be made from the price of the car at *Step 1* of the calculation of the cash equivalent in section 121(1) of this Act if the car has been manufactured to run on road fuel gas and is not a bi-fuel car. The deduction that can be made is the amount that is reasonably attributable to the car being manufactured to run on road fuel gas, rather than only on petrol. The section derives from section 168AB(2) and (4) of ICTA.

560. *Subsection (1)* states when the section applies.

561. *Subsection (2)* provides for the appropriate deduction from the price arrived at after *Step 1* of the calculation in section 121(1). This is a slight variation on the calculation used in the source legislation. See *Change 26* in Annex 1.

Section 147: Classic cars: 15 years of age or more

562. This section provides for modifications to the calculation of the cash equivalent of the car benefit in section 121(1) of this Act if the car is a classic car. The section derives from section 168F(1) to (8) of ICTA.

563. The section heading emphasises that the provision applies to modern classics as well as to vintage or veteran cars.

564. *Subsection (1)* states when the section applies by reference to the age and market value of the car. A car that is 15 or more years old, with a market value of £15,000 or more and in excess of the amount carried forward from *Step 3* of the "normal" calculation in section 121(1) falls within this provision.

565. *Subsection (2)* applies the modification provided for in this section to the calculation in section 121(1). This is the substitution of the market value (after adjustment for any capital contributions by the employee) of the car on the last day of the tax year involved (or the last day the car is available to the employee in that year, if earlier) for the amount arrived at after *Step 3* under the normal calculation method.

566. *Subsections (3)* and *(4)* define the market value of the car.

567. *Subsections (5)* to *(7)* provide for a deduction (limited to £5,000 in any tax year) from the market value to reflect any capital contributions by the employee.

Section 148: Reduction of cash equivalent where car is shared

568. This section provides for a reduction of the cash equivalent of the benefit of a car where that car is shared by at least two employees who are chargeable to tax in respect of its availability. This section derives from paragraph 3 of ESC A71.

569. The concession was couched in terms of the apportionment of "a single car benefit charge". This Act adopts a different approach by providing for a reduction of the relevant cash equivalent for each employee to whom the section applies. See item B of *Change 27* in Annex 1.

570. This section, by virtue of the provisions in section 5, applies to office-holders as well as employees. See item D of *Change 27* in Annex 1.

571. *Subsection (1)* states when the section applies. That is when two or more employees are chargeable to tax in respect of the provision of the car (of which they each have shared private use) by their employer. No reduction will be necessary if the car is shared between one such an employee and another employee who is not chargeable in respect of the provision of the car. That is because there will be only one cash equivalent arising from the provision of the car.

572. Converting the concession to legislation has produced a subtle change to how section 218 of this Act (which determines whether an employee is lower-paid) will apply, compared with how the source legislation in section 167(2) of ICTA worked with the concession. See item C of *Change 27* in Annex 1.

573. *Subsection (2)* provides for the reduction of each employee's cash equivalent of the car benefit, initially calculated ignoring the fact that the car is shared, on a just and reasonable basis. See item B in *Change 27* in Annex 1.

574. *Subsection (3)* modifies how subsection (2) is to be interpreted.

575. *Subsection (4)* extends the section to cover private use of a car by a member of the employee's family or household.

Section 149: Benefit of car fuel treated as earnings

576. This section brings into charge, as an employee's earnings, the cash equivalent of the benefit arising from the provision of fuel for a car to which section 120 of this Act applies. The section derives from section 158(1), (9) and part of (3) of ICTA.

577. *Subsection (1)* states the main principle, which is that any fuel benefit associated with a car benefit is taxed as earnings. The rewrite of the source legislation has clarified the timing of the charge. See *Note 7* in Annex 2.

578. *Subsection (1)(b)* now refers to "that person", rather than "the employee" to avoid a repetitive reference to "the employee" that might have been regarded as indicating that the car must have been made available by reason of the same employment as that providing the car fuel. There is no such stipulation on the face of section 158(1) of ICTA.

579. *Subsection (2)* applies the provisions that determine how the cash equivalent of the fuel benefit is calculated.

580. *Subsection (3)* gives examples of what constitutes the provision of fuel. The definitions of "non-cash voucher" and "credit-token" used in subsection (3)(b) and (3)(c) are listed in Schedule 1 to this Act.

581. *Subsection (4)* excludes the provision of electrical energy from the benefit charge.

Section 150: Car fuel: calculating the cash equivalent

582. This section defines the cash equivalent of the benefit of the provision of car fuel. The section derives from section 158(2) of ICTA.

583. *Subsection (1)* gives the basis of calculation, which is to take the "appropriate percentage" of £14,400.

584. *Subsection (2)* states the meaning of "appropriate percentage" in this section. That is the same percentage as is used to calculate the cash equivalent of the car for which the fuel is provided.

585. *Subsection (3)* gives signposts to three sections that modify the cash equivalent in particular circumstances.

Section 151: Car fuel: nil cash equivalent

586. This section prevents a benefits charge when there is no private use of fuel or the employee pays for the private use. The section derives from section 158(6) of ICTA.

587. *Subsection (1)* provides that the cash equivalent will be nil if either of the conditions defined in subsections (2) or (3) is met.

588. *Subsection (2)* applies to cases where the employee is required to pay for, and does pay for, all fuel for private use.

589. *Subsection (3)* applies when fuel is provided only for business travel.

Section 152: Car fuel: proportionate reduction of cash equivalent

590. This section provides for a proportionate reduction in the cash equivalent of the fuel benefit for particular circumstances, which may apply during part of a tax year. This section derives from section 158(5), (6A), (6B), and (8) of ICTA.

591. *Subsection (1)* applies when the car for which the fuel is provided is unavailable.

592. *Subsection (2)* covers circumstances where the fuel is not available for private use or its cost has to be and is reimbursed by the employee.

593. *Subsection (3)* is to prevent unintended advantage being obtained from the legislation by repeated changes in the circumstances that apply to the provision of the fuel.

594. *Subsection (4)* gives a formula to calculate the reduced cash equivalent. The formula uses "Y", defined as "the number of days in the tax year in question", instead of the fixed figure of "365" in the source legislation. That copes automatically with leap years. See item A of *Change 28* in Annex 1.

Section 153: Car fuel: reduction of cash equivalent

595. This section provides for a reduction of the cash equivalent of the fuel benefit in certain circumstances when a car is shared. The section is new. It is an extension of the change referred to in paragraph 569. See items B and D of *Change 27* in Annex 1.

Section 154: Benefit of van treated as earnings

596. This section states the principle that the cash equivalent of the benefit arising from the provision of a van is treated as the employee's earnings from the employment. The section reflects the approach in section 120 of this Act, the corresponding section for cars. The section derives from section 159AA(1) of ICTA. The rewrite of the source legislation has clarified the timing of the charge. See *Note 7* in Annex 2. See also item A of *Change 2* in Annex 1 in relation to when the earnings are treated as received.

Section 155: Method of calculating the cash equivalent of the benefit of a van

597. This section states the principles involved in calculating the cash equivalent of the benefit of a van. The section derives from paragraphs 1(1), 4(1) and 5(6) and (10) of Schedule 6A to ICTA.

598. *Subsection (1)* states the starting point of the calculation. That is whether or not the van is shared at any time in the tax year.

599. *Subsection (2)* identifies the provision that contains the basis of calculation that applies if the van was not a shared van, as defined in section 156 of this Act, for any period in the tax year.

600. *Subsection (3)* identifies the provision that contains the basis of calculation that applies if the van was a shared van, as defined in section 156, for the whole of the tax year.

601. *Subsection (4)* applies when the van is shared for only part of the year, and simplifies the proposition set out in the source legislation. See item C of *Note 17* in Annex 2.

602. *Subsections (5)* and *(6)* make it clear which vans are counted in the calculation of the value of shared availability under, respectively, the normal and alternative methods of calculation.

603. *Subsection (7)* states the rule for calculating the total value of shared availability when an employee shares more than one van.

604. *Subsection (8)* gives a signpost to a section that imposes an overall limit on the cash equivalent of the benefit arising from the provision of a van or vans.

Section 156: Meaning of "shared van"

605. This section defines the term "shared van". The section derives from paragraph 4(2), (3), (4) and (5) of Schedule 6A to ICTA.

606. *Subsections (1)* to *(3)* determine, for the purposes of sections 155 to 165 of this Act, whether a van is a "shared van". Subsection (3)(a) emphasises, by its reference to "different employees", that it denotes a group of employees that may vary over the period.

607. *Subsection (4)* provides that if a van is available to only one employee for a period of 30 days or more the van will not count as a "shared van" for that period.

608. *Subsection (5)* requires shared use for any part of a day to be counted as shared use for that day.

Section 157: Value of exclusive availability

609. This section gives the value of the benefit of a van that is available to only one employee. It sets out the steps involved in the calculation using a method statement. The section derives from paragraph 1(2) and parts of paragraphs 2(1) and 3(1) of Schedule 6A to ICTA.

Section 158: Deduction for periods of unavailability or shared use

610. This section provides for an adjustment of the value calculated under section 157 if the van is not available or is shared for any period in the tax year. The section derives from parts of paragraph 2(1) and from paragraph 2(2) and (3) of Schedule 6A to ICTA.

611. *Subsection (1)* provides for a deduction to be made from the value calculated at *Step 2* of section 157 when there are "excluded days" in relation to the van.

612. *Subsection (2)* defines "excluded days" as days when the van is unavailable or shared.

613. *Subsection (3)* gives a formula to calculate the deduction. The formula uses "Y" for the number of days in the year instead of "365" in the source legislation. This is the same change in principle as that described in paragraph 594. See item A of *Change 28* in Annex 1.

614. *Subsection (4)* defines the periods of non-availability. Apart from periods relating to the van first being available or ceasing finally to be available, such periods must last for a continuous period of at least 30 days. They can run from the beginning of the tax year involved to the date on which the van first became available or from the date when the van ceased permanently to be available to the end of that tax year. There can also be one or more periods of temporary non-availability for each continuous period of 30 days or more. Such periods can span two tax years, ie the period of 30 days or more does not have to fall wholly within one tax year.

Section 159: Deduction for payments for private use

615. This section provides for adjustment of the value calculated under section 157 of this Act for payments made by the employee for private use of a van. The section derives from paragraph 3(1), (2) and (3) of Schedule 6A to ICTA.

616. *Subsection (1)* states when the section applies. That is when, as a condition of the van being made available for private use, the employee is required to pay for, and does pay for, that use. The words "(whether by way of deduction from earnings or otherwise)" avoid any doubt about whether a deduction from earnings can amount to a payment. The same approach is used in sections 144(1)(a) and 165(1)(a) of this Act.

617. *Subsections (2)* and *(3*) provide for the deduction of the appropriate amount at *Step 4* of the calculation in section 157.

618. *Subsection (4)* specifies that for cases where the van is shared for part of the tax year, the deduction relates to the period(s) when it is not shared.

619. *Subsection (5)* extends the section to private use of a van by a member of the employee's family or household.

Section 160: Value of shared availability

620. This section introduces the two methods of calculating the value of shared availability, the second of which has to be claimed by the employee. This section is new.

Section 161: Value of shared availability: normal calculation

621. This section gives the normal rule used to calculate the value of the shared availability of one or more vans. The section derives from paragraphs 5(1), (4) and (5), 7 and part of paragraph 9(1) of Schedule 6A to ICTA.

622. *Subsection (1)* sets out the steps involved in the calculation using a method statement. This is the calculation that applies if the employee does not claim the alternative calculation under section 164 of this Act.

623. The words in parentheses in *Step 1* make it clear that "made available by the same employer" means made available to any of the participating employees, whether or not including the one whose liability is being calculated.

624. The second sentence at the end of *Step 2* states explicitly what was formerly implicit. See item B of *Note 17* in Annex 2.

625. *Subsection (2)* focuses primarily on the employee whose tax liability is being calculated, rather than on all the shared vans and all the participating employees in relation to those vans. See item A of *Note 17* in Annex 2.

Section 162: Shared van: meaning of "participating employee"

626. This section defines the term "participating employee", which is used in section 161. The section derives from paragraph 5(2) and (3) of Schedule 6A to ICTA.

627. *Subsection (1)* applies when only one van is involved.

628. *Subsection (2)* applies when more than one van is involved.

629. *Subsection (3)(a)* and *(b)* extends the section to private use of a van by a member of the employee's family or household.

Section 163: Shared van: basic value

630. This section provides for the calculation of the basic value of a shared van. The section derives from paragraph 6(1), (2), (3) and (4) of Schedule 6A to ICTA.

631. *Subsection (1)* sets out the steps involved in the calculation using a method statement. The value that is calculated is applied at *Step 4* of section 161 of this Act.

632. In subsection (1) the formula at *Step 3* provides for adjustments to the basic value for periods when the van was not a shared van and for any period of 30 days or more when it was incapable of use. The formula uses "Y" for the number of days in the year instead of "365" in the source legislation. This is the same change in principle as that described in paragraph 594. See item A of *Change 28* in Annex 1.

633. *Subsections (2)* and *(3)* identify the days that must be excluded at *Step 3.*

Section 164: Value of shared availability: alternative calculation

634. This section provides for an alternative way to calculate the value of the shared availability of a van. The section derives from paragraph 8(2), (3) and (4) and parts of paragraph 8(1) and 9(1) of Schedule 6A to ICTA. Paragraph 8(1)(a) of Schedule 6A to ICTA has not been rewritten, as it is no longer necessary.

635. *Subsection (1)* applies the section only when an employee makes a claim for it to apply instead of section 161 of this Act (value of shared availability: normal calculation).

636. *Subsection (2)* sets out the steps involved in the calculation using a method statement. *Step 1 (b)* excludes vans other than vans made available to the employee and the employee's family or household. That is because subsection (3)(b) defines relevant days, an essential part of the calculation, by reference only to vans made use of privately by the employee or a member of the employee's family or household.

637. *Subsection (3)* identifies the days that must be counted in the formula at *Step 3* of subsection (2).

638. *Subsection (4)* provides that a claim under this section is treated under section 95 of TMA 1970 as a claim for relief. Section 42 of TMA 1970 applies to this claim.

Section 165: Deduction for payments for private use

639. This section provides for an adjustment to the value of the shared van availability to take account of payments the employee makes for the private use of a shared van. The section derives from paragraph 9(2) and (3) and part of paragraph 9(1) of Schedule 6A to ICTA.

640. *Subsection (1)* provides that a deduction is to be made in the calculations in section 161 or section 164 of this Act if the employee is required to pay, and does pay, for private use. The words "(whether by way of deduction from earnings or otherwise)" avoid any doubt about whether a deduction from earnings can amount to a payment. This follows the approach that is used in sections 144(1)(a) and 159(1)(a) of this Act.

641. *Subsections (2)* to *(4)* state how to calculate the deduction. The wording of these subsections closely follows that of the source legislation. The possible argument that subsection (4) operates to prevent any deduction at all where a global sum is paid for private use of any of the vans was considered. Such a restrictive interpretation would be unreasonable. It is better not to complicate further these already complex provisions by seeking to address this subtle point. It can be dealt with using the "care and management" provisions in section 1 of TMA 1970.

642. *Subsection (5)* extends the section to private use by a member of the employee's family or household.

Section 166: Vans: limit of cash equivalent

643. This section sets a maximum cash equivalent on an employee's van benefit for a tax year, in particular circumstances. The section derives from paragraph 11 of Schedule 6A to ICTA.

644. The limit applies only if no more than one van is available, for private use, to the employee or the employee's family or household at any one time in the tax year.

Section 167: Pooled cars

645. This section determines how pooled cars are treated under the benefits provisions. The section derives from section 159(1), (2) and (3) of ICTA.

646. *Subsection (1)* applies the provisions to a car that is a pooled car.

647. *Subsection (2)* treats pooled cars as not having been available for private use of any of the employees concerned. It also prevents them from being treated as an employment-related benefit for the purposes of Chapter 10 of Part 3 of this Act. See *Note 18* in Annex 2.

648. *Subsection (3)* sets out the conditions for a car to be treated as a pooled car.

649. *Subsection (3)(b)* uses the term "the employee's employment". Generally use of that term has been avoided but here it helps clarity.

Section 168: Pooled vans

650. This section determines how pooled vans are treated under the benefits provisions. This section works in relation to vans as section 167 works in relation to cars. This section derives from section 159AB of ICTA.

651. *Subsection (1)* applies the provisions to a van that is a pooled van.

652. *Subsection (2)* treats pooled vans as not having been available for private use of any of the employees concerned. It also prevents them from being treated as an employment-related benefit for the purposes of Chapter 10 of Part 3 of this Act. See *Note 18* in Annex 2.

653. *Subsection (3)* sets out the conditions for a van to be treated as a pooled van.

654. *Subsection (3)(b)* uses the term "the employee's employment". Generally use of that term has been avoided but here it helps clarity.

Section 169: Car available to more than one member of family or household employed by same employer

655. This section removes a car or car fuel benefit charge on an employee who would otherwise be taxed on the car benefits relating to a member of his or her family

or household. The section derives from paragraphs 1 and 2 of ESC A71. See items A and D of *Change 27* in Annex 1.

656. *Subsection (1)* states the circumstances in which the section can apply.

657. *Subsection (2)* removes the tax charge on the employee in two specified cases.

658. *Subsection (2)(a)* specifies the first case, which is when the family or household member is chargeable on the benefit in his or her own right.

659. *Subsections (2)(b)*, *(3)* and *(4)* specify the second case, which is when the family or household member is not chargeable on the benefit in his or her own right and the car is provided for reasons that do not arise out of the family or household relationship.

Section 170: Orders etc. relating to this Chapter

660. This section provides the Treasury with powers to make regulations affecting the legislation in this Chapter. It brings together various provisions from various individual sections dealing with different aspects of car and van benefit charges in the source legislation. The section derives from sections 158(4), 168C(5), 168D(6), 168F(11) and 168G(2) of ICTA and from paragraphs 4(2) and 5E of Schedule 6 to ICTA.

661. The wording of *subsection (2)* has not been aligned with *subsection (6)*. The section accurately reproduces the legislation from which it derives and further internal alignment could, in certain cases, work against the taxpayer's interests, as for example in section 132(3)(b) and section 147(1)(b) of this Act.

Section 171: Minor definitions: general

662. This section gives definitions of terms that are used widely in this Chapter. The section derives from parts of sections 168(5) and (5A), 168A(9), 168AA(3), and 168AB(3) of ICTA and from paragraphs 5A(5), 5B and 5D(3) of Schedule 6 to ICTA.

Section 172: Minor definitions: equipment to enable a disabled person to use a car

663. This section brings together the definitions that relate specifically to a car available for use by a disabled person. The section derives from section 168AA(1) and (2) of ICTA.

Chapter 7: Taxable Benefits: Loans

Overview

664. This Chapter deals with the benefits that may arise from loans obtained by reason of an employee's employment. These benefits may be due to a low rate of interest charged on the loan, or the writing off of a loan. The cash equivalent of the benefit of a loan is treated as earnings of the employee's employment.

Section 173: Loans to which this Chapter applies

665. This section describes the loans to which the Chapter applies. It derives from section 160 of ICTA.

666. *Subsection (1)* applies this Chapter to loans if they are employment-related.

667. *Subsection (2)* defines "loan" and sets out what is meant by making a loan.

668. *Subsection (3)* is a reminder that sections 288 and 289 of this Act (limited exemption for certain bridging loans connected with employment moves) may mitigate the charge under these provisions.

Section 174: Employment-related loans

669. This section sets out the basis on which a loan comes within the provisions of this Chapter. It derives from sections 160 and 161 of and paragraphs 1 and 2 of Schedule 7 to ICTA.

670. *Subsection (1)* describes loans which are employment-related. The fact that the loan is made to "an employee or a relative of an employee" indicates that at the time the loan is made there must be an employment.

671. *Subsection (2)* defines "employment-related loans" and the working of this subsection is illustrated by the flow diagram on page 76.

672. *Subsection (3)* provides that if a loan is made to an employee in anticipation of the employment commencing it is an employment-related loan, provided the employment is taken up. It derives from paragraph 2 of Schedule 7 to ICTA.

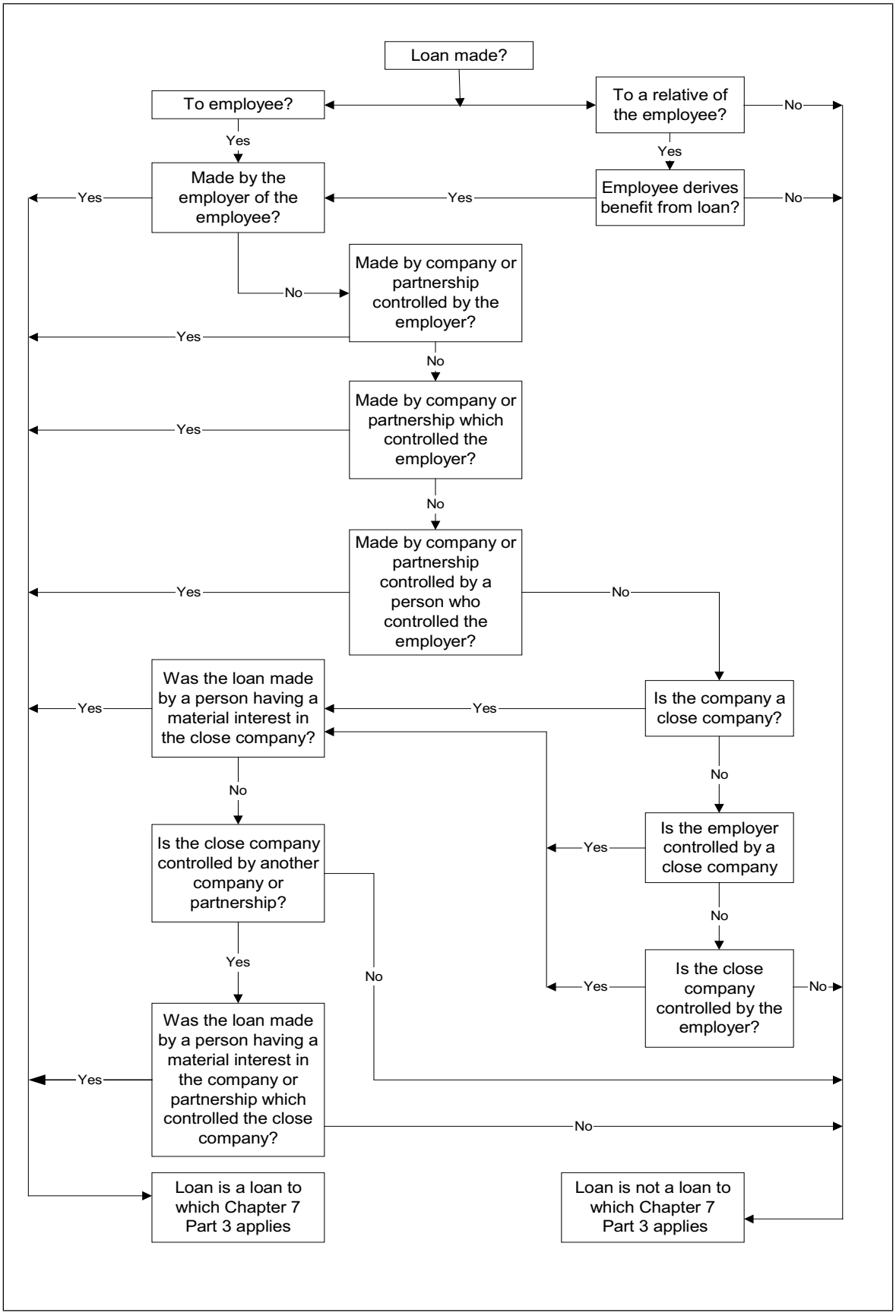
673. *Subsection (4)* provides that loans made by a person who was not the original lender or who facilitates the continuation of an existing loan fall within the section.

674. *Subsection (5)* excludes from the charge certain loans of a personal or domestic nature.

675. *Subsection (6)* defines what is meant by a "relative" for the purposes of the section.

Section 175: Benefit of taxable cheap loan treated as earnings

676. This section brings within the charge to tax the benefit arising on certain employment-related loans (each of which is referred to as a "taxable cheap loan") on which no interest is paid or interest is paid at a low rate.


Loan made?
To employee?
To a relative of the employee?
No
Yes
Yes
Made by the employer of the employee?
Yes
Yes
Employee derives benefit from loan?
No
No
Made by company or partnership controlled by the employer?
Yes
No
Made by company or partnership which controlled the employer?
Yes
No
Made by company or partnership controlled by a person who controlled the employer?
Yes
No
Was the loan made by a person having a material interest in the close company?
Yes
Yes
Is the company a close company?
No
Is the close company controlled by another company or partnership?
Yes
Is the employer controlled by a close company
No
Yes
No
Is the close company controlled by the employer?
Yes
No
Was the loan made by a person having a material interest in the company or partnership which controlled the close company?
Yes
No
Loan is a loan to which Chapter 7 Part 3 applies
Loan is not a loan to which Chapter 7 Part 3 applies

677. *Subsections (1)* and *(2)* provide that the cash equivalent of the benefit of a taxable cheap loan is treated as earnings from an employment. They also describe the circumstances in which an employment-related loan is a "taxable cheap loan". They derive from section 160(1) of ICTA. Subsection (1) sets out for which year the cash equivalent is to be treated as earnings. See *Note 7* in Annex 2.

678. *Subsection (3)* gives the broad rule for computing the cash equivalent of the benefit. *Subsection (4)* provides that in considering whether a loan falls within this Chapter it must be looked at separately from any other loan. They derive from section 160(4) and paragraph 3(1) of Schedule 7 to ICTA.

679. *Subsection (5)* is a signpost to section 180 of this Act (threshold for benefit of loan to be treated as earnings) which sets out the £5,000 threshold and to section 186 of this Act (replacement loans) which makes an exception to subsection (4).

Section 176: Exception for loans on ordinary commercial terms

680. This section deals with employers whose business includes the lending of money by preventing loans made on ordinary commercial terms from being taxable cheap loans. It derives from section 161B of, and Schedule 7A to, ICTA.

681. *Subsection (1)* provides that a loan on commercial terms is not a taxable cheap loan.

682. S*ubsection (2)* provides a definition of "loan on ordinary commercial terms" which includes three conditions.

683. *Subsections (3)* to *(7)* set out those conditions and define terms used in them.

684. *Subsection (8)* provides that certain incidental expenses are to be ignored in determining, for the three conditions in subsection (2), whether loans are made or exercisable on the same terms or conditions.

685. *Subsection (9)* requires that certain amounts arising from variation of a loan are ignored for the purposes of ascertaining, for the second and third conditions, whether loans are held or exercised on the same terms.

686. *Subsection (10)* defines "member of the public" for the purposes of this section.

Section 177: Exceptions for loans at fixed rate of interest

687. This section exempts certain types of fixed interest loan. It derives from section 161(2) and (3) of ICTA.

688. *Subsection (1)* applies to loans made on or after 6 April 1978 at fixed rates for fixed periods. It applies when there is an increase in the official rate of interest for a

year subsequent to that in which the loan was made. When that happens a calculation under section 182 or section 183 of this Act might show that the interest paid on the loan was less than what would have been paid if the official rate of interest had applied to the loan. In such a case, provided nothing other than the official rate of interest has changed, and provided the condition in subsection (2) is met, the loan is not to be regarded as a taxable cheap loan.

689. *Subsection (2)* provides as a condition for subsection (1) that the interest paid on the loan for the year in which it was made was not less than what would have been paid at the official rate for that year.

690. *Subsection (3)* exempts fixed rate loans from being taxable cheap loans if they were made before 6 April 1978, when there was no official rate of interest, and the condition in subsection (4) applies.

691. *Subsection (4)* sets out the condition for subsection (3), that the interest should be at an arm's length rate when the loan was made.

692. *Subsection (5)* defines "fixed rate loan".

Section 178: Exceptions for loans where interest qualifies for tax relief
693. This section provides that loans which would qualify for tax relief in a tax year if interest were paid on them are not taxable cheap loans for that year. *Paragraphs (a)* to *(d)* set out the types of interest. It derives from section 161A(2) of ICTA.

Section 179: Exception for certain advances for necessary expenses
694. This section provides that, where certain conditions are met, small temporary advances of expenses by an employer to an employee for necessary expenditure are not taxable cheap loans. It derives from Inland Revenue Statement of Practice 7/79. It is a minor change to law. See *Change 29* in Annex 1.

695. *Subsection (1)* provides that advances by an employer to an employee for necessary or incidental overnight expenses are not taxable cheap loans where certain conditions are met. S*ubsection (2)* sets out those conditions.

696. *Subsections (3)* and *(4)* provide that the limits for two of the conditions can be extended.

697. *Subsections (5)* to *(7)* define terms used.

Section 180: Threshold for benefit of loan to be treated as earnings
698. This section prevents a tax charge on small amounts by providing a £5,000 threshold which applies in two circumstances. It derives from sections 161 and 161A(1) of ICTA.

699. *Subsection (1)* sets out the circumstances in which the cash equivalent is not treated as earnings.

700. *Subsection (2)* provides that all taxable cheap loans are aggregated to find whether the normal £5,000 threshold is exceeded for the purposes of subsection (1)(a).

701. *Subsection (3)* describes how the alternative threshold in subsection (1)(b) is calculated. This applies when the loan is a non-qualifying loan and total taxable cheap loans exceed the threshold. If qualifying loans are deducted and the total is then less than £5,000 the cash equivalent of the non-qualifying loans is not treated as earnings. That reflects the Inland Revenue practice of ignoring excepted loans and is a minor change to the law. See *Change 30* in Annex 1.

702. *Subsections (4)* and *(5)* define "non-qualifying loan" and "qualifying loan".

Section 181: The official rate of interest

703. This section provides for the setting of the official rate of interest under section 178 of FA 1989 and allows special rates to be used for foreign currency loans. It derives from section 160(5) of ICTA.

704. *Subsection (1)* defines "the official rate of interest".

705. *Subsection (2)* allows regulations made under section 178 of FA 1989 to specify a different official rate in the case of loans in another currency. "Normally lives" and "has lived at some time" are not defined in section 160(5) of ICTA. They therefore take their normal meaning. SE 26105 in the Inland Revenue Schedule E Manual provides guidance on this.

706. *Subsection (3)* provides that the power given under subsection (2) does not affect the general power under section 178 of FA 1989 to make different provisions.

Section 182: Normal method of calculation: averaging

707. This section sets out the normal method for calculating the amount of interest that would be payable at the "official rate for a tax year" by the averaging method. It derives from paragraph 4(1) of Schedule 7 to ICTA.

708. This method of calculation does not explicitly apply in deciding whether a loan is within sections 160(1) or 161(2) of ICTA, although it is applied for those purposes in practice. Stating that the methods of calculation are used for all purposes of this Chapter legislates that practice. This is a minor change to the law. See *Change 31* in Annex 1.

709. A method statement sets out how to do the calculation, which applies the average official rate for the period to the average amount outstanding to arrive at the notional interest for that period.

Section 183: Alternative method of calculation

710. This section allows the use of a more precise method of calculating the interest at the official rate on a loan than the method given in section 182. It derives from paragraphs 5 and 5A of Schedule 7 to ICTA.

711. *Subsection (1)* allows either the Inland Revenue or the employee to choose this method of calculation. This is for the purposes of the Chapter and is not confined to the calculation of the cash equivalent. See *Change 31* in Annex 1. For the reference to the Inland Revenue see *Change 158* in Annex 1.

712. *Subsection (2)* sets out the time limit for making the election. This is different from the way the limit is expressed in paragraph 5(2) of Schedule 7 to ICTA which provides that the election must be made "before" the end of the period of 12 months beginning with 31 January following the end of the tax year. This subsection allows it to be made "on or before" that date. This is a minor change to the law. See *Change 32* in Annex 1.

713. *Subsection (3)* shows the calculation as a method statement. This arrives at the precise amount of interest on a day-to-day basis using the exact amount of the loan outstanding for each day. In paragraph 5(3)(c) of Schedule 7 to ICTA the total is divided by 365 days. As in a leap year the daily total would be based on 366 days, this subsection divides the total by the number of days in the tax year. This is a minor change to the law. See *Change 28* in Annex 1.

714. *Subsection (4)* requires that the alternative method should apply in certain circumstances where the cash equivalent of the benefit on the same loan is treated as the earnings of two or more employees.

Section 184: Interest treated as paid

715. This section treats the cash equivalent of an employment-related loan as if it were interest paid so that tax relief can be given where the loan is for a qualifying purpose. It derives from parts of section 160(1) and section 160(1A) of ICTA.

716. *Subsection (1)* sets out the circumstances in which the section applies.

717. *Subsection (2)* treats the employee as having paid interest equal to the cash equivalent of the benefit.

718. *Subsection (3)* prevents a claim that the interest should be treated as paid and so qualify as a deduction from the amounts treated as earnings by another chapter of the benefits code.

719. *Subsection (4)* provides the mechanism for allocating to a tax year the cash equivalent to be treated as interest.

720. *Subsection (5)* makes it clear that, although the cash equivalent is treated as if it were interest paid by the employee, it is not treated as interest received by the lender.

Section 185: Apportionment of cash equivalent in case of joint loan etc.

721. This section allows the apportionment of the cash equivalent of a loan between two or more employees who are chargeable under this Chapter in respect of the same loan. It derives from paragraph 5A(1) of Schedule 7 to ICTA.

Section 186: Replacement loans

722. This section prevents manipulation of the averaging method in section 182 of this Act where a loan which is later replaced is repaid part way through the month. So that complete months are included in the calculation the section treats the replacement loan as the original loan. It derives from paragraph 4(2) to (4) of Schedule 7 to ICTA.

723. *Subsection (1)* sets out the circumstances in which the provisions apply and deals with both the replacement by a further employment-related loan and the insertion of a loan which is not employment-related between two that are.

724. *Subsection (2)* treats all loans falling within subsection (1) as if they were one continuous loan.

725. *Subsection (3)* follows the practice of applying the treatment of one continuous loan not just to the calculation of the official rate of interest which would be paid for the year but also to any interest paid on the loans for the purpose of calculating the cash equivalent. This is a minor change to the law. See *Change 33* in Annex 1.

726. *Subsection (4)* defines "further employment-related loan".

Section 187: Aggregation of loans by close company to director

727. This section provides for the aggregation of certain loans on an election where the borrower is a director of a close company which is the lender. It derives from section 160(1B) and (1BA) of ICTA.

728. *Subsection (1)* sets out the circumstances when the section applies.

729. *Subsection (2)* allows the lender to elect for aggregation for a tax year to apply to the borrower.

730. *Subsection (3)* explains the effect of the election.

731. *Subsection (4)* places a restriction on which loans may be aggregated.

732. *Subsection (5)* says by whom and how and within what time limit the election may be made. See *Change 158* in Annex 1 regarding the reference to "the Inland Revenue".

Section 188: Loan released or written off: amount treated as earnings

733. This section treats employment-related loans which are released or written off as earnings. It derives from section 160 of ICTA.

734. *Subsection (1)* applies in the case of a continuing employment and treats the amounts written off as earnings for the year in which the loan is released or written off. It derives from section 160(2) but that section does not specify the tax year. See *Note 7* in Annex 2.

735. *Subsection (2)* applies subsection (1) where an employment-related loan is released or written off after the employment has ceased or at a time when the employee is lower-paid in accordance with Chapter 11 of Part 3 of this Act. If the employment has ceased there is no taxable employment and the section would not apply. Deeming that the employment has not ceased allows the section to apply in the case of a release or writing off for the year in which the event occurs. It is also necessary for the employment to be one which is not an "excluded employment"; otherwise the section would not apply. Where the employment has become an "excluded employment" this subsection deems it not to be "excluded". This derives from section 160(3) of ICTA.

736. *Subsection (3)* preserves chargeability where subsection (2) applies and a loan replaces the employment-related loan. It derives from section 160(3A) of ICTA.

Section 189: Exception where double charge

737. This section ensures that where the release or writing off of a loan might be chargeable to tax under other provisions there is only one charge to tax. It derives from section 161(5) of ICTA.

738. *Subsection (1)* provides the general rule that if another provision in the Income Tax Acts applies this section does not.

739. This clarifies the position that there will be no double charge if a loan made to a participator in a close company is written off and section 421 of ICTA applies. It is a minor change to the law. See *Change 34* in Annex 1.

740. *Subsections (2)* and (3) provide exceptions to subsection (1). In both cases it is made explicit which provision takes precedence when there is a possible double charge. This change in approach is described more fully in *Note 19* in Annex 2.

Section 190: Exclusion of charge after death of employee

741. This section provides a general exemption from the provisions of the Chapter if the employee dies. It derives from section 161 of ICTA.

742. *Subsection (1)* removes the charge on a taxable cheap loan for the period from the date of death where the employee has died but the loan is not repaid. It provides that the loan is treated as no longer outstanding as from the date of death for the

purposes of calculating the cash equivalent. This change in approach is described more fully in *Note 20* in Annex 2.

743. *Subsection (2)* removes the charge if the loan is released or written off on or after the death of the employee.

Section 191: Claim for relief to take account of event after assessment

744. This section allows adjustments to the figures in cases where subsequent events affect the amount chargeable. It derives in part from section 160(4A) of ICTA.

745. *Subsection (1)* introduces the claim.

746. *Subsection (2)* allows for the fact that interest may be paid after the tax liability for the year has been determined.

747. *Subsection (3)* allows for repayment of a loan that has been released or written off. Allowing a claim for a loan that has been released or written off is a minor change to the law. See *Change 35* in Annex 1.

748. *Subsection (4)* provides for the situation where tax payable has been decided on the basis that the condition in section 288(1)(b) of this Act in respect of bridging loans will not be met and that condition is in fact met. It derives from section 191B(13) of ICTA.

749. *Subsection (5)* allows the adjustment to be made.

Chapter 8: Taxable benefits: notional loans in respect of acquisitions of shares

Overview

750. This Chapter deals with a benefit which may arise on certain acquisitions of shares by employees. It derives from those parts of section 162 of ICTA which deal with acquisition of shares at undervalue. The legislation is included in the benefits code because the benefit is treated as a notional loan and, as such, some of the provisions in Chapter 7 of Part 3 apply to it.

Section 192: Application of this Chapter

751. This section sets out the subject of the legislation. It derives from section 162(1) and (9) and section 168(3)(b) of ICTA and also contains new material.

752. *Subsection (1)* describes the circumstances relating to an acquisition of shares which will bring it within the provisions of this Chapter.

753. *Subsection (2)* makes it clear that the shares can be in a company other than the employer.

754. *Subsection (3)*. It derives from section 168(3)(b) of ICTA. It is now explicit that a right or opportunity to acquire shares, or an interest in shares, which is made

available by an employer, is to be regarded – with certain exceptions – as being made available by reason of the employee's employment. This change in approach is described more fully in *Note 21* in Annex 2.

755. *Subsection (4)* defines the term "the acquisition" and gives shares acquired the label "employment-related shares".

Section 193: Notional loan where acquisition for less than market value

756. This section is derived from parts of section 162(1), (2) and (9) of ICTA and contains new drafting material.

757. *Subsection (1)* outlines the circumstances in which a benefit arises. It also provides that payments made before the acquisition will be allowable. This is a minor change to the law. See *Change 36* in Annex 1.

758. *Subsection (1)(a)* applies the section to employment-related shares for which no payment is made.

759. *Subsection (1)(b)* covers the situation in which some payment is made. The subsection prevents shares which are not fully paid at the time of issue (but which later become fully paid) from being valued as part-paid shares.

760. *Subsection (3)* provides that the benefit is treated, under Chapter 7 of Part 3, as an employment-related loan on which no interest is payable.

761. *Subsection (4)* lists the provisions in Chapter 7 of Part 3 which apply to the notional loan. This is a minor change to the law. See *Change 37* in Annex 1.

762. The provisions listed include section 175 of this Act, which specifies the tax year for which the cash equivalent is treated as earnings. See *Note 7* in Annex 2.

763. *Subsection (5)* lists the provisions of the Act which may exempt a person from liability to tax under this section.

Section 194: The amount of the notional loan

764. This section shows how the initial amount of the loan is calculated, and how the amount is reduced or subsequently varied in certain circumstances. It is derived from section 162(2), (3), (9) and (11) and section 185(8) of ICTA and includes new drafting material. See *Note 22* in Annex 2.

765. The amount of the notional loan is used in the calculation of the cash equivalent of the benefit in accordance with section 182 or section 183 of this Act.

766. *Subsection (1)* sets out how to arrive at the initial amount of the loan. The value taken is that of fully paid up shares. The value is reduced by any "deductible amounts".

767. *Subsection (2)* sets out what are the deductible amounts. *Paragraph (a)* allows the payment made for the acquisition as a "deductible amount". A payment may be made before the shares are acquired and it has always been the practice to allow any advance payment of this sort as well as any payment made at the actual time of the acquisition. The words "or before" have been added to make this clear. This is a minor change to the law. See *Change 36* in Annex 1.

768. *Paragraphs (b)*, *(c)(i)* and *(c)(ii)* of s*ubsection (2)* derive from the words "so much of the undervalue on acquisition as is not chargeable to tax as an emolument of the employee" in section 162(3) of ICTA. This change in approach is explained in *Note 22* in Annex 2.

769. *Paragraph (c)(iii)* of *subsection (2)* provides that an amount that counts as employment income under sections 476 or 477 of this Act is a deductible amount. This is a minor change to the law. See *Change 38* in Annex 1.

770. *Subsection (3)* provides for the amount of the notional loan to be reduced where payments are made for the shares after the time they are acquired. The reduced amount is used in the calculation of the benefit in sections 182 or 183 of this Act, which entail ascertaining the maximum amount of the loan outstanding on a particular day.

Section 195: Discharge of notional loan: amount treated as earnings

771. This section covers the circumstances in which a notional loan is treated as discharged and the consequences of that treatment. It is derived from section 162(3), (4) and (5) of ICTA and contains new drafting material.

772. *Subsection (1)* sets out circumstances in which the notional loan is treated as discharged. The words "is released, transferred or adjusted" in section 162(4)(b) of ICTA have been left out on the grounds that they are unnecessary. There is no other way that the obligation could cease to bind the employee. The words "by surrender or otherwise" in section 162(4)(c) of ICTA have not been used in *paragraph (c)* because they are unnecessary.

773. *Subsection (2)* provides that the amount of a notional loan discharged in the circumstances described in subsection (1)(b) and (c) is treated as earnings.

774. *Subsection (3)* ensures that the amount in subsection (2) can be chargeable in a tax year after the year in which the employment has ended or has become an excluded employment as defined in section 63(4) of this Act. This derives from section 160(3) of ICTA, which is applied to the termination of a notional loan by section 162(5) of ICTA. If the employment has ceased there is no taxable employment and the section would not apply. Deeming the employment not to have ceased allows the section to apply in the case of the discharge of a notional loan for the year in which the event as a result of which it is discharged occurs. It is also necessary for the employment to be one which is not an "excluded employment" otherwise the section

would not apply. Where the employment has become an "excluded employment" this subsection deems it not to be "excluded".

Section 196: Effects on other income tax charges

775. This section derives from section 162(11) of ICTA which operates to give priority to any section by virtue of which an acquisition of shares results in an amount being chargeable to tax as emoluments.

776. *Paragraph (b)* of this section refers to sections 476 and 477 of this Act, which are derived from section 135 of ICTA. This is a minor change to the law. See *Change 38* in Annex 1.

Section 197: Minor definitions

777. This section defines terms which are used in the sections and clarifies what counts as payment for shares.

778. The section is derived from section 162(1), (9) and (10) of ICTA and contains new drafting material.

779. *Subsection (2)* makes the meaning of "acquisition" very wide to discourage schemes intended to avoid chargeability under this Chapter. The meaning of "market value" is as in Part 8 of TCGA 1992.The wording of the definition has been changed to bring it into line with definitions of market value used elsewhere in this Act. See *Note 23* in Annex 2.

780. *Subsection (3)* ensures that payment for shares made in kind or by any other means is included and that legal liability to make it is not needed for it to count as a payment.

Chapter 9: Taxable benefits: disposals of shares for more than market value

Overview

781. This Chapter deals with the benefits which may arise from certain disposals of shares. It derives from those parts of section 162 of ICTA which deal with the disposal of shares at a price greater than their market value.

Section 198: Shares to which this Chapter applies

782. This section sets out the subject of the legislation. It derives from parts of sections 162(1), (6) and (9) and 168(3) of ICTA.

783. *Subsection (1)* describes the circumstances which bring shares within the provisions of this Chapter.

784. *Subsection (2)* labels the shares "employment-related shares".

785. *Subsection (3)* makes it clear that the employment-related shares can be in a company other than the employer. It derives from section 162(1)(a).

786. *Subsection (4)* applies to determine, in a similar way to the "provision" of other benefits, whether the right or opportunity to acquire shares made available by the employer is "by reason of the employment". This change in approach is explained more fully in *Note 21* in Annex 2. It derives from section 168(3)(b).

Section 199: Disposal for more than market value: amount treated as earnings

787. This section sets out the circumstances in which a benefit arises and how it is to be chargeable to tax. It derives from parts of section 162(6), (7), (8), and (9) of ICTA.

788. *Subsection (1)* applies the provisions of the section in the case of a disposal of the employment-related shares. The words in section 162(6)(a) of ICTA "by surrender or otherwise" have not been used as they are unnecessary.

789. *Subsection (2)* derives from section 162(8) of ICTA. It prevents chargeability when the disposal takes place after the death of the employee. In rewriting this the words "whether by his personal representatives or otherwise" have been left out. These words do not add anything and are unnecessary.

790. *Subsection (3)* provides a formula to arrive at the amount to be treated as earnings. If any part of that amount is earnings by virtue of section 62 of this Act any possible double charge is prevented by section 64(1) and (2) of this Act.

791. *Subsection (4)* derives partly from section 162(7) of ICTA. The references to the employment becoming excluded employment are new. *Note 24* in Annex 2 explains why they are necessary.

792. *Subsection (5)* explains how to arrive at the market value of an interest in shares.

Section 200: Minor definitions

793. This section defines various terms used in this Chapter. It derives from section 162(1), (9) and (10) of ICTA.

794. The meaning of "market value" is defined. The wording of the definition has been changed to bring it into line with definitions of market value used elsewhere in this Act. See Note 23 in Annex 2.

Chapter 10: Taxable benefits: residual liability to charge

Overview

795. This Chapter derives from the provisions of sections 154 and 156 of ICTA, but has a very different structure. The structure of the benefits code is outlined in the overview of Chapter 2 Part 3 of this Act.

796. Sections 201 and 202 together identify the benefits which are within this Chapter.

797. Section 203 provides that the cash equivalent of the benefit is treated as earnings and gives details of how to calculate its amount.

798. Sections 204, 205 and 206 indicate how to calculate the cash equivalent for each different way of providing an employment-related benefit.

799. Sections 207, 208, 209 and 210 are the supplementary provisions.

800. Sections 212, 213, 214 and 215 provide that certain scholarships are benefits within this Chapter.

Section 201: Employment-related benefits

801. This section derives from parts of sections 154 and 168(3) of ICTA.

802. *Subsections (1)* and *(2)* derive from section 154(1) of ICTA and introduce the labels "employment-related benefit" and "excluded benefit".

803. *Subsection (3)* derives from section 168(3) of ICTA.

804. *Subsections (4)* and *(5)* make it explicit that if the employment is held at some time in the tax year it is immaterial whether or not the employment is held at the time the benefit is provided. Subsection (4) further clarifies this proposition by stating that references to an employee may therefore include a former or a prospective employee. These provisions derive from and clarify the meaning of the words "where in any year a person is employed" in section 154(1) of ICTA. This change in approach is explained more fully in *Note 14* in Annex 2.

Section 202: Excluded benefits

805. This section derives from section 154(1)(b) and part of section 154(2) of ICTA. It clarifies what is meant by "the cost of the benefit is not (apart from this section) chargeable to tax as his income." Benefits which are within, or specifically excepted from, other chapters of the benefits code are not within this Chapter. This section does not exclude benefits which are earnings within section 62 of this Act. That is not necessary because section 64 of this Act applies to prevent any element of double charge. See *Change 15* in Annex 1. The identification of excluded benefits is explained more fully in *Note 25* in Annex 2. The benefit of certain transport vouchers in section 86 of this Act is not excluded from this Chapter because Chapter 4 of Part 3 provides an exemption only for the lower paid.

Section 203: Cash equivalent of benefit treated as earnings

806. This section establishes that the cash equivalent is to be treated as earnings, and provides guidance on how to work out the cash equivalent.

807. *Subsection (1)* derives from the closing words of section 154(1) of ICTA. It provides that the cash equivalent is the amount treated as earnings. The words "for the

tax year in which it is provided" are not in section 154. This clarification of the timing rule is explained more fully in *Note 7* in Annex 2.

808. *Subsection (2)* derives from section 156(1) of ICTA. It provides the basic rule that the cash equivalent is the cost of provision less amounts made good.

809. *Subsection (3)* derives from section 156(2) to (7) of ICTA and indicates which sections provide the rules for finding the cost of the benefit.

Section 204: Cost of the benefit: basic rule

810. This section derives from section 156(2) of ICTA. The benefits within this Chapter can be provided in different ways. The "cost of the benefit" is the basic amount and this section sets out what that is.

811. The words "(including a proper proportion of any expense relating partly to provision of the benefit and partly to other matters)" provide for apportionment of the cost of the benefit in appropriate circumstances. A case before the Special Commissioners reported recently has made that possibility clear.

Section 205: Cost of the benefit: asset made available without transfer

812. This section, which derives from section 156(5) to (7) and (9)(b) of ICTA, explains how to quantify the cost of the benefit when the ownership of the asset is not transferred to the employee.

813. *Subsection (1)* derives from the opening words of section 156(5) of ICTA. It establishes the circumstances in which the following provisions of this section will apply.

814. *Subsections (2)* to *(5)* derive from section 156(5)(a) and (b) to (7) of ICTA and provide the rules for determining the cost of the benefit.

Section 206: Cost of the benefit: transfer of used or depreciated asset

815. This section derives from section 156(3), (4) and (9)(b) of ICTA. Under the normal rules for determining the cash equivalent for the purposes of this Chapter, the cost of the asset would be used. This section provides that market value at the time of transfer may be used instead of cost.

816. *Subsections (1)* and *(2)* provide for the alternative of market value to be used. They derive from section 156(3) and the opening words of section 156(4).

817. *Subsections (3)* to *(5)* derive from section 156(4) and (9)(b). As the relief provided by subsections (1) and (2) of this section could be abused by providing an asset for use and subsequently transferring it when the market value was very small, the relief is limited. This provision applies only to assets within section 205. In the case of an asset provided before this Act comes into force the transitional provision in paragraph 32 of Schedule 7 to this Act will apply.

818. *Subsection (5)* is derived from section 156(4)(a) and (b).

Section 207: Meaning of "annual rental value"

819. This section defines "annual rental value" for the purposes of this Chapter. It does not replace the use of gross rateable value, which will continue. It derives from section 156(6) and section 837 of ICTA which in turn draws on section 23 of the General Rate Act 1967 (although that Act was repealed in 1988).

820. This section does not affect the Inland Revenue practice of using the gross rateable value as a proxy for "annual value". That practice will continue. The main use of this section is to provide guidance on how to arrive at the annual value of properties for which rent is not paid and in practice is only needed in cases where no gross rateable value can be found. It provides the definition of annual rental value for land. Schedule 1 to the Interpretation Act 1978 defines "land" as including "buildings and other structures". Chapter 5 of Part 3 of this Act applies to living accommodation, so this Chapter applies only to accommodation which is not living accommodation.

821. *Subsection (1)* defines "annual rental value". Section 837(1) refers to "rates and taxes" on the premises. This section includes a fuller and more updated description of domestic property charges: "taxes, rates or charges". See *Change 24* in Annex 1.

822. The following subsections set out the adjustments to make in order to arrive at the rent to be used for land. They derive from section 23 of the General Rate Act 1967 which was repealed in 1988. As a consequence of that repeal the reference to that Act in section 837(2) has not been included here. Instead the general thrust of the rules have been rewritten in this section. See *Change 23* in Annex 1.

823. *Subsection (2)* applies in relation to subsection (1). It ensures that the annual value does not include the cost of anything provided which is not provided in the case of unfurnished property. This is important in cases where the only available comparisons are rent of fully furnished and serviced properties. If, in considering what the rent of the property would be, the nearest comparison is rent for a property for which services are provided at an inclusive rent, in order to reduce the rent to that for an unfurnished, non-serviced property the cost of the services provided are deducted. This means that if there is a profit element in the provision of the services it is treated as rent in arriving at the annual value.

824. *Subsections (3)* and *(4)* extend the process of comparison and adjustment. They follow the thrust of section 23(3) and (4) of General Rate Act 1967, which ensured that when a property was valued by looking at comparative rents of similar properties the value was not distorted by the existence (in the comparative case) of separate payments for services in addition to what one might call the basic rent. In particular it added the separate payments to the rental payments and allowed for certain deductions to be made. It did not allow any deduction in computing the value based on a comparative rent for amounts paid in respect of repairs, insurance or

maintenance of other property belonging to or occupied by the landlord. In the case of payments for other types of services only the cost element of them was deducted. These subsections follow that method of comparison and adjustment.

825. *Subsection (5)* has the effect that the services whose cost of provision may be deducted are those which are not normally met by a landlord in the provision of unfurnished property. Again, the wording is not derived directly from section 23 of the General Rate Act 1967 but follows the general thrust of provisions of that section.

Section 208: Meaning of "market value"
826. This section derives from section 168(7) of ICTA and defines market value.

Section 209: Meaning of "persons providing benefit"
827. This section derives from section 154(3) of ICTA and identifies the person providing the benefit.

Section 210: Power to exempt minor benefits
828. This section derives from section 155ZB of ICTA, which allows regulations to be used to introduce minor exemptions from section 154 of ICTA where the benefits in question are generally available to all employees on similar terms. Before FA 2000 introduced this provision all exemptions from a charge under section 154 had to be introduced through a Finance Act.

Special rules for scholarships
Overview
829. This group of sections derives from section 165 of ICTA.

Section 211: Special rules for scholarships: introduction
830. This is mainly an introductory section which explains the layout and provides the meaning of scholarship.

Section 212: Scholarships provided under arrangements entered into by employer or connected person
831. This section extends the circumstances in which a scholarship is a benefit provided by reason of the employment.

832. *Subsection (1)* derives from section 165(2) of ICTA. A scholarship is an employment-related benefit by virtue of section 201 of this Act if it is provided by reason of the employment. That would not be the case if the provision of the scholarship did not fall within the normal meaning of "by reason of the employment" because of the way in which it was provided. This section extends the meaning of "by reason of the employment".

833. *Subsection (2)* derives from the closing words of section 165(2) of ICTA. It prevents claims being made that the scholarship is not within subsection (2)(b) because no cost to the employer or connected person is involved.

834. *Subsection (3)* is a minor change to the law. It is possible that the extended meaning of "by reason of the employment" could result in arrangements made by individuals to provide for the education of members of their family or household being employment-related benefits because of the terms of subsection (1) of this section. An example would be an educational trust set up by a grandparent and the parent of someone who benefited from the trust was an employee in the grandparent's business. See *Change 39* in Annex 1.

835. *Subsection (4)* prevents subsection (1) from disapplying the opening words of section 201(3) of this Act.

Section 213: Exception for certain scholarships under trusts or schemes

836. This section, which derives from section 165(3) of ICTA, provides an exception for certain full-time scholarships. This may apply where the scholar is a member of the employee's family or household but where the scholarship has been awarded on merit and is one which satisfies the conditions of section 331 of ICTA.

837. *Subsection (1)* derives from the opening words of section 165(3) of ICTA.

838. *Subsection (2)* derives from section 165(3)(c). It states one of the conditions which must be met for the exception to apply. That condition is that if the opening words of section 201(3) of this Act were disregarded, or the extension to the usual definition of "by reason of the employment" in section 212 were disregarded, the scholarship would not be an employment-related benefit.

839. *Subsection (3)* derives from section 165(3)(b) and provides the terms to satisfy the condition.

840. *Subsection (4)* derives from section 165(3)(a). The exception can apply only to scholarships provided from a trust fund or scheme.

841. *Subsection (5)* derives from the closing words of section 165(3). It ensures that for the exception to apply only a limited amount of the total amount paid out is on scholarships for members of the household or family of employees. The scholarships included are those provided by reason of any employee's employment. For this purpose subsection (6) explains the meaning of employment.

842. *Subsection (6)* derives from section 165(6)(b). "Employment" for the purposes of condition D has a special meaning. It includes all employments even if the employee is not resident and not ordinarily resident in the United Kingdom and performs the duties of the employment outside the United Kingdom. It also includes scholarships which are payable by reason of "excluded" employments.

843. *Subsection (7)* provides definitions of terms used in the section.

Section 214: Scholarships: cost of the benefit

844. This section derives from SE 30003 in the Inland Revenue Schedule E Manual. It provides a special rule for determining the cost of the benefit of an employment-related scholarship which is provided from a trust fund. Incorporating this practice is a minor change to the law. See *Change 40* in Annex 1. The application of the normal rule for the cost of the benefit in section 204 of this Act could result in the whole of the amount of capital paid into such a trust fund being taken into account. This section prevents that and provides that the cost of the benefit is to be the total of payments made to the scholar.

Section 215: Limitation of exemption for scholarship income in section 331 of ICTA

845. This section derives from section 165(1) of ICTA. Section 331 of ICTA gives exemption from income tax for scholarship income where the holder of the scholarship is in full-time education. The cases of Wicks v Firth and Johnson v Firth (1982) 56 TC 318 in the House of Lords decided that scholarship income was exempt from all income tax charges if it fulfilled the conditions in section 331. This section prevents section 331 from applying to a scholarship which is an employment-related benefit within section 212 if the scholar is not an employee.

Chapter 11: Taxable benefits: exclusion of lower-paid employments from parts of benefits code

Introduction

846. Most of the provisions that form part of the benefits code derive from Chapter 2 of Part 5 of ICTA. Those provisions do not apply to all Schedule E taxpayers. Until changes introduced by the FA 1989, Chapter 2 was entitled "Supplementary charging provisions applicable to directors and higher-paid employees and office holders". This title reflected the origins of the legislation but the threshold for the application of these provisions certainly had not kept pace with inflation. By 1989 it had become difficult to contend that all the employees within the scope of Chapter 2 were necessarily "higher-paid". Thus, in 1989, the title of the Chapter was changed to "Employees earning £8,500 or more and directors".

847. However, the basic concept of the Chapter remained unchanged. It began from the position that no-one was within the scope of the Chapter and then brought in those employees who met its criteria. But it is now the case that by far the majority of employees do earn over £8,500. The benefits code therefore reverses the basic concept so that the benefits provisions apply to all employees, unless they fall within the class of excluded employees.

848. The purpose of this Chapter is to identify those employees who are not within the scope of certain of the benefits provisions.

849. This change of approach is described in full in *Note 26* in Annex 2.

Section 216: Provisions not applicable to lower-paid employments

850. *Subsection (1)* is the legislative statement of the new approach that is being made in the benefits code, reproducing the effect of section 167(1) of ICTA, although by a different route. The code applies to all employees (including office-holders) except that the provisions specified in subsection (4) do not apply to any employee in lower-paid employment who also meets one of conditions A or B.

851. *Subsection (2)* sets out condition A – that the employee is not a director.

852. *Subsection (3)* sets out condition B which applies to employees who are directors, and is satisfied if

- they have no material interest in the company; and
- either the employment is as a full-time working director; or
- the company is non-profit making or is established for charitable purposes only.

853. These special rules for certain directors in condition B derive from section 167(1) and (5) of ICTA.

854. *Subsection (4)* lists the Chapters that do not apply to the lower-paid. These are the charging provisions that derive from Chapter 2 of Part 5 of ICTA.

855. *Subsection (5)* limits the meaning of "employee" in the Chapters listed in subsection (4) to exclude any employees satisfying the tests in subsection (1). It is new.

856. *Subsection (6)* provides signposts to provisions elsewhere that affect the operation of subsection (1).

Section 217: Meaning of "lower-paid employment"

857. This section defines the concept of "lower-paid employment" that was introduced in the previous section. It introduces the concept of an earnings rate for the employment for the year of less than £8,500.

858. The concept of the "earnings rate" enables Inland Revenue practice as set out in the Schedule E Manual at SE 20101 to SE 20111 to be more easily incorporated in the calculation set out in section 218. By focusing on the "earnings rate" for a particular year it is clear that it is entitlement for the year that is relevant rather than actual receipts. There is no necessary correlation between the amounts included in the calculation of the £8,500 and the amount actually charged to tax in that year. The latter computation is on a receipts basis.

859. This wording makes it clear that there can be only one earnings rate for any employment for any one year. A single tax year cannot be apportioned into separate periods counting as lower-paid and not lower-paid for the same employment.

860. This section derives from section 167(1)(b), as expanded upon by Inland Revenue practice set out in the Schedule E Manual at SE 20110 in particular.

Section 218: Calculation of earnings rate for a tax year

861. *Subsection (1)* of this section contains a method statement that sets out what is taken into account when calculating the annual rate. It derives from section 167(2) of ICTA. Further guidance on the interpretation of the method of calculation is available in the Schedule E Manual at SE 20101 to SE 20111.

862. Paragraph (b) in *Step 1* of the statement makes clear that one must assume, for the purposes of the calculation, that the employment is not lower-paid so that the cash equivalents of any of the benefits specified in section 216(4) are included in the calculation. The cash equivalent of any benefits that are chargeable on the lower-paid are also included in the calculation.

863. *Step 2* adds in any extra amount required under the special rules relating to the provision of a car, set out in full in section 219.

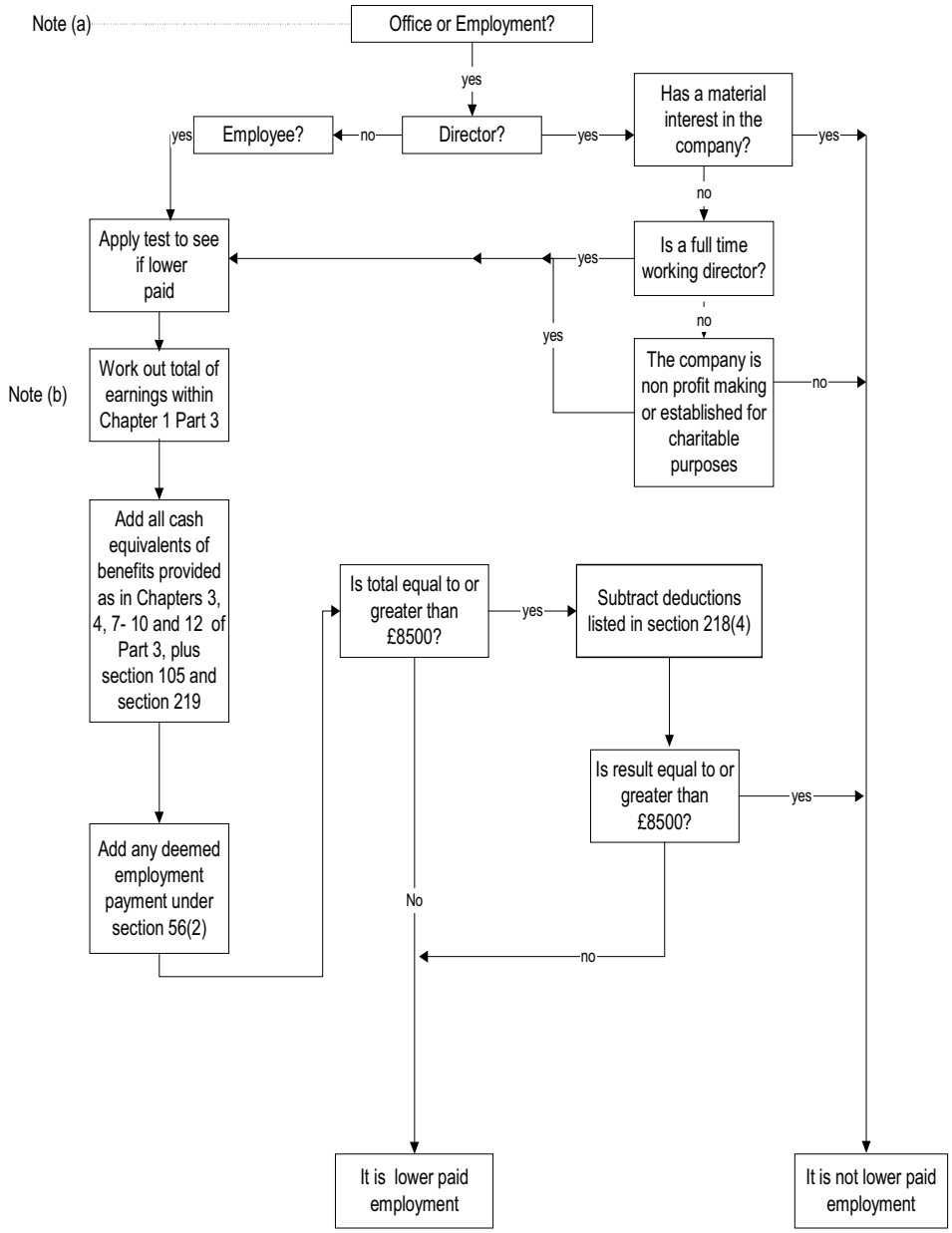
864. *Step 3* subtracts any authorised deductions. It derives from section 167(2)(b), but it seems more sensible to list what deductions may be allowed, rather than just listing prohibited deductions as in section 167(2)(b). In the Schedule E Manual SE 20104 makes clear what deductions can be made in calculating the earnings rate for the year. This change in approach is described in detail in *Note 26* in Annex 2.

865. *Subsection (2)* makes sure that section 216(1) is disregarded for the purposes of Step 1 of the method statement.

866. *Subsection (3)* draws attention to special rules that apply if the benefits in question are the provision of living accommodation.

867. *Subsection (4)* lists the "authorised deductions" that may be subtracted at *Step 3* of the method statement. The list reflects SE 20104 of the Schedule E Manual.

868. There follows a flow diagram that demonstrates the decisions that must be made in the process of determining whether an employment is lower-paid.



Note (a) To identify the office or employment here see section 220 and the explanatory notes on that section.

Note (b) Earnings within Chapter 1 Part 3 comprise money and money's worth see section 62. To see how to arrive at the amount for these purposes see the explanatory notes on section 218.

Section 219: Extra amounts to be added in connection with a car

869. This section sets out the special rules applicable to *Step 2* in section 218 and deals with the treatment of car benefit. It derives from section 167(2)(a), (2B), (2C) and (2D) of ICTA.

870. *Subsection (1)* sets out that the extra amounts are to be added in connection with a car where a car is made available by reason of the employment in the tax year in question.

871. *Subsections (2) to (4)* describe the first type of extra amount to be added. This is the higher of:

- the cash equivalents of the car benefit and of any fuel benefit (calculated in accordance with Chapter 6); and

- where an alternative to the benefit of the car is offered, the amount which might be chargeable to tax under Chapter 1.

872. *Subsections (5) and (6)* set out the second kind of extra amount to be added. These are amounts which would come into charge under Chapters 3 and 4 if it were not for the effect of the exemptions in sections 239 or 269. This derives from the effect of disapplying section 157(3) in section 167(2)(a) and from 167(2D).

873. *Subsection (7)* makes sure that section 216(1) is disregarded for the purposes of computing any extra amounts to be added in connection with a car.

Section 220: Related employments

874. *Subsection (1)* explains that this section applies if a person has two or more related employments.

875. *Subsection (2)* sets out that none of the related employments are lower-paid if when the earnings rates of all related employments are added together they total £8,500 or more, or if any of the related employments would not itself satisfy the conditions in section 216(1).

876. *Subsection (3)* sets out how to determine whether employments are "related". Broadly, where an employee has employments with separate entities that are under common control, the employments are treated as being with the same employer. The result reached by applying this subsection to the facts of a particular case can then be fed into subsection (2).

877. This section derives from section 167(3) and (4).

878. Subsection (3)(b)(ii) reproduces the effect of section 167(4) of ICTA in a neater way. Section 167(4) applies to treat employees of a partnership or body ("A") over which an individual or another partnership or body ("B") has control as if the

employment were with B. If B controls another body ("C"), and one applies section 167(4) to employees of C, they are also treated as if their employment is with B. Thus employees of both A and C (bodies under common control of B) are treated as if their employment is with B. Section 220(3)(b)(ii) reproduces this effect without having to look first at employees of A and then at employees of C separately.

Chapter 12: Payments treated as earnings

Overview

879. This Chapter deals with certain distinct types of payments that are treated as earnings. Thus the chargeable amounts to which these sections give rise constitute "general earnings" within section 7 of this Act.

Section 221: Payments where employee absent because of sickness or disability

880. Sick pay paid to an employee by an employer under the contract of employment will usually be chargeable as earnings under Chapter 1 of Part 3. This section derives from section 149 of ICTA and provides for payments in the nature of sick pay financed by employers through insurance policies and trust funds to be taxed in the same way. If the particular payment already falls within the scope of Chapter 1 of Part 3, this section does not apply.

881. It has to be inferred from section 149(1) of ICTA that a sickness payment is deemed to be earnings for the period of absence. *Subsection (3)* makes the position explicit.

882. *Subsection (4)* derives from section 149(2) of ICTA and ensures that where both the employer and the employees contribute towards the cost of providing sick pay, the benefits paid to employees are taxed only to the extent that the employer finances them.

883. *Subsection (6)* derives from section 149(1) and (3) of ICTA and ensures that payments to the sick employee's family or third parties on behalf of the employee (or his family) are also taxable. The source provision uses the term "family or household". In this section the reference to "household" has been dropped because the term has a different meaning in the benefits code. The range of persons covered is instead included in the definition of a person's family in section 721(4) of this Act. This is a change of approach explained more fully in *Note 27* in Annex 2.

Section 222: Payments by employer on account of tax where deduction not possible

884. This section derives from section 144A of ICTA, which was part of a series of provisions intended to counter difficulties in the application of PAYE where an employee was "paid" in a readily convertible asset eg a gold bar. Many of the provisions made changes to the PAYE vires. Broadly the effect of the changes was to treat the employer as making a payment equal to the amount of income represented by the readily convertible asset. These deemed payments are known as "notional

payments" and the PAYE rules apply to them as they do to straightforward cash payments.

885. This particular section deals with one of the consequences of imposing PAYE on "notional payments". It would not always be possible to "deduct" tax from such "notional payments" and PAYE tax may well be accounted for separately. In order to prevent the employee obtaining a tax advantage it is necessary to adjust the employee's tax liability. If the employee does not reimburse the employer in respect of that liability within 30 days the section imposes an additional liability on the employee receiving the "notional payment". The basic conditions for the section to apply are set out in *subsection (1)*, which derives from section 144A(1) of ICTA. The PAYE provisions in Part 11 of this Act, as referred to in subsection (1)(a), omit those that are not about notional payments or contain only definitions.

886. *Subsection (2)* specifies that the amount of income tax due in respect of the notional payment is treated as earnings from the employment. It therefore reflects the amendment to section 144A(1) of ICTA made by paragraph 4 of Schedule 6 to FA 2002.

887. *Subsection (3)* derives from section 144A(2) of ICTA. The list of provisions referred to here matches those mentioned in subsection (1)(a) and (1)(b).

Section 223: Payments on account of director's tax other than by the director

888. This section derives from section 164 of ICTA and denies a tax advantage to directors where their company pays their fees without deduction of PAYE and the company (or another person) then separately pays the PAYE due. If this were done, the cost to the company would be less than paying the equivalent gross fee subject to deduction of PAYE. The amount assessable on the director would be the amount actually received.

889. The section counters this device by treating the amount paid to the Board of Inland Revenue as earnings of the employment chargeable to income tax. It applies only to payments that fall within section 203 of ICTA. It does not apply to "notional payments" in respect of readily convertible assets that fall within section 222 above. It is the different nature of the respective payments that provides the main borderline between this section and section 222. The reference to "the Board" has been retained here (rather than changing to "the Inland Revenue") so as to be consistent with the provisions dealing with the payment of tax.

890. The section applies only to directors. However the same device in the case of non-directors could fall within the scope of Chapter 10 of Part 3 of this Act (taxable benefits: residual liability to charge).

891. *Subsection (1)* derives from section 164(1) of ICTA and sets out the basic conditions for the section to apply. The source legislation says that the section applies where "the whole of that amount is not so deducted" ("amount" there means the tax

due). This section makes it clear that the provision is not restricted to cases where nothing is deducted, but also applies where not all of the amount is deducted. The fact that section 164 of ICTA applies to partial deductions is clear from the reference in section 164(1) to the amount "so deducted".

892. *Subsections (2)* and *(3)* clarify how the words in section 164(1) of ICTA "where in any year" are interpreted. This change in approach is explained more fully in *Note 14* in Annex 2.

893. *Subsection (4),* which also derives from section 164(1) of ICTA, makes the amount of tax accounted for to the Board of Inland Revenue count as earnings of the director. The year of charge is made explicit. See *Note 7* in Annex 2. The amount charged is subject to possible reduction under subsection (6).

894. *Subsection (5)* derives from the first proposition in section 164(3) of ICTA and provides a timing rule where the tax is accounted for in a year after the employment has ceased.

895. *Subsection (6)* brings together the provisions regarding the amounts to be deducted in arriving at the net taxable amount. Two of the rules derive from the last part of section 164(1) of ICTA and the other rule from the second proposition in section 164(3) of ICTA.

896. *Subsection (7)* derives from section 164(2) of ICTA.

897. *Subsection (8)* derives from section 168 of ICTA. It is necessary to bring the definitions into this section because this provision is not in the benefits code.

Section 224: Payments to non-approved personal pension arrangements

898. This section provides that an employer's payments under non-approved personal pension arrangements made by the employee are treated as earnings. It derives from section 648 of ICTA.

899. It contrasts with section 308 of this Act, which exempts from income tax as earnings an employer's contributions under approved personal pension arrangements made by the employee.

900. *Subsection (1)* sets out that the payments are treated as earnings from the employment. In view of the content of Chapter 2 of Part 2, it is unnecessary to add (as in section 648 of ICTA) that the payments are so treated "for all the purposes of the Income Tax Acts". The year of charge is made explicit. See *Note 7* in Annex 2.

901. *Subsection (2)* provides that the employer's payments are not treated as earnings under this section to the extent they are otherwise chargeable to income tax. For example, if contributions are so made that only a charge by virtue of section 62 of

this Act (earnings) otherwise applies, section 224 will apply to the extent, if any, that section 62 does not apply.

902. Conversely, if a charge would only arise otherwise by virtue of section 203 of this Act (cash equivalent of benefit treated as earnings), but the payments are wholly or partly exempted from that charge by section 307 of this Act (death or retirement benefit provision), a charge under this section will apply on the amount so exempt.

903. *Subsection (3)* provides relevant definitions by cross-reference to section 630(1) of ICTA.

904. The Board of Inland Revenue may approve a personal pension scheme. The provisions for approval of a pension scheme are set out in section 631 of ICTA.

Section 225: Payments for restrictive undertakings

905. This section deals with the situation where a monetary payment is made in return for the giving of a restrictive undertaking. It derives from section 313(1), (2), (3) and (6)(a) of ICTA.

906. The sum described as " … an emolument of the office or employment … " in section 313(1) has become " … earnings from the employment … " in *subsection (3)*. That reflects the general change in terminology in this Act.

907. The section has a timing provision of its own in *subsection (3)*. If there is no employment at the time the payment is made the timing rule in whichever is appropriate of section 17 or 30 of this Act will operate.

908. Section 313(6)(a) restricts the application of section 313 to employments from which the income was or would have been chargeable under Case I or Case II of Schedule E. *Subsections (6)* and *(7)* reproduce that restriction for this and the following section.

Section 226: Valuable consideration given for restrictive undertakings

909. This section brings together the provisions that apply when the payment for the restrictive undertaking is in a non-monetary form. That is more logical and convenient than their present separation. It derives from section 313(4) and (6)(b) of ICTA.

910. The use of two sections emphasises the way the section relating to a non-monetary consideration operates through the preceding one.

Part 4: Employment income: exemptions

Chapter 1: Exemptions: general

Section 227: Scope of Part 4

911. This section introduces Part 4, setting out the effect of the exemptions within it. It is new.

912. *Subsections (2) and (3)* explain that there are two different kinds of exemption. An "earnings-only exemption" is an exemption that removes either any charge to tax under Part 2 as general earnings or a particular charge to tax as general earnings, for example, by removing a charge under a particular chapter of the benefits code.

913. An "employment income" exemption removes *any* charge to tax under Part 2.

914. There is considerable variety in the forms of words used to express exemptions in ICTA. However, not all the differences in wording signify an actual difference in the effect. Close examination of the various exemption provisions in ICTA shows that an exemption can only affect a possible charge to tax under Schedule E in three ways:

- it can remove a single type of charge; eg section 155(1A) of ICTA says

  (1A) Section 154 does not apply to a benefit consisting in the provision for the employee of a car parking space at or near his place of work.

- it can remove any charge as "emoluments" (rewritten in this Act as "general earnings"); eg section 200B(2) (work-related training provided by employers) says

  (2) Subject to section 200C, the emoluments of the employee from the office or employment shall not be taken to include….

- it can remove any charge to tax under Schedule E, eg section 197AD(1) of ICTA says

  (1) There is no charge to tax under Schedule E in respect of approved mileage allowance payments for a qualifying vehicle.

915. In this Act the effects described in the first two bullets only impact on general earnings, and exemptions which have those effects are described as "earnings-only" exemptions. The type of exemption that, in ICTA, removes any charge to tax under Schedule E is labelled an "employment income" exemption in this Act.

916. If a benefit is received in circumstances to which Chapter 3 of Part 6 (payments and benefits on termination of employment etc) could apply, any "earnings-only" exemptions are ignored in deciding whether or not the benefit is within that Chapter.

917. But if the benefit or income is the subject of an "employment income" exemption, there is no possibility of any charge to tax on that benefit or income under Chapter 3 of Part 6, nor under any other provision in this Act.

918. There are also some exemptions that have a wider effect and remove the possibility of any charge to tax at all. These are described in section 228(2).

Section 228: Effect of exemptions on liability under provisions outside Part 2

919. All of the exemptions in this Part operate to remove a charge to tax under Part 2 of this Act. *Subsection (1)* sets out the proposition that, in general, this is the only kind of charge to tax that these exemptions affect.

920. However, Part 4 includes a number of exemptions that have a wider effect. There are various phrases used in the exemption provisions in ICTA which make it clear that they operate to remove *any* charge to income tax. Examples are:

> …shall not be regarded as income for any purpose of the Income Tax Acts – section 200(1) (expenses of Members of Parliament)
>
> …shall be exempt from income tax – section 322(2) (consular officers and employees)

921. Some of the exemptions set out in ESCs are also worded so that they remove any charge to income tax on the income in question. Examples are:-

> Income tax is not charged on…. – ESC A6 (Miners: free coal and allowances in lieu)
>
> …the employee will not be charged to income tax….. – ESC A66 (Payments for employees' journeys home: late night travel and breakdown in car-sharing arrangements).

922. *Subsection (2)* includes a list of all the exemptions in Part 4 that have this wider application and provides that they have effect to remove any charge to income tax.

923. The move to a common formulation, "no liability to income tax arises", for all exemptions, including those listed in section 228(2), is explained in detail in *Note 28* in Annex 2.

Chapter 2: Exemptions: mileage allowances and passenger payments

Overview

924. This Chapter rewrites the provisions for the exemption from tax as earnings of mileage allowance payments and passenger payments. Section 57 of FA 2001 introduced those provisions, which are effective from 2002-03 onwards. The Chapter also rewrites the provisions relating to mileage allowance relief that section 57 introduced. Given that those latter provisions mean that employees can get a deduction from their earnings if their circumstances permit, it might be thought that they should more properly appear among the travel-related expenses in Chapter 2 of Part 5 of this Act. The provisions for mileage allowance relief appear in this Chapter for the following reasons:

- The relief provided does not depend upon the employees having incurred any expenditure. It ensures that the employees receive the maximum relief that is approved for mileage allowance payments against their earnings, even if the mileage allowance payments made by the employer are less than that maximum amount. For that reason the relief would not sit comfortably in

Chapter 2 of Part 5 of this Act, which is headed "Deductions for employee's expenses"; and

- Keeping the payments and relief provisions together means that the terms or labels for these related provisions only have to be defined once. That has resulted in a considerable saving of length and a compactness of presentation.

925. The provisions that, by virtue of Part 1 of Schedule 12 to FA 2001, were introduced as Schedule 12AA to ICTA have been incorporated in the rewritten sections. That accords with the policy of avoiding the use of schedules, if possible.

926. The consequential amendments in Part 2 of Schedule 12 to FA 2001 have been incorporated into the rewritten sections as relevant.

Section 229: Mileage allowance payments
927. This section sets out the basic availability of the exemption for approved mileage allowance payments. The section derives from section 197AD of ICTA.

928. *Subsection (1)* has a reordered wording compared with the source legislation. When terms or labels first appear in this and subsequent subsections signposts to where they are defined accompany them.

929. *Subsection (2)* explains what are mileage allowance payments, in the process excluding passenger payments from them.

930. *Subsection (3)* explains what are approved mileage allowance payments.

931. *Subsection (4)* gives details of two circumstances in which the exemption does not apply.

Section 230: The approved amount for mileage allowance payments
932. This section gives details of the approved amount for mileage allowance payments. The several ideas contained in paragraph 4(2) of Schedule 12AA to ICTA now appear in separate subsections. The section derives from paragraph 4 of Schedule 12AA.

933. *Subsection (1)* gives a formula to calculate the approved amount for mileage allowance payments for a given type of vehicle.

934. In s*ubsection (2)* the mileage rate information has been converted to tabular form.

935. *Subsection (3)* qualifies what is meant by the expression "the first 10,000 miles" in subsection (2), dealing particularly with the possibility that the same person might undertake business travel in respect of two or more associated employments.

936. *Subsection (4)* gives details of when one employment is associated with another.

937. In s*ubsection (5)* the reference to the definition of "control" is now direct, rather than diverting the user to section 168(12) of ICTA, only to find that that in turn refers to section 840 of ICTA.

938. *Subsection (6)* provides the Treasury with powers to make regulations to alter the rates or rate bands in subsection (2).

Section 231: Mileage allowance relief

939. This section explains what mileage allowance relief is and how the employee may be entitled to it. The section derives from section 197AF of ICTA.

940. *Subsection (1)* describes the circumstances in which entitlement to mileage allowance relief can arise.

941. *Subsection (2)* states how to calculate the amount of mileage allowance relief to which the employee is entitled.

942. *Subsection (3)* gives details of two circumstances in which mileage allowance relief is not available.

Section 232: Giving effect to mileage allowance relief

943. This section deals with the mechanics of giving effect to mileage allowance relief. The main difference between it and the source legislation is the absence of any reference to the Cases of Schedule E. The consequences of this are most evident in *subsections (2)* and *(3)*. The section derives from section 197AG of ICTA.

944. *Subsection (1)* relates the deduction to a tax year.

945. *Subsection (2)* corresponds with the references to Cases I and II of Schedule E in section 197AG(2).

946. *Subsection (3)* corresponds with the references to Case III of Schedule E in section 197AG(3).

947. *Subsection (4)* contains some assumptions supplementary to the operation of subsection (3).

948. *Subsection (5)* gives an order of precedence as between deductions available under subsections (2) and (3).

949. *Subsection (6)* prevents a double deduction.

950. *Subsection (7)* defines two terms used in this section by reference to provisions in another Part of this Act.

Section 233: Passenger payments
951. This section sets out the basic availability of the exemption for passenger payments. The section derives from section 197AE of ICTA.

952. *Subsection (1)* gives details of the circumstances in which the exemption for passenger payments is available.

953. *Subsection (2)* qualifies part of the provisions in subsection (1).

954. *Subsection (3)* explains what are passenger payments.

955. *Subsection (4)* explains what are approved passenger payments.

956. *Subsection (5)* supplies additional information in relation to subsection (2).

Section 234: The approved amount for passenger payments
957. This section gives details of the approved amount for passenger payments. The section derives from paragraph 5 of Schedule 12AA to ICTA.

958. *Subsection (1)* gives a formula to calculate the approved amount for passenger payments.

959. *Subsection (2)* explains how the calculation is affected if there are times in the tax year when two or more passengers for whom the employee is entitled to passenger payments are carried concurrently.

960. *Subsection (3)* provides the Treasury with powers to make regulations to alter the rate in subsection (1).

Section 235: Vehicles to which this Chapter applies
961. This section defines the vehicles to which this Chapter applies. The section derives from paragraph 3 of Schedule 12AA to ICTA.

962. *Subsection (1)* simply names the types of vehicle within the Chapter.

963. *Subsections (4)* and *(5)* contain definitions of the meanings of "motor cycle" and "cycle" that refer to the Road Traffic Act 1988. When this Act was published as a draft Bill for consultation it included an expanded version of this section in which those definitions were reproduced in full. If either of the Road Traffic Act 1988 definitions were to change then, assuming the policy is to keep the definitions aligned, an amendment to the rewritten legislation would be required to maintain that alignment. That would have to be done by way of primary legislation, for which it might be difficult to find parliamentary time. That is an undesirable side effect of the

expanded definitions. The Act therefore reverts to definitions that refer to the Road Traffic Act 1988.

964. As at February 2003, the definition of "motor cycle" in section 185(1) of the Road Traffic Act 1988 is as follows:

> "motor cycle" means a mechanically propelled vehicle, not being an invalid carriage, with less than four wheels and the weight of which unladen does not exceed 410 kilograms;

965. and the definition of "cycle" in section 192 of that Act is as follows:

> "cycle" means a bicycle, a tricycle or a cycle having four or more wheels, not being in any case a motor vehicle.

966. *Subsection (6)* contains some additional definitions of terms used in subsection (3).

Section 236: Interpretation of this Chapter

967. This section contains additional information needed to interpret the provisions in this Chapter. The presentation of this material varies slightly from the source legislation to make it easier to use. The section derives from parts of paragraph 1 and paragraphs 2 and 6 of Schedule 12AA to ICTA.

968. *Subsection (1)* gives signposts to three definitions used in this Chapter.

969. *Subsection (2)* defines what is a "company vehicle" by reference to other provisions in this Act.

970. *Subsection (3)* gives signposts to the provisions that define what is meant by when cars and vans are made available for private use and when they are made available by reason of the employment.

Chapter 3: Exemptions: other transport, travel and subsistence

Section 237: Parking provision and expenses

971. This section derives from the provisions in sections 197A and 155(1A) of ICTA, which provide an exemption from tax in respect of the provision of car parking, and the equivalent provisions for motor cycle parking and facilities for parking bicycles in section 49(2) of FA 1999. It only applies to parking places at the place of work. In this section the defined expression "workplace" has been used instead of "place of work". See *Note 29* in Annex 2.

972. There are definitions of "motor cycle" and "cycle" in section 49(3) of FA 1999. But there is no definition of "car" in sections 155(1A) or 197A of ICTA. As the subject of the exemption is a parking space, definitions of what might be put in it did not appear to add anything, so they have not been reproduced here.

Section 238: Modest private use of heavy goods vehicles

973. This section derives from section 159AC of ICTA which prevents a benefit being chargeable where there is modest private use of a heavy goods vehicle. The exemption here goes wider and provides for no liability to income tax however that liability may arise. See *Change 41* in Annex 1.

974. The exemptions in section 159AC(2)(b), (3)(a) and (3)(c) of ICTA, dealing with expenses in connection with the vehicle, are dealt with in section 239.

Section 239: Payments and benefits connected with taxable cars and vans and exempt heavy goods vehicles

975. When an employee is chargeable to tax under the provisions in Chapter 6 of Part 3 in respect of a car or van that charge is intended to cover all the expenses in connection with the vehicle, other than the provision of a driver and, in relation to a car, of fuel. *Subsections (1), (2) and (4)* of this section provide various exemptions from tax. They derive from sections 157(3) and 159AA(3) of ICTA. *Subsection (3)* preserves the charge for car fuel.

976. If a heavy goods vehicle, which is not used wholly or mainly for private use, is exempted from the Chapter 6 of Part 3 charge by section 238 it is also exempt in respect of expenses connected with it. This rule derives from section 159AC(3) of ICTA.

977. As exemptions for all types of vehicle are expressed in the same terms in ICTA, they have been brought together in this section as a single exemption. Furthermore, the exemptions have been widened so that they now apply however the liability may arise. See *Change 42* in Annex 1. The use of "taxable" car or van, and "exempt" heavy goods vehicle are labels to assist in identifying the basis on which the exemption is due.

978. In the source legislation, the exemption for the discharge of liability and certain expense payments in connection with an exempt heavy goods vehicle only applies in a case where there would otherwise have been a charge to tax under Chapter II of Part V of ICTA – applicable only to employees earning £8,500 or more and directors. In *subsection (8)*, the exemption has been extended to employees in "excluded employment". See *Change 43* in Annex 1.

Section 240: Incidental overnight expenses and benefits

979. This section sets out the exemption for incidental overnight expenses. In so far as it relates to earnings and as expenses it derives from section 200A of ICTA. The exemption from a charge to tax under the benefits code derives from section 155(1B) of ICTA.

980. In the source legislation, sums paid by way of incidental overnight expenses are not eligible for the exemption in if the employee is already allowed a deduction under one of the provisions listed in section 200A(1)(b) of ICTA. That list includes all

the provisions under which a deduction may be available. However, the approach in ICTA of listing all the references is long-winded and not necessarily easy to follow. It is simpler to say in *subsections (1)(c) and (2)(b)* "would not be deductible under Part 5". This substitution of a general reference is analysed in *Change 44* in Annex 1.

981. In *subsection (1)(b)* a new label of "the overnight stay conditions" has been used to describe the conditions which have to be satisfied in identifying a "qualifying period". Those conditions are explained in *subsection (4).*

982. *Subsection (2)* exempts the charge on benefits under Chapter 10 of Part 3 where relief for the cost of the benefit could not be obtained under section 365, if the employee had paid for it. Subsection (2) derives from section 155(1B) of ICTA.

983. In setting out the condition about deductibility of travelling costs, section 200A(3)(b)(i) of ICTA contains a list of deduction provisions which are regarded as satisfying the test. In line with the simplification above, s*ubsection (5)* replaces this list and instead refers to expenses "deductible under Part 5 (otherwise than under any of the excepted foreign travel provisions)". The "excepted foreign travel provisions" are listed in *subsection (7).*

Section 241: Incidental overnight expenses and benefits: overall exemption limit

984. The exemption for incidental overnight expenses in section 240 is a limited exemption. This section sets out the limit on the exemption and how it is applied and mainly derives from section 200A(2), (4) and (5) of ICTA. The cap on the exemption applies to the sum of the expenses and benefits exempted under section 240 and the amount exempted for non-cash vouchers and credit-tokens under section 268. The label "the exemption provisions total" in *subsection (2)* is used to refer to the aggregate total eligible for exemption under both of these sections.

985. *Subsection (3)* sets out "the permitted amount" for each qualifying period. The "permitted amount" is a new label for the amount described as the "authorised maximum" in section 200A(4) of ICTA.

Section 242: Works transport services

986. This section rewrites most of section 197AA of ICTA as extended by section 60 of FA 2001. That provision excludes from the charge to tax under section 154 the benefit arising from the provision of a works bus or minibus service for employees. This section goes wider and provides for no liability to income tax. See *Change 45* in Annex 1.

987. The definitions of "qualifying journey" and "workplace" in section 197AA(3) and (7) have been taken to a new interpretative section, section 249, which applies to the whole Chapter. The definition of "qualifying journey" reflects the amendment to section 197AB of ICTA (support for public transport bus services) made by section 33 of FA 2002. It will enable bus and minibus journeys which start or end at pick-up points to qualify.

988. The only part of section 197AA of ICTA that has not been rewritten in this section is subsection (6). This deals with the exemption from the charge to tax under section 141 of ICTA (non-cash vouchers) where the employee is given a non-cash voucher to evidence entitlement to use the works transport service. That exemption is covered in section 266.

Section 243: Support for public bus services

989. This section derives from section 197AB of ICTA. That section excludes from the charge under section 154 the benefit arising from any financial or other support provided by one or more employers for a public bus service that their employees use for journeys to and from the workplace, or between workplaces. The section takes into account the amendments made by section 33 of FA 2002. Certain definitions are now in section 249. In providing for no liability to income tax the exemption in ICTA has been widened in the same way as in section 242. See *Change 46* in Annex 1.

Section 244: Cycles and cyclist's safety equipment

990. This section derives from section 197AC of ICTA. This prevents an employee being chargeable to income tax under section 154 in respect of the provision of a cycle or associated safety equipment. The part of section 197AC dealing with the provision of a voucher entitling the employee to use a cycle or safety equipment is covered in section 266.

991. The exception only applies where the employer provides the cycle or safety equipment for the employee's use rather than transferring it to him. If the cycle or equipment is given to the employee to keep, the benefit arising is still chargeable to tax in the normal way.

992. The definition of "qualifying journey" in section 197AB(4) of ICTA has been taken to a new interpretative section, section 249, and in doing so has been extended by adopting the amendment to section 197AB made by section 33 of FA 2002.

993. Section 197AC(6) of ICTA includes an interpretation of "employment". This has not been rewritten because the extension of the term to include "offices" is dealt with in section 5.

Section 245: Travelling and subsistence during public transport strikes

994. This section derives from ESC A58. It exempts payments and benefits in respect of travelling and subsistence when there is a disruption in public transport. Legislating the concession is a minor change to the law. See *Change 47* in Annex 1.

995. In the normal way when the employer pays the cost of, or provides transport for, "ordinary commuting" it would in most cases be chargeable to tax and no deduction would be allowed. Nor would deductions be allowed for accommodation and subsistence paid for or provided near to the permanent workplace. This section provides an exemption for payments and benefits provided to employees to ensure they are able to get to work when there is a public transport strike.

996. If the employee is working at a temporary workplace, or on a training course, the provision of transport, accommodation and subsistence is not exempt, but a deduction is allowed under Part 5.

Section 246: Transport between work and home for disabled employees: general
997. This and the following section derive from ESC A59 and some practice as published in the Inland Revenue guidance manuals. Legislating the concession is a minor change to the law. See *Change 48* in Annex 1.

998. The section provides a complete exemption from income tax where an employer provides help with home to work commuting for a disabled employee, except where a car is provided. No special mention of travelling to training is necessary because such travelling (except where it is in substance "ordinary commuting" eg when the training is held at the normal workplace) is exempt for everyone. Where that example involves a disabled employee this section provides an exemption.

Section 247: Provision of cars for disabled employees
999. This section also derives from ESC A59 and established Inland Revenue practice and concerns cases where a car is provided for a disabled employee. Legislating the concession and practice is a minor change to the law. See *Change 48* in Annex 1.

Section 248: Transport home: late night working and failure of car-sharing arrangements
1000. This section derives from ESC A66. It grants an exemption from income tax in the cases of exceptional late night working and the failure of car-sharing arrangements. Legislating the concession is a minor change to the law. See *Change 49* in Annex 1.

1001. The concession is limited to 60 occasions overall in the tax year. For each occasion after the sixtieth there is liability in the normal way.

1002. The journeys concerned are from work to home only. The term "ordinary commuting" cannot be used as this would include journeys from home to work.

1003. The conditions for the exemption require judgements about when it is "not…reasonable to expect" an employee to use public transport – subsection (2)(c)(ii), and what are "unforeseen and exceptional circumstances" in subsection (3)(b). It is not possible to define these questions of judgement further.

Section 249: Interpretation of this Chapter
1004. This section brings together definitions which apply to several provisions in this Chapter. The definition of "qualifying journey" has been extended by the addition of the words "the whole or part of" as made by section 33 of FA 2002 in relation to section 197AB of ICTA (support for public transport bus services). Adopting this

extended definition in sections 242 and 244 is a minor change to the law. See *Change 50* in Annex 1.

Chapter 4: Exemptions: education and training

Overview

1005. This Chapter contains exemptions from income tax on the provision of education and training for an employee by employers and third parties. It derives from sections 200B to 200D of ICTA (work-related training provided by employers etc), and from sections 200E to 200J of ICTA (education and training funded by employers etc).

1006. The sections first describe the provision and costs to which they apply. They then define the type of training or education with which they are concerned. Finally, they set out circumstances in which exemption from tax does not apply.

Section 250: Exemption of work-related training provision

1007. This section provides there is no liability to income tax on the provision of work-related training for an employee by the employer or by a person other than the employer.

1008. It derives from sections 200B (expenditure by the employer) and 200D (expenditure by a third party) of ICTA.

1009. Although it is possible for an employee to be exempt from tax under both section 250 and section 311 (retraining courses), it is not necessary (as in section 200C(4) of ICTA) to exclude provision exempted elsewhere, as exemption can be given under either. See *Note 30* in Annex 2.

1010. *Subsection (1)* sets out the exemption. It covers both the provision and the payment or reimbursement of the cost of provision of the training (and any benefit incidental to the training) plus specified related costs.

1011. To accord with Inland Revenue practice, the exemption is expressed to cover training and training costs, whether provided or incurred by the employer or by a third party. See *Change 52* in Annex 1.

1012. The exemption is so expressed that no charge arises under Part 2, whether as general earnings or specific employment income, on the provision and costs of work-related training. This reflects Inland Revenue practice not to apply any employment income charge which might arguably apply (say, a specific employment income charge, such as Chapter 3 of Part 6 where the training relates to a change of duties). See *Change 51* in Annex 1.

1013. *Subsection (2)* specifies the ancillary costs within subsection (1)(b)(ii) to which the exemption applies. See *Change 53* in Annex 1.

Section 251: Meaning of "work-related training"
1014. This section defines "work-related training" for the purposes of the exemption. It derives from section 200B of ICTA.

1015. The definition covers both the objectives of the training and the employment (or related employment) to which the benefit of that training must be relevant.

Section 252: Exception for non-deductible travel expenses
1016. This section deals with travel and subsistence to which the exemption does not apply. It derives from section 200C of ICTA.

1017. *Subsection (1)* sets out the conditions to be satisfied if travel and subsistence are not to be excepted from the exemption. Travel must meet condition A or B; subsistence must meet condition B.

1018. The section dispenses with a requirement that the expenses are incurred wholly, exclusively and necessarily in undertaking the training. Instead, as a result of cross-reference to other provisions in this Part and in Part 5, it simply requires amounts to be necessarily expended on travelling or subsistence. This accords with Inland Revenue practice and aligns the rules relating to travel and subsistence expenses in this section with those in sections 310 and 311 in Chapter 10 of this Part (exemptions: termination of employment). See *Change 53* in Annex 1.

1019. *Subsections (2)* and *(3)* set out conditions A and B respectively.

1020. Travel and subsistence expenses meeting condition B include expenses that, on the assumptions in subsection (4), would be deductible under any provision of Part 5. Under ICTA, expenses within the exemption are restricted to expenses deductible only under selected sections of those rewritten in that Part. See *Change 54* in Annex 1.

1021. This section is listed in section 332 (meaning of "the deductibility provisions"). Various provisions in Part 5 then ensure that certain rules in Part 5 do not adversely restrict expenses, deductible under that Part, for the purposes of condition B.

1022. *Subsection (4)* sets out the assumptions to be made for the purposes of subsections (2) and (3).

1023. *Subsection (5)* provides definitions for the purposes of the section.

Section 253: Exception where provision for excluded purposes
1024. This section deals with provision to which the exemption does not apply. It derives from section 200C of ICTA.

1025. *Subsection (1)* disapplies the exemption to provision for excluded purposes.

1026. Relief under section 32 Finance Act 1991 (vocational training) was repealed by Finance Act 1999, with effect from 1 September 2000 (SI 2000 No 2004, Finance Act 1999, section 59(3)(b), (Appointed Day) Order). As the exclusion from the exemption of amounts eligible for vocational training relief is obsolete, this Act does not rewrite section 200C(5) of ICTA.

1027. *Subsections (2)* to *(4)* list and define the excluded purposes.

Section 254: Exception where unrelated assets are provided

1028. This section excepts provision of assets from the exemption, where the assets are not training-related. It derives from section 200C of ICTA.

1029. *Subsections (2)* and *(3)* define "training-related asset" and "training materials".

1030. The definition of "training materials" consists of an illustrative, rather than exhaustive, list to cater for future development in the means of delivering training without having to amend the list. See *Note 31* in Annex 2.

Section 255: Exemption for contributions to individual learning account training

1031. This section provides there is no liability to income tax, from a current or former employment, on the provision of, and payment or reimbursement of the costs of, individual learning account training given by a person other than the trainee's employer (or former employer).

1032. It derives from sections 200E (education and training funded by employers) and 200J (education and training funded by third parties) of ICTA.

1033. Although an employee may be exempt from tax under section 255 and either or both of sections 250 (work-related training) and 311 (retraining courses), provision exempted elsewhere need not be excluded (as in section 200H of ICTA), because exemption can be given under any of these. This Act does not therefore rewrite section 200H. See *Note 30* in Annex 2.

1034. *Subsection (1)* sets out the exemption, which covers the provision of training by a training provider, funding of that training, incidental benefits of training and specified other costs paid or reimbursed.

1035. To accord with Inland Revenue practice, the exemption is expressed to cover the provision, funding and benefit of individual learning account training, whether funded or provided by the employer (or former employer) or a third party. See *Change 52* in Annex 1.

1036. The exemption is so expressed that no charge arises under Part 2, whether as general earnings or specific employment income, on the funding and provision of individual learning account training. As with work-related training (section 250), it is

Inland Revenue practice not to apply any employment income charge which might arguably apply. See *Change 55* in Annex 1.

1037. *Subsection (2)* defines the trainees eligible for the exemption as account holders under the Learning and Skills Act 2000 and parties to arrangements under the Education and Training (Scotland) Act 2000.

1038. *Subsection (3)* specifies the ancillary costs within subsection (1)(d) to which the exemption applies. See *Change 53* in Annex 1.

Section 256: Meaning of "individual learning account training"

1039. This section defines "individual learning account training" for the purposes of the exemption by reference to the Learning and Skills Act 2000 and the Education and Training (Scotland) Act 2000.

1040. It derives from section 200E of ICTA.

Section 257: Exception for non-deductible travel expenses

1041. This section deals with travel and subsistence to which the exemption does not apply. It derives from section 200F of ICTA.

1042. *Subsection (1)* sets out the conditions to be satisfied if travel and subsistence are not to be excepted from the exemption. Travel must meet condition A or B; subsistence must meet condition B.

1043. The section dispenses with a requirement that the expenses are incurred wholly, exclusively and necessarily in undertaking the training. Instead, as a result of cross-reference to other provisions in this Part and in Part 5, it simply requires amounts to be necessarily expended on travelling or subsistence. This accords with Inland Revenue practice and aligns the rules relating to travel and subsistence expenses in this section with those in sections 310 and 311 in Chapter 10 of this Part (exemptions: termination of employment). See *Change 53* in Annex 1.

1044. *Subsections (2)* and *(3)* set out conditions A and B respectively.

1045. Travel and subsistence expenses meeting condition B include expenses that, on the assumptions in subsection (4), would be deductible under any provision of Part 5. Under ICTA, expenses within the exemption are restricted to expenses deductible only under selected sections of those rewritten in that Part. See *Change 54* in Annex 1.

1046. This section is listed in section 332 (meaning of "the deductibility provisions"). Various provisions in Part 5 then ensure that certain rules in Part 5 do not adversely restrict expenses, deductible under that Part, for the purposes of condition B.

1047. *Subsection (4)* sets out the assumptions to be made for the purposes of subsections (2) and (3).

1048. *Subsection (5)* provides definitions for the purposes of the section.

Section 258: Exception where provision for excluded purposes
1049. This section deals with provision to which the exemption does not apply. It derives from section 200F of ICTA.

1050. *Subsection (1)* disapplies the exemption to provision for excluded purposes.

1051. *Subsections (2)* and *(3)* list and define the excluded purposes.

Section 259: Exception where unrelated assets are provided
1052. This section excepts provision of assets that are not training-related from the exemption. It derives from section 200F of ICTA.

1053. *Subsections (2)* and *(3)* define "training-related asset" and "training materials" similarly to section 254(2) and (3).

1054. The definition of "training materials" again consists of an illustrative, rather than exhaustive, list to cater for future development in means of delivering training without having to amend the list. See *Note 31* in Annex 2.

Section 260: Exception where training not generally available to staff
1055. This section sets out the requirement that individual learning account training be generally available to an employer's staff or former staff. It derives from section 200G of ICTA.

1056. *Subsection (1)* limits the exemption to funding and other costs incurred under "existing arrangements" which cover the making of contributions to such funding and other costs of individual learning account training for employees generally.

1057. The section extends contributions made to "existing arrangements" to contributions made by a third party as well as an employer (or former employer).

1058. *Subsection (2)* defines "existing arrangements" so as to link the making of contributions to arrangements in place at the time the contributions are made, whether by the employer (or former employer) or by a third party. See *Note 32* in Annex 2.

1059. *Subsections (3)* to *(5)* authorise the Treasury to make regulations to determine the employer of Crown servants for the purposes of this section.

Chapter 5: Exemptions: recreational benefits

Recreational facilities

1060. The first three sections in this Chapter deal with the exemption where an employer provides certain sporting or recreational facilities for employees. These sections derive from section 197G of ICTA. The final two sections cover annual parties and functions and third party entertainment, the first deriving from an ESC and the second from section 155(7) of ICTA.

1061. The material in section 197G of ICTA has been reordered. The first section sets out the benefits to which the exemption applies, and the conditions that must be met for the exemption to apply to those benefits and the second the benefits to which the exemption does not apply. The third section notes how Treasury powers can apply or not apply these rules.

1062. In these three sections "facilities" in the plural has replaced "facility", used in section 197G(3)(c) to (f) and in the opening words to and in section 197G(4)(b) of ICTA, to denote that it is the tangible facilities which are meant and not the opportunity to use them.

Section 261: Exemption of recreational benefits

1063. *Subsection (1)* provides for the exemption from income tax. *Subsection (2)* makes it clear that both the use of the facilities and the right or opportunity to use them are within the exemption. The availability and use of the facilities must meet the conditions set out in *subsections (3)* to *(5)* for the benefit to be exempt.

1064. The simplest case where this exemption can apply is that of a single employer. If all the conditions in subsections (3) to (5) are met, the exemption applies. In that case "the employer in question", (subsection (3)), is the single employer.

1065. Two or more employers may provide facilities jointly. In such a case each employer is looked at separately. The condition in *subsection (3)* requires that the facilities must be available generally to the employees of that employer, the "employer in question". If one employer restricts the availability to certain employees, none of the employees of *that* employer can claim the exemption.

1066. The use of the words "members of the public generally" in *subsection (4)*, is to indicate that the exemption cannot apply to facilities available for public use, whether these are public facilities or in-house facilities made available to the "public generally". However, in-house facilities made available for use to a particular sector of "the public", meaning people other than employees, such as a local school allowed to have swimming lessons, does not prevent the exemption from applying, provided the condition in subsection (5) is met.

1067. The test at *subsection (5)* looks at actual use of the facilities rather than the people to whom they are made available. There are several different things taken into

account here. To simplify this, subsection (5) uses the expression "employment-related" and subsection (6) then defines what that means.

1068. Under *subsections (6)* and *(7)*, use by former employees and their families is included, provided the employer has made the facilities available generally to the employees.

1069. The words in brackets in subsection (5) indicate that where there is provision for the employees of more than one employer, all users must be considered. If an employer has restricted use, so that the test at subsection (5) fails for that employer, it does not prevent the use test being satisfied for other employers. Provided the restricting employer has only small numbers actually using the facilities, the "mainly" test is satisfied. This can best be explained using an example.

1070. Example. Suppose a facility is:

- available to a few of A's employees; and
- available to all of B's employees; but
- not available to the public generally.

The exemption does not apply to A's employees because the condition in subsection (3) is not satisfied. Subsection (3) is satisfied for B's employees.

The opportunity to use the facilities may be employment-related for B's employees but not for A's. If B's employees who use the facilities substantially outnumber the employees of A, who use them, they will be used mainly by employees whose opportunity to use them is employment-related. The condition in subsection (5) is then satisfied for B's employees, and the exemption will apply for them.

1071. An employer may provide a non-cash voucher, which the employee must present to use the facilities provided. If the facilities meet the conditions set out, and the voucher can only be used for that purpose, section 266(3) provides that there is no liability to income tax on the cost of provision of the voucher.

Section 262: Benefits not exempted by section 261
1072. *Subsection (1)* sets out the benefits that are not within the exemption and *subsection (2)* explains some of the terms in subsection (1).

Section 263: Power to alter benefits to which section 261 applies
1073. This section gives the Treasury the power to limit or extend the scope of the exemption. The administrative procedure is contained in section 828(3) of ICTA.

Section 264: Annual parties and functions

1074. This section derives from, and gives statutory effect to, ESC A70B (Staff Christmas parties). That concession operates to exempt the employee from any income tax liability on specified office parties. See *Change 56* in Annex 1. The section covers office-holders as well as employees although the concession does not expressly do so. See section 5(2).

1075. Although the heading to the concession is "Staff Christmas Parties", the extension of the original concession to other parties indicates that it refers to annual functions in general. This is reflected in the less specific heading to this section: "Annual parties and functions".

1076. *Subsection (1)* provides that the section applies to functions available to employees generally. In accordance with how the ESC was understood, it is made clear that there is scope for parties to be held in different locations.

1077. *Subsections (2)* to *(5)* show how the monetary limit is applied. S*ubsection (4)(b)*, read together with the whole section, makes it clear that the exemption effectively applies to persons attending as guests of the employees.

1078. When an ESC contains monetary limits, changes in those limits are made by press release or by republishing the ESC with different amounts. This is not possible for legislation. There are a number of exemptions in current legislation for which the Treasury fixes an amount. This Act adopts the same approach for rewritten concessions and includes a general power for the Treasury to increase the amounts in section 716. This provision is listed there.

1079. The equivalent exemption for the provision by way of a non-cash voucher (for example, a ticket for entry to a function is a voucher) is included in section 266(3) rather than within this section.

Section 265: Third party entertainment

1080. This section derives from the exemption in section 155(7) of ICTA. If the provision of the benefit in this case is "by reason of the employment" it would be within the terms of section 201 without the exemption in *subsection (1)*.

1081. The conditions in *subsections (2) to (5)* make it clear that the reason for the entertainment must be gratuitous, and not in any way a reward for past or future services, nor from anyone connected with the employer. If these conditions are not met, there is no exemption.

1082. The exemption is expressed as there being "no liability to income tax". This is wider than section 155(7) of ICTA which is expressed as an exemption from section 154 of ICTA, the general charging provision for benefits in kind. See *Change 57* in Annex 1.

1083. If the provision of the entertainment is by way of a non-cash voucher or a credit-token, there are corresponding exemptions in sections 266 and 267. In ICTA these exemptions are in sections 141(6B) and 142(3B).

Chapter 6: Exemptions: Non-cash vouchers and credit-tokens

Overview

1084. This Chapter provides exemptions which apply to non-cash vouchers and credit-tokens. Anything provided by way of a non-cash voucher or credit-token which is not in the exemptions provided by this Chapter remains chargeable, even if it would be exempt where provided direct. Bringing these exemptions together is a change in approach.

1085. The derivations of the exemptions in this Chapter are those given for the exemptions applying to equivalent direct provision.

1086. The different wording used in each section and subsection in this Chapter reflects the different ways in which vouchers and credit-tokens may be used and the circumstances in which the exemption will apply.

Section 266: Exemption of non-cash vouchers for exempt benefits

1087. *Subsection (1)* derives from sections 141(6A), and (6B) and 197A of ICTA, section 49(1) of FA 1999, and ESCs A59 and A66. All these exemptions apply to non-cash vouchers to the extent that they are used to obtain the exempt item. The inclusion of the exemptions provided by the ESCs is a minor change to the law. See *Changes 48* and *49* in Annex 1.

1088. *Subsection (2)* derives from sections 197AA, 197AB(5) and 197AC(5) of ICTA. In each of these provisions the voucher is not handed over, but is used as evidence of entitlement.

1089. *Subsection (3)* derives from sections 197(2) and 197G(1) of ICTA and ESCs A58, A70B and A74. For each of these the voucher is used only for the exempt purpose. The inclusion of the exemptions provided by the ESCs is a minor change to the law. See *Changes 47, 56* and *58* in Annex 1.

1090. *Subsection (4)* provides the voucher exemption in respect of something exempted by use of the regulations in respect of minor benefits.

1091. *Subsection (5)* ensures that exemptions under this section apply even if the employee is in lower-paid employment. Unlike other benefits charges, chargeability for non-cash vouchers and credit-tokens applies to all employees.

Section 267: Exemption of credit-tokens used for exempt benefits

1092. This section derives from section 142(3A) and (3B) of ICTA, section 49(1) and (2) of FA 1999, and ESCs A58, A59, A66 and A74. The inclusion of the

exemptions provided by the ESCs is a minor change to the law. See *Changes 47, 48* and *49* in Annex 1.

Section 268: Exemption of vouchers and tokens for incidental overnight expenses
1093. This section exempts from charge by virtue of Chapter 4 of Part 3 both non-cash vouchers and credit-tokens used to meet "incidental overnight expenses". It derives mainly from sections 141(6C) and 142(3C) of ICTA.

1094. *Subsection (1)* sets out the terms of the exemption where the voucher or token is used to obtain goods, services or money.

1095. *Subsections (2) to (5)* set out the conditions to be satisfied.

1096. *Subsection (6)* provides definitions of terms used in the section by cross-reference to the exemption in sections 240 (incidental overnight expenses and benefits) and 241 (incidental overnight expenses and benefits: overall exemption limit) for equivalent direct provision.

Section 269: Exemption where benefits or money obtained in connection with taxable car or van or exempt heavy goods vehicle
1097. This section exempts from charge by virtue of Chapter 4 of Part 3 both non-cash vouchers and credit-tokens used for expenditure on taxable cars or vans, or on exempt heavy goods vehicles.

1098. *Subsection (1)* sets out the exemption. It derives from sections 157(3)(b), 159AA(3)(b) and 159AC(3)(b) of ICTA.

1099. *Subsection (2)* qualifies the exemption by reference to the provisions of section 149 (benefit of car fuel treated as earnings) where what is obtained is fuel for a car.

1100. *Subsections (3) and (4)* provide definitions of terms used in the section and make clear the tax year for which the car, van or heavy goods vehicle is taxable or exempt. See *Note 33* in Annex 2.

1101. The definition of how a heavy goods vehicle is "exempt" for the purposes of this section ensures that the exemption applies where the employee is in lower-paid employment. This is a minor change to the law. See *Change 43* in Annex 1.

Section 270: Exemption for small gifts of vouchers and tokens from third parties
1102. This section provides there is no liability to tax by virtue of Chapter 4 of Part 3, in respect of small gifts from third parties which take the form of a non-cash voucher or credit-token, where conditions are satisfied. It derives from ESC A70A and is a minor change to the law. See *Change 59* in Annex 1.

1103. *Subsection (1)* sets out the terms of the exemption where the conditions are satisfied.

1104. *Subsections (2) to (4)* set out the conditions, in part by cross-reference to the provisions of section 324 (small gifts from third parties).

Chapter 7: Exemptions: Removal benefits and expenses
Section 271: Limited exemption of removal benefits and expenses: general
1105. This section gives details of the limited exemption for removal expenses. It sets out the general proposition that no liability to income tax arises in respect of any removal benefits or reimbursed removal expenses listed in this Chapter, up to the limit set out in section 287 of this Act. The section derives from parts of paragraph 1 of Schedule 11A to ICTA.

1106. *Subsection (1)* sets out the basic proposition that the exemption is available. The opening words of paragraph 1(1) of Schedule 11A, "where by reason of a person's employment" have not been rewritten. Those words are not necessary because there is no tax charge in respect of benefits or reimbursed expenses unless they arise "by reason of a person's employment". The exemptions in this Chapter only apply where there is the possibility of such a charge.

1107. *Subsection (2)* reproduces the effect of the exclusion, by virtue of paragraph 1(1) of Schedule 11A, of certain income from the exemption because it is within Case III of Schedule E. Paragraph 2 of Schedule 11A ensures that the exemption from charge under Cases I and II of Schedule E does not result in the benefits or expenses being chargeable under Case III of Schedule E, as a result of the operation of section 131(2) of ICTA. In this Act, by virtue of the provisions that define "taxable earnings" for the purposes of Chapter 4 of Part 2, it is no longer possible for the same earnings to fall within one of those provisions and also within "taxable earnings" as defined for the purposes of Chapter 5 of Part 2. As a consequence there is no need to rewrite paragraph 2.

1108. *Subsection (3)* gives a signpost to the section containing the limit on the exemption.

Section 272: Removal benefits and expenses to which section 271 applies
1109. This section identifies the types of benefits and expenses that qualify for the exemption. It derives from paragraphs 3, 4, 7 and 16 of Schedule 11A to ICTA.

1110. *Subsection (1)* lists all the benefits potentially within the scope of the limited exemption set out in section 271. It gives signposts to the sections that contain the detailed descriptions of those benefits and states the overriding conditions that must be satisfied.

1111. *Subsection (2)* ensures that if a voucher or credit-token is used to obtain goods or services or money to pay for them such benefits are within the scope of the exemption. See *Change 60* in Annex 1.

1112. *Subsection (3)* lists the types of expenses that qualify for the exemption. It relies largely on the list in subsection (1) and adds, in *paragraph (c)*, one expense for which there is no corresponding benefit.

1113. One of the conditions for the exemption to be available is that the benefits must be provided or that the reimbursed expenses must be incurred on or before a particular day. In the source legislation that day is called the "relevant day" and is defined in paragraph 6 of Schedule 11A to ICTA. That label has been changed to "the limitation day", which is defined in section 274 of this Act.

Section 273: Conditions applicable to change of residence

1114. This section gives more details about the three conditions referred to in section 272(1)(a). The section derives from paragraph 5 of Schedule 11A to ICTA. The words in brackets in paragraphs 5(1)(b) and (c) of Schedule 11A have not been reproduced, as they do not add anything.

1115. *Subsection (1)* introduces the three subsections that give details of the conditions.

1116. *Subsection (2)* identifies the three possible events that can trigger the exemption.

1117. *Subsection (3)* is concerned with the reason for the change of residence.

1118. *Subsection (4)* contains a restriction on the application of the exemption if a change of residence would be unnecessary.

Section 274: Meaning of "the limitation day"

1119. This section defines "the limitation day", which rewrites the idea labelled "the relevant day" in ICTA, using a reference to a new concept, "the employment change". The section derives from paragraph 6 of Schedule 11A to ICTA.

1120. *Subsection (1)* defines "the limitation day", subject to subsection (2).

1121. *Subsection (2)* gives scope for the Inland Revenue to extend the period before the limitation day, if it seems reasonable to do so. The reference to "Inland Revenue" reflects the practice whereby the Board of Inland Revenue delegates the initial decision on this matter to the Officer in Charge of the local office concerned. See *Change 158* in Annex 1.

Section 275: Meaning of "the employment change"

1122. This section is pure drafting, which defines the new label "the employment change".

1123. A number of the later paragraphs in Schedule 11A to ICTA refer to the circumstances set out in paragraph 5(1). The relevant change in those circumstances, now rewritten in section 273(2), has been given the label "the employment change" to make the rewriting of those references more straightforward.

Section 276: Meaning of "residence", "former residence" and "new residence" etc.

1124. This section defines three labels related to the employee's various possible residences, including a definition of "residence" itself. The section derives from section 191B(16) of ICTA and paragraph 25 of Schedule 11A to ICTA.

1125. In s*ubsection (1)* there is no longer a reference to an employee's "sole or main residence". Instead the residence in question is defined more closely as being the employee's main residence.

1126. *Subsection (2)* defines "former residence" and "new residence".

1127. *Subsection (3)* defines what is meant by "an interest in a residence".

Section 277: Acquisition benefits and expenses

1128. This section combines two similar provisions and so cuts out duplication. It sets out the benefits and expenses associated with the acquisition of a residence that come within this Chapter. The same approach (of combining the rules for benefits and expenses) has been adopted in a number of the following sections. The section derives from paragraphs 9 (expenses) and 18 (benefits) of Schedule 11A to ICTA.

1129. *Subsection (1)* makes it clear that the interest in the new residence need not be held exclusively or indeed at all by the employee, provided it is held (either exclusively or jointly) by one or more members of the employee's family or household.

1130. *Subsection (2)* identifies the types of benefit within the section.

1131. *Subsection (3)* identifies the types of expenses within the section, by building on the description of some of the benefits covered and adding those expenses where there is no equivalent benefit.

1132. *Subsection (4)* broadens the scope of who can raise a loan, other than or as well as the employee, in similar terms to those applying to an interest in the new residence covered in subsection (1).

1133. *Subsection (5)* defines terms used in subsection (3)(d).

Section 278: Abortive acquisition benefits and expenses

1134. This section brings together in one section the provisions relating to expenses and benefits connected with an abortive acquisition of a new residence. It describes the circumstances that could lead to it being applied and relates back to section 277 to identify the type of benefits or expenses covered. The section derives from paragraphs 10 (expenses) and 19 (benefits) of Schedule 11A to ICTA.

Section 279: Disposal benefits and expenses

1135. This section brings together in one section the provisions relating to expenses and benefits connected with the disposal of the employee's former residence. The section derives from paragraphs 8 (expenses) and 17 (benefits) of Schedule 11A to ICTA.

1136. *Subsection (1)* describes the circumstances in which the section applies.

1137. *Subsection (2)* identifies the types of benefit within the section.

1138. *Subsection (3)* identifies the types of expenses within the section, by building on the description of some of the benefits covered and adding those expenses where there is no equivalent benefit.

1139. *Subsection (4)* broadens the scope of who can have an interest in the former residence, other than or as well as the employee, in similar terms to those applying to an interest in the new residence as covered in section 277(1), dealt with in paragraph 1129.

1140. *Subsection (5)* defines what is meant by "related loan" for the purposes of this section. This Act widens the scope of loans that qualify for exemption under this section. See *Change 61* in Annex 1.

Section 280: Transporting belongings

1141. This section brings together in one section the provisions relating to expenses and benefits connected with the transportation of belongings. It derives from paragraphs 11 (expenses) and 20 (benefits) of Schedule 11A to ICTA.

1142. *Subsection (1)* identifies the types of benefit within the section.

1143. *Subsection (2)* identifies the types of expenses within the section, by reference to the description of the benefits covered.

1144. *Subsection (3)* defines "domestic belongings" and "transportation".

Section 281: Travelling and subsistence

1145. This section brings together in one section the provisions relating to expenses and benefits connected with travelling and subsistence. It derives from paragraphs 12 (expenses), 21 (benefits) and 28 of Schedule 11A to ICTA.

1146. *Subsection (1)* identifies the types of benefit within the section. *Subsection (1)(f)* introduces a new label "education-linked living accommodation". *Subsection (1)(g)* introduces a new label "the employee's accommodation". It also widens the scope of the exemption for travel to and from such accommodation. See *Change 62* in Annex 1.

1147. *Subsection (2)* defines "education-linked living accommodation".

1148. *Subsection (3)* defines "the employee's accommodation".

1149. *Subsection (4)* identifies the types of expenses within the section, by reference back to the description of the benefits covered.

1150. *Subsection (5)* identifies some exclusions from the exemptions provided by this section, by reference to circumstances described in subsequent sections.

1151. *Subsection (6)* defines "new duties", "former area", "new area", "relevant child" and "subsistence".

Section 282: Exclusion from section 281 of benefits and expenses where deduction allowed

1152. This section identifies benefits and expenses that are excluded from the exemptions provided for in this Chapter. It derives from paragraphs 12(4) and 21(7) and (8) of Schedule 11A to ICTA.

1153. *Subsection (1)* states the general proposition about exclusion of certain benefits or expenses by reference to an amount being deductible under other provisions.

1154. *Subsection (2)* identifies those provisions.

1155. *Subsection (3)* deals with the circumstance where a deduction might be allowed for only part of a benefit provided. In that case the other part of the benefit might still be exempt.

Section 283: Exclusion from section 281 of taxable car and van facilities

1156. This section provides that the exemption does not apply to car or van benefits. It derives from paragraphs 21(2) and (4) to (6) of Schedule 11A to ICTA.

1157. *Subsection (1)* provides that the exemption in section 281(1) does not apply to car or van benefits. The Act widens the scope of the exemption when compared with a strict interpretation of the source legislation. See *Change 63* in Annex 1.

1158. *Subsection (2)* identifies the sections containing the definitions of the terms used in subsection (1).

Section 284: Bridging loan expenses

1159. This section deals with bridging loan expenses (interest) connected with an employee's change of residence resulting from an employment change. It derives from paragraph 13 of Schedule 11A to ICTA.

1160. *Subsection (1)(a)* combines the first two conditions that the bridging loan must satisfy, which are in paragraph 13(1)(a) and (b) of Schedule 11A. *Subsection (1)(b)* and *(c)* list the other conditions.

1161. *Subsection (2)* gives a restricted definition of interest that falls within the section. Paragraphs 13(4) and (5) of Schedule 11A set out the purpose for which the loan must have been used. The Act combines those provisions without any change in effect. The same change as described in paragraph 1140 in relation to section 279 has been made here. See *Change 61* in Annex 1.

1162. *Subsection (3)* places a further restriction on the amount of interest that can come within the section.

1163. The source legislation does not specify how to allocate the total loan interest between exempt and non-exempt parts of the loan where paragraph 13(3) and (4) of Schedule 11A both apply. *Subsection (4)* recognises that possibility by introducing the idea of "the appropriate fraction". See *Change 64* in Annex 1.

1164. *Subsection (5)* includes a method statement to explain how to arrive at the appropriate fraction. See *Change 64* in Annex 1.

1165. *Subsection (6)* combines in one subsection the provisions from paragraph 13(7) of Schedule 11A that extend the meaning of interest payable by an employee and paragraph 13(8) of Schedule 11A that apply a parallel extension in meaning to references to a loan being raised by the employee.

Section 285: Replacement of domestic goods

1166. This section brings together in one section the provisions relating to expenses and benefits connected with replacing domestic goods. The heading in the source legislation, "duplicate expenses", does not really describe what this provision is about. The new heading is more informative. The section derives from paragraphs 14 (expenses) and 22 (benefits) of Schedule 11A to ICTA.

1167. *Subsection (1)* describes the circumstances in which the section operates. Under paragraph 14(2) of Schedule 11A if an employee sells any of the domestic goods replaced by the new goods covered by paragraph 14(1) of Schedule 11A, the sale proceeds have to be deducted from the amount that qualifies under that paragraph. This subsection does not reproduce that requirement to deduct the sale proceeds of replaced domestic goods. See *Change 65* in Annex 1.

1168. *Subsection (2)* broadens the scope of who can have an interest in the new and/or former residence(s), other than or as well as the employee, in similar terms to those applying to an interest in the new residence as covered in section 277(1), dealt with in paragraph 1129.

Section 286: Power to amend sections 279 to 285

1169. This section brings together the provisions dealing with the Treasury's regulation-making powers. It derives from paragraphs 15 (expenses) and 23 (benefits) of Schedule 11A to ICTA.

1170. *Subsection (1)* provides powers that allow the Treasury to make regulations to extend sections 279 to 285 to bring within their scope benefits or expenses not otherwise covered.

1171. *Subsections (2)* and *(3)* allow the Treasury some latitude in what they may do and how they may do it.

Subsection (4) prevents the Treasury from making retrospective regulations under the powers in this section.

Section 287: Limit on exemption

1172. This section sets out the limit on the total amount of the exemption available under this Chapter. It derives from paragraph 24 of Schedule 11A to ICTA.

1173. *Subsection (1)* states the limit that applies to the amount of benefits and expenses that can be exempted.

1174. *Subsection (2)* includes a list of items that count towards the £8,000 limit. *Subsection (2)(b)* states that the benefit code earnings, which in this Act includes amounts related to the use of vouchers and/or credit-tokens, are to be counted towards the value of the exemption. See *Change 60* in Annex 1.

1175. *Subsection (3)* explains what is meant in subsection (2) by "the section 62 earnings".

1176. *Subsection (4)* explains what is meant in subsection (2) by "the benefits code earnings". In combination with subsection (2)(b) it prevents any possible double counting of an amount. See *Change 66* in Annex 1.

1177. The source provisions also go into great detail about how to quantify the amount of benefit relating to the provision of living accommodation in paragraph 24(4) to (8) of Schedule 11A. *Subsection (5)* amalgamates all that detail. It brings together the various permutations for the computation of amounts chargeable in such cases.

Section 288: Limited exemption of certain bridging loans connected with employment moves

1178. This section gives details of what kind of loan is covered. It contains a formula for working out the day by which the loan must be repaid if there is to be no charge to tax under what was section 160 of ICTA (rewritten in Chapter 7 of Part 3 of this Act, mainly in section 175). It also includes some interpretative provisions. The section derives from section 191B(1) to (6), (10) to (12) and parts of (8), (9) and (13) of ICTA.

1179. *Subsection (1)* describes the circumstances in which the exemption arises.

1180. *Subsection (2)* describes in what circumstances a loan is within the term "a removal benefit" as used in subsection (1).

1181. *Subsection (3)* describes how there can be "unused removal benefit exemption" as mentioned in subsection (1).

1182. *Subsection (4)* shows how to calculate the amount of "the exempted loan discharge period", as mentioned in subsection (1).

1183. *Subsection (5)* broadens the scope of who can raise a loan that qualifies for the exemption. Similarly it broadens who can have an interest in the new and/or former residence(s), other than, or as well as, the employee. It does that in similar terms to those applying to an interest in the new residence as covered in section 277(1), dealt with in paragraph 1129.

1184. *Subsection (6)* provides for the tax payable to be decided on a provisional basis, should the whole circumstances surrounding the loan not be known at the time the need to make a decision arises.

Section 289: Relief for certain bridging loans not qualifying for exemption under section 288

1185. This section provides a measure of relief for those loans that do not qualify under the provisions of the section 288. It derives from section 191B(8) and (13) of ICTA.

1186. *Subsection (1)* describes the circumstances in which this section applies.

1187. An employee who has a bridging loan that would otherwise come within the provisions of the preceding section may not repay that loan until after the day determined by the formula set out in section 288(4). If so, the employee would not come within the exemption now set out in that section. In such a case the employee's liability in respect of the beneficial loan under section 175 of this Act is worked out as if the loan had been made on the day determined by that formula. *Subsection (2)* rewrites the corresponding provision from the source legislation.

1188. *Subsection (3)* maintains the position in the source legislation whereby that extension only applies to those matters covered by what was section 160 of ICTA and not to the matters covered by what was section 161 of ICTA.

1189. *Subsection (4)* provides for the tax payable to be decided on a provisional basis, should the whole circumstances surrounding the loan not be known at the time the need to make a decision arises.

Chapter 8: Exemptions: Special kinds of employees
Section 290: Accommodation benefits of ministers of religion
1190. This section provides that there is no liability to tax in respect of benefits arising in connection with accommodation provided for a full-time minister (defined at subsection (5)) in premises owned by a charity or ecclesiastical corporation.

1191. It derives from section 332 of ICTA.

1192. *Subsection (1)* provides that no liability to tax arises in respect of the payment or reimbursement of a statutory amount or statutory deduction. Both these terms are defined at subsection (5).

1193. *Subsection (2)* provides that no liability to tax arises in respect of expenses paid or reimbursed in connection with the provision of the accommodation where the minister is in "excluded employment". "Excluded employment" is defined in section 239(9).

1194. *Subsection (3)* excludes from the exemptions any parts of the property for which the minister is in receipt of rent.

1195. *Subsection (4)* defines the premises in respect of which benefits qualify for the exemption.

1196. *Subsection (5)* provides definitions for terms used in the section, including a definition of "charity" drawn from section 506(1) of ICTA. See *Note 34* in Annex 2.

Section 291: Termination payments to MPs and others ceasing to hold office
1197. This section derives from section 190 of ICTA. It refers to Acts that give MPs, MEPs and certain other political office-holders an entitlement to termination payments. That entitlement, established prior to termination, makes the payments chargeable to tax as earnings. The payments are in fact compensation for loss of office. If it were not for the predetermined entitlement they would normally fall within section 148 of ICTA and tax would be chargeable on an amount above the £30,000 threshold.

1198. This section ensures that such payments are not treated as earnings and are instead taxed as termination payments under Chapter 3 of Part 6 (which derives from section 148 of ICTA), subject to the threshold set out in that Chapter.

1199. Section 190(3) of ICTA applies to "grants and payments if they are not pension payments". The reference to pension payments is unnecessary because section 190 applies to "emoluments" and pension payments are not taxed as emoluments. The reference to pension payments has not been included in the rewritten section because they are not taxed as employment income.

1200. The reference to the Parliamentary Pensions Act 1984 has been omitted as it was repealed by the Ministerial and other Pensions and Salaries Act 1991 and would only apply where the loss of office was before 28 February 1991. It is now spent.

1201. The meaning of "a relevant office" is set out in section 4(6) of the Ministerial and Other Pensions and Salaries Act 1991. Broadly it covers all Government Ministers, Opposition Leaders and Whips, the Chairman and Deputy Chairmen of Ways and Means, and the Chairman and Deputy Chairman of Committees of the House of Lords.

Section 292: Overnight expenses allowances of MPs

1202. This section derives from part of section 200 of ICTA. It provides an exemption from income tax for certain allowances paid to Members of Parliament which without the exemption would be chargeable to tax as earnings.

1203. The allowances that qualify are those provided for by a resolution of the House of Commons covering the overnight expenses set out in the section, where an MP has to stay away from home overnight either in London or in the constituency in order to carry out Parliamentary duties.

1204. The material in sections 200 and 200ZA of ICTA has been rearranged. Overnight expense allowances to members of the House of Commons are dealt with in this section. Those paid to members of the Scottish Parliament, the National Assembly for Wales and the Northern Ireland Assembly are covered in section 293. Travel by members to European Union institutions or to the parliament of another member State is dealt with in section 294.

1205. Although the allowances are exempt from tax this section does not prohibit a deduction for an MP's expenses in respect of which the allowances are paid. That prohibition is in section 198(4) of ICTA, which is rewritten as section 360.

Section 293: Overnight expenses of other elected representatives

1206. This section derives from the overnight expenses part of section 200ZA of ICTA in respect of elected representatives of the Scottish Parliament, the National Assembly for Wales and the Northern Ireland Assembly.

1207. This exemption has not been combined with the similar one for Members of the House of Commons because the detailed rules are different. It is clearer to keep them separate. Again, this section is supplemented by section 360.

Section 294: EU travel expenses of MPs and other representatives
1208. This section brings together the exemption for European Union travelling expenses paid to MPs and members of the Scottish Parliament, the National Assembly for Wales and the Northern Ireland Assembly. It derives from parts of sections 200 and 200ZA of ICTA.

1209. The definition of European Union travel expenses is the same in both section 200 and section 200ZA of ICTA. It incorporates the extension to EU candidate countries made by section 41 of FA 2002. Combining the relevant parts of the two sections cuts out duplication. Again this section is supplemented by section 360.

Section 295: Transport and subsistence for Government ministers etc.
1210. This section provides an exemption in respect of transport or subsistence provided for certain Government office-holders, mainly Ministers, and members of their families or households. It derives from section 200AA of ICTA. The exemption also covers payments and reimbursements of travel and subsistence expenses if they are made by or on behalf of the Crown.

1211. The exemption was extended in FA 1999 to apply to Ministers and similar office-holders serving in the Scottish Parliament, the National Assembly for Wales and the Northern Ireland Assembly.

1212. For the purposes of this exemption, the provision of transport includes the provision of a car, which would otherwise give rise to a charge to tax under the benefits code. The source legislation applies the exemption specifically to cars, but then goes on to define a car as "any mechanically propelled road vehicle" – a phrase which could include, for example, a van or a motorbike. This slight incongruity has been removed by applying the exemption to the provision of a "vehicle", and defining "vehicle" in the same way as "car" is defined in the source legislation. It therefore applies to vans and motorbikes as well as cars.

Section 296: Armed forces' leave travel facilities
1213. This section provides there is no liability to tax on armed forces' leave travel facilities. It derives from section 197 of ICTA.

1214. *Subsection (1)* sets out the exemption. It covers the various travel warrants and allowances, including allowances for the use of private cars, made available to service personnel.

1215. The section substitutes "the armed forces of the Crown" for the wording, "the naval, military or air forces of the Crown", in section 197 of ICTA. The two terms are construed as having the same meaning and include all United Kingdom service personnel, both members of a regular force and members of a reserve force. References to the "armed forces" now also include the women's services, which was

not the position in 1977 when the exemption was introduced. The same term is used in this section and in section 297 for the same body of taxpayers.

1216. *Subsection (2)* excludes the provision of a vehicle for leave travel. Such provision remains taxable as a benefit under Chapter 6 of Part 3 (taxable benefits: cars, vans and related benefits). "Travel facilities" are not otherwise defined or limited.

Section 297: Armed forces' food, drink and mess allowances

1217. This section provides that no liability to income tax arises in respect of allowances paid to members of the armed forces, if those allowances are paid instead of food or drink, or as a contribution to the expenses of a mess. The section is the first of two that derive from parts of section 316 of ICTA.

1218. The legislation in section 316 derives from a number of different provisions originally enacted between 1946 and 1951. Those provisions were consolidated first as section 457 of ITA 1952 and then as section 366 of ICTA 1970 before becoming section 316. In the case of Lush (HM Inspector of Taxes) v Coles (1967) 44 TC 169, at 172G, Stamp J described them as containing "something of a hotchpot".

1219. Section 316 has five subsections, which may be divided into three categories.

1220. The first category consists of subsection (3), which deals with food and mess allowances. Subsection (3) is dealt with in this section. The subsection makes provision for two different categories of allowances; and it has been found helpful to deal with the two categories separately.

1221. The second category consists of subsection (4), which deals with training expenses allowances. Subsection (4) is dealt with in section 298.

1222. The third category consists of subsections (1), (2) and (5). These subsections deal with re-enlistment bounties and gratuities under schemes set up in 1946 and 1950 for certain categories of military personnel who had seen active service, either during the Second World War or in the years immediately following it. So far as may now be discovered, these schemes all came to an end many years ago; and consultations between the Inland Revenue and the Ministry of Defence have led to agreement that these provisions should not be retained. These subsections are not rewritten in this Act on the grounds that they are obsolete.

Section 298: Reserve and auxiliary forces' training allowances

1223. This section provides that no liability to income tax arises in respect of training allowances and bounties payable out of the public revenue to members of the reserve and auxiliary forces of the Crown. The section is the second of two deriving from provisions contained in section 316 of ICTA, and derives from subsection (4) of that section.

1224. This provision was litigated in Lush (HM Inspector of Taxes) v Coles (1967) 44 TC 169, where the taxpayer was an officer in the Civil Defence Corps who received a training bounty of £15 from local authority funds. The General Commissioners upheld his appeal against an assessment under Schedule E on the grounds that the bounty fell within what is now section 316(4). But the Inspector's appeal to the High Court was successful, because Stamp J held that a sum paid out of local authority funds could not be described as being paid "out of the public revenue".

Section 299: Crown employees' foreign service allowances
1225. This section provides there is no liability to tax on allowances paid to Crown employees as compensation for the extra cost of having to live outside the United Kingdom when working abroad. It derives from section 319 of ICTA.

1226. An allowance is exempt only if a certificate as to its purpose has been given by the Treasury or by an appropriate Minister.

1227. *Subsection (2)* lists the persons who, in addition to the Treasury, may give such a certificate.

1228. That list derives from the Transfer of Functions (Foreign Service Allowance) Order, SI 1996 No 313 (as varied by the Transfer of Functions (Lord Advocate and Secretary of State) Order, SI 1999 No 678 with effect from 19 May 1999, and the Ministry of Agriculture, Fisheries and Food (Dissolution) Order 2002, SI 2002 No 794 with effect from 27 March 2002).

Section 300: Consuls
1229. This section provides that employment income from the office of a consul (defined in subsection (3)) in the United Kingdom in the service of a foreign state is not liable to income tax.

1230. It derives from section 321 of ICTA.

1231. *Subsection (1)* provides the exemption.

1232. *Subsection (2)* provides that the income is also disregarded in estimating income for any other income tax purpose.

1233. *Subsection (3)* defines "consul".

Section 301: Official agents
1234. This section provides that employment income from an employment as an official agent (defined at subsection (5)) in the United Kingdom for a foreign state is not liable to tax if certain conditions are met.

1235. It derives from section 321 of ICTA.

1236. *Subsection (1)* provides that no liability arises on the employment income when two conditions are met.

1237. *Subsection (2)* gives the first of those conditions.

1238. *Subsection (3)* gives the second of those conditions.

1239. *Subsection (4)* provides that such income is disregarded in estimating the amount of income for any income tax purpose.

1240. *Subsection (5)* defines "official agent".

1241. *Subsection (6)* provides a condition to the definition of "official agent" in subsection (5).

Section 302: Consular employees

1242. This section provides that employment income from an employment in the United Kingdom as a consular employee (defined at subsection (4)) of a foreign state is not liable to tax where the appropriate Order in Council has been made and certain conditions are met.

1243. It derives from section 322 of ICTA.

1244. *Subsection (1)* provides that no liability arises on the employment income when an Order in Council gives effect to a reciprocal arrangement (defined at subsection (4)) and one of two conditions is met.

1245. *Subsection (2)* gives the first condition.

1246. *Subsection (3)* gives the second condition. Following the enactment of the British Overseas Territories Act 2002, references to "British Dependent Territories citizen" in earlier enactments are to be read as "British overseas territories citizen". This has been incorporated here.

1247. *Subsection (4)* defines "consular employee" and "reciprocal arrangement".

1248. *Subsection (5)* allows an Order in Council to limit the operation of the section in such a way as is considered necessary or expedient.

1249. *Subsection (6)* allows the Order in Council to have effect from an earlier date than the date on which it is made and to contain transitional provisions.

1250. *Subsection (7)* provides that the statutory instrument containing the Order is subject to a negative resolution.

1251. *Subsection (8)* provides that this section operates without prejudice to section 301.

Section 303: Visiting forces and staff of designated allied headquarters

1252. This section confers income tax benefits upon visiting forces and NATO staff.

1253. The section derives from section 323 of ICTA, which confers two income tax benefits:

- earnings paid by the government of a designated country or by a designated allied headquarters are exempt from income tax; and
- an individual to whom the section applies is not treated as resident in the United Kingdom by reason solely of being a member of a visiting force or of being attached to, or an employee of, a designated allied headquarters.

1254. This section deals with the first income tax benefit. It is proposed to deal with the second benefit in a future rewrite Bill.

1255. The exemption from income tax applies for several different descriptions of individuals:

- members of a visiting force of a designated country;
- members of a civilian component of a visiting force of a designated country;
- members of the armed forces of a designated country attached to a designated allied headquarters;
- members of a civilian component of the armed forces of a designated country attached to a designated allied headquarters; and
- employees of a designated allied headquarters who come within a description agreed between the government and the other members of the NATO Council.

1256. Section 323 of ICTA is entitled "Visiting forces". This section has a longer title, which is designed to be more informative.

1257. Two definitions needed for this section are contained in Part 1 of the Visiting Forces Act 1952. The definitions are those of a visiting force, in section 12(1) of that Act, and of a member of a civilian component of a visiting force, in section 10 of that Act. No attempt has been made to set out those definitions in this section – partly for reasons of length and partly because there is no wish to lose the explicit link between this section and the 1952 Act.

1258. Following the enactment of the British Overseas Territories Act 2002, references to "British Dependent Territories citizen" in earlier enactments are to be read as "British overseas territories citizen". This change has been incorporated in *subsection (4)*.

1259. In this section, the cross-references to the Visiting Forces Act 1952 differ slightly from those in section 323 of ICTA. *Subsection (5)* contains a reference to "Part 1 of the Visiting Forces Act 1952" as opposed to the reference to "the Visiting Forces Act 1952" in section 323(4). The additional words "Part 1 of" were in section 367(3) of ICTA 1970 (the predecessor of section 323(4) of ICTA 1988). These words have been reinstated, because the two most important interpretative provisions, for present purposes, are in Part 1 of the 1952 Act and apply for the purposes of that Part. Those provisions are the definitions of a member of a civilian component of a visiting force and of a visiting force.

1260. Subsection (5) also corrects another minor drafting error in section 323(4). That subsection refers to subsections (1) and (2) of section 323, and it is then stated that "those subsections shall be construed as one with the Visiting Forces Act 1952". However, the reference to a "civilian component" of a visiting force depends entirely upon subsection (4) itself; and no requirement is imposed to construe subsection (4) as one with the 1952 Act. It is thought that there cannot be any doubt that the provisions of section 10 of the Visiting Forces Act 1952 must be applicable; and the provision has been rewritten on this basis.

1261. Section 323 is one of a number of provisions that confer tax benefits to visiting forces and NATO staff. Other provisions are:

- section 11(1) of TCGA 1992 (for capital gains tax);
- section 155 of the Inheritance Tax Act 1984 (for inheritance tax); and
- section 74 of the Finance Act 1960 (for stamp duty).

Section 304: Experts seconded to European Commission

1262. This section provides there is no liability to tax on daily subsistence allowances paid by the European Commission to "detached national experts".

1263. It derives from ESC A84. See *Change 67* in Annex 1.

1264. *Subsection (1)* sets out the exemption for allowances paid to persons seconded under the "detached national experts scheme".

1265. Detached national experts are people seconded to the Commission to advise and assist Commission officials for periods from three months to three years, under a scheme introduced on 26 July 1988.

1266. *Subsection (2)* defines "detached national experts scheme" and provides for the exemption from tax to continue in the event that the scheme is replaced by a new scheme having broadly the same effect.

Section 305: Offshore oil and gas workers: mainland transfers

1267. This section provides an exemption from income tax for certain benefits received by a limited number of employees who work on offshore oil or gas installations. It derives from ESC A65. Legislating the concession is a minor change to the law. See *Change 68* in Annex 1.

1268. Those employees whose permanent workplace is the installation would normally be chargeable to tax in respect of any transport, accommodation and subsistence provided. That is because the travel to that workplace would be travel between home and work, so no deduction could be claimed under Part 5 for that or for any associated accommodation and subsistence. Under ESC A65 such benefits are not charged to tax.

1269. The provision of transport exempted by this section is confined to that part of the journey between home and work which starts at the mainland departure point from which the oil and gas rig workers are normally transported to the offshore installation. In *subsection (3)* this is defined as "transfer transport". Apart from travel from the nearby overnight accommodation (defined in *subsection (6)* as "local transport"), it does not provide exemption for travel between the mainland departure point and a place other than the offshore installation.

1270. If the employee has a permanent workplace on the mainland, the provision of transport to the installation is not exempt, but a deduction under Part 5 would be available. The same applies to the accommodation and subsistence in connection with such travel. This position is preserved by *subsection (5)* which makes it clear that the exemption only applies to the provision of transport, accommodation and subsistence for which a deduction would not be due if the employee had met the cost.

Section 306: Miners etc.: coal and allowances in lieu of coal

1271. This section provides an exemption from income tax to free coal, and smokeless fuel, and payments in lieu of free coal given to miners and certain other colliery workers. It derives from ESC A6. Legislating the concession is a minor change to the law. See *Change 69* in Annex 1.

1272. *Subsection (1)* identifies the scope of the exemption and who qualifies.

1273. *Subsection (2)* limits the scope of the exemption to the provision of free coal, or the payment of cash in lieu, of an amount that represents a reasonable level of personal consumption. But *subsection (3)* assumes that this condition is met unless the Inland Revenue can show that it is not. The purpose of these two subsections is to reproduce the restriction that applies to all ESCs - a concession will not be given where an attempt is made to use it to avoid tax. It is not expected that anyone

benefiting from the concession will not continue to benefit from exemption under this section.

1274. *Subsection (4)* gives the definition of "colliery worker". It includes all those persons who were regarded as coming within the scope of the concession.

Chapter 9: Exemptions: Pension provision
Section 307: Death or retirement benefit provision
1275. This section provides an exemption from the charge under the benefits code in respect of the provision by an employer for death or retirement benefits for an employee. It derives from a combination of the exemptions currently available under section 155(4) of ICTA and under ESC A72. That concession widens the scope of section 155(4), which only applies to death etc benefits payable to an employee's spouse, children or dependants. The concession covers death etc benefits payable to other members of the employee's family or household as defined in section 168(4) of ICTA. That definition is now in section 721(5).

1276. To the extent that this section legislates ESC A72 it is a minor change to the law. See *Change 70* in Annex 1.

1277. An employee normally nominates the person to whom any death benefits should be paid. The exemption only applies if that nominee remains a member of the employee's family or household.

Section 308: Exemption of contributions to approved personal pension arrangements
1278. This section provides there is no liability to income tax on contributions by an employer under approved personal pension arrangements made by the employee. It derives from section 643(1) of ICTA.

1279. *Subsection (1)* provides there is no liability to income tax on such contributions as earnings.

1280. *Subsection (2)* sets out relevant definitions by cross-reference to section 630(1) of ICTA.

1281. A personal pension scheme may be approved by the Board of Inland Revenue under section 631 of ICTA, in accordance with the rules in Chapter 4 of Part 14 of that Act.

Chapter 10: Exemptions: Termination of employment
Section 309: Limited exemptions for statutory redundancy payments
1282. This section provides for limited exemptions from income tax in respect of redundancy payments and approved contractual payments.

1283. *Subsection (1)* provides that there is no liability to income tax on redundancy payments and approved contractual payments as general earnings, except where *subsection (2)* applies. That subsection applies where the amount of an approved contractual payment exceeds the amount which would have been due if a redundancy payment had been payable. In such a case the excess is liable to income tax.

1284. *Subsection (3)* provides that there is no liability to income tax on redundancy payments and approved contractual payments as specific earnings, except under Part 6 Chapter 3 (payments and benefits on termination of employment).

1285. This section derives from parts of sections 579 and 580 of ICTA. It is drafted by reference to an "approved contractual payment" as opposed to the "corresponding amount of any other employer's payment" – the expression used in section 579(1). The section also introduces the expression "statutory payment" to describe the sum specified in section 579(6). These new expressions should make the legislation easier to follow. They also have the consequence that it is possible to dispense with the definition of "the Minister" in section 580(1)(c).

Section 310: Counselling and other outplacement services

1286. This section provides there is no liability to income tax on the provision of counselling and other services in connection with the cessation of a person's employment.

1287. It derives from sections 589A and 589B of ICTA as they apply to an employee. The provisions of 589A and 589B as they apply to an employer do not change, except that they have been amended to reflect the minor changes to the law made in this section. See paragraph 69 of Schedule 6.

1288. *Subsection (1*) provides the exemption and the conditions to be satisfied.

1289. *Subsection (2)* sets out condition A, which relates to the purpose of the provision of the services.

1290. *Subsection (3)* sets out condition B, which relates to the services provided.

1291. *Subsection (4)* sets out condition C, which relates to the qualifying two year period of continuous employment.

1292. Under the Employment Rights Act 1996, some events that involve a change in the identity of the employer are treated as not breaking the continuity of employment. The two year requirement is therefore expressed in terms of the employment that is ceasing, not of employment by the employer. See *Change 71* in Annex 1.

1293. *Subsection (5)* sets out condition D, which relates to the availability of the services to employees generally.

1294. *Subsection (6)* sets out condition E, which relates to travel expenses.

1295. Travel expenses meeting condition E include expenses that, on the assumptions in subsection (7), would be deductible under any provision of Part 5. Under ICTA, expenses within the exemption are restricted to expenses deductible only under selected sections of those rewritten in that Part. See *Change 73* in Annex 1.

1296. This section is listed in section 332 (meaning of "the deductibility provisions"). Various provisions in Part 5 then ensure that certain rules in Part 5 do not adversely restrict expenses, deductible under that Part, for the purposes of condition E.

1297. *Subsection (7)* sets out the assumptions made in applying condition E to travelling expenses. To accord with Inland Revenue practice, one of those assumptions is that the expenses are incurred and paid by the employee. But the assumption that they are paid out of emoluments has not been rewritten. See *Change 81* in Annex 1.

1298. To accord with Inland Revenue practice, the section omits the condition in section 589B(2)(e) of ICTA, that the services are provided in the United Kingdom, and the apportionment rule in section 589B(3) which applies if services are provided partly in and partly outside the United Kingdom. A similar condition, in section 589(1)(d) of ICTA, has been omitted from section 311 for the same reason. Removal of this condition aligns sections 310 and 311 with the exemptions in Chapter 4 of Part 4. See *Change 72* in Annex 1.

Section 311: Retraining courses

1299. This section provides there is no liability to income tax on payment or reimbursement of retraining course expenses when a person's employment has ceased or is expected to cease.

1300. It derives from sections 588 and 589 of ICTA as they apply to an employee. The provisions of 588 and 589 as they apply to an employer do not change, other than to adopt the minor changes to the law made in this section. See paragraph 67 of Schedule 6.

1301. *Subsection (1)* provides the exemption and the conditions to be satisfied.

1302. *Subsection (2)* defines "retraining course expenses" for the purposes of the exemption.

1303. *Subsection (3)* sets out the course conditions.

1304. The section does not require a course to be undertaken "with a view to retraining the employee". In practice a course is regarded as so undertaken if the

conditions in the section are satisfied. This additional requirement is superfluous. See *Change 74* in Annex 1.

1305. To accord with Inland Revenue practice, the section also omits the condition in section 589(1)(d) of ICTA, that all teaching and practical application forming part of the course takes place in the United Kingdom. A similar condition, in section 589B(2)(e) of ICTA, has been omitted from section 310 for the same reason. Removal of this condition aligns sections 310 and 311 with the exemptions in Chapter 4 of Part 4. See *Change 72* in Annex 1.

1306. *Subsection (4)* sets out the employment conditions.

1307. Under the Employment Rights Act 1996, some events that involve a change in the identity of the employer are treated as not breaking the continuity of employment. The requirement that the employee be employed continuously for two years prior to retraining or, if earlier, when the employment ceased, is therefore expressed, as in section 310(4), in terms of the employment that is ceasing, not of employment by the employer.

1308. Expressing the requirement this way aligns sections 310 and 311 in their treatment of the same requirement. See *Change 71* in Annex 1.

1309. *Subsection (5)* sets out the conditions that relate to travelling expenses.

1310. As in section 310, travel expenses meeting this condition include expenses that, on the assumptions in subsection (6), would be deductible under any provision of Part 5. Under ICTA, expenses within the exemption are restricted to expenses deductible only under selected sections of those rewritten in that Part. See *Change 73* in Annex 1.

1311. This section is listed in section 332 (meaning of "the deductibility provisions"). Various provisions in Part 5 then ensure that certain rules in Part 5 do not adversely restrict expenses, deductible under that Part, for the purposes of subsection (5).

1312. *Subsection (6)* sets out the assumptions made in applying the condition in subsection (5) to travelling expenses. To accord with Inland Revenue practice, one of those assumptions is (as in section 310) that the expenses are incurred and paid by the employee. But the assumption that they are paid out of emoluments has not been rewritten. See *Change 81* in Annex 1.

Section 312: Recovery of tax

1313. This section provides machinery for an assessment to charge the amount due if exemption under section 311 has been given and there is a subsequent failure to meet certain of the conditions in section 311(4).

1314. It derives from section 588 of ICTA.

1315. *Subsection (1)* sets out the circumstances in which the section applies.

1316. *Subsection (2)* sets out what will be assessed if the section applies, and provides the mechanism for such an assessment.

1317. *Subsection (3)* provides the time limit for the making of such an assessment.

1318. *Subsections (4)* to *(6)* contain provisions which:

- require the employer or former employer to notify the Inland Revenue of a failure within the terms of subsection (1) to meet the conditions in section 311(4); and

- permit the Inland Revenue to require information from a person they have reason to believe has failed to fulfil that requirement.

Chapter 11: Miscellaneous exemptions
Section 313: Repairs and alterations to living accommodation
1319. This section derives from section 155(3) of ICTA. It only applies in the case of provided accommodation which falls within Chapter 5 of Part 3.

1320. In the case of alteration and additions to the property within *subsection (2)(a*), the cost would sometimes result in an increase in the cash equivalent under Chapter 5 of Part 3. In order to prevent a double charge to tax it is necessary to exempt the cost of the alterations and additions which fall through to Chapter 10 of Part 3 because the cost of provision was "not otherwise chargeable to tax".

1321. The second part of this exemption at *subsection (2)(b)* refers to landlord's repairs, the definition of which prevents it extending to tenant's repairs, or improvements disguised as repairs.

Section 314: Council tax etc. paid for certain living accommodation
1322. This section derives from section 145(4) of ICTA. Without this section, a tax liability could still arise if charges in connection with the property were paid (or the cost reimbursed) by the employer.

1323. *Subsection (1)* applies the section when certain exceptions from a charge on living accommodation apply.

1324. *Subsection (2*) applies the exemption to a fuller and more updated description of domestic property charges: "council tax or rates, water or sewerage charges", in line with Inland Revenue practice. This is a minor change to the law. See *Change 75* in Annex 1.

Section 315: Limited exemption for expenses connected with certain living accommodation

1325. This section limits the amount charged to tax in respect of certain expenditure (or reimbursement of expenditure by the employee) in connection with living accommodation. It derives from section 163 of ICTA. It applies to all employees whether in excluded employment or not whereas section 163 applies only to those employments within Chapter 2 of Part 5 of ICTA. This is a minor change in the law. See *Change 76* in Annex 1.

1326. *Subsections (2)* and *(3)* set out the conditions which must be satisfied for the exemption to apply.

1327. *Subsection (4)* provides a formula to calculate the amount to which the exemption is applied. The following example shows how the formula works, using NE, DA, DE and SMG as defined in the section.

1328. Assume an employee's earnings are £10,000 a year (and there are no deductions) and no sums made good. The formula works to give the right pro-rata result for each of the following circumstances:

- Employment held and accommodation provided for whole year

  NE = £10,000; DA = 365; DE = 365; SMG = 0

  so limit is (10% x £10,000 x 365/365) – 0 = £1,000

- Employment held for whole year, accommodation provided for 6 months

  NE = £10,000; DA = 183; DE = 365; SMG = 0

  so limit is (10% x £10,000 x 183/365) – 0 = £500

- Employment held and accommodation provided for 6 months

  NE = £5,000; DA = 183; DE = 183; SMG = 0

  so limit is (10% x £5,000 x 183/183) – 0 = £500

1329. *Subsection (5)* is a method statement to calculate the amount of net earnings to be used in subsection (4).

Section 316: Accommodation, supplies and services used in employment duties

1330. This section derives from section 155ZA of ICTA which excludes from section 154 of ICTA the charge on benefits arising from the provision of

accommodation, supplies and services mainly used to perform an employee's duties of the employment, but also used to a minor degree for other purposes.

Section 317: Subsidised meals

1331. This section derives from section 155(5) of ICTA which provides an exemption for canteen meals and from ESC A74. The ESC provides an exemption for the provision of any free or subsidised meals on the employer's premises, but not elsewhere, provided that all the employer's employees are able to obtain such meals or have vouchers or tokens enabling them to obtain such meals, regardless of where those meals are obtained. To the extent that this section legislates ESC A74 it is a minor change to the law. See *Change 77* in Annex 1.

1332. Section 155(5) of ICTA and the concession requires meals to be available to the staff "generally". It was not clear how that test applies when employees work at different locations. In practice the rule is applied sensibly and the new section provides clarification by focusing on the employees at a particular location.

1333. Section 155(5) of ICTA and ESC A74 only provide an exemption from the benefits charge. This section goes further and provides a complete exemption from income tax. This is a minor change to the law. See *Change 77* in Annex 1.

Section 318: Care for children

1334. This section provides there is no liability to tax on the benefit of "workplace nursery" facilities provided for the children of employees. It derives from section 155A of ICTA.

1335. *Subsection (1)* provides exemption for the benefit which arises by virtue of Chapter 10 of Part 3 (taxable benefits: residual liability to charge), where the provision of care for a child meets the conditions in subsections (3), (4) and (6).

1336. *Subsection (2)* set out the limited exemption where only part of the provision meets those conditions.

1337. *Subsection (3)* contains conditions applying to the child for whom care is provided.

1338. Section 155A of ICTA used the term "parental responsibility", which is defined by cross-reference to the Children Act 1989. The definition in the latter Act is used directly in subsection (3)(c).

1339. *Subsection (4)* contains conditions applying to the premises at which care is provided for the child.

1340. The cross-references required for the definition in *subsection (5)* of the term "registration requirement" (used in subsection (4)) have been updated.

1341. *Subsections (6)* and *(7)* contain conditions applying to the employer's involvement in providing the premises at which care is provided.

1342. *Subsection (8)* defines "care" for the purposes of the exemption.

Section 319: Mobile telephones
1343. This section derives from section 155AA of ICTA, which excludes from section 154 of ICTA the benefit arising from the provision of a mobile telephone. It is no longer necessary to make any special mention of mobile phones provided in connection with a taxable car, van or exempt heavy goods vehicle, as benefits provided in connection with such vehicles are adequately covered by section 239. Accordingly section 155AA(3) has not been rewritten. See *Note 35* in Annex 2.

Section 320: Limited exemption for computer equipment
1344. This section derives from section 156A of ICTA, which provides a limited exemption in respect of computer equipment provided to employees or members of their families or households.

1345. The exemption only applies where the employer provides the computer equipment for the use of the employee (or members of his or her family etc) rather than transferring it to him or her. In a case where the computer is given to the employee to keep, the benefit arising is still chargeable to tax in the normal way.

1346. The exemption is not available in cases where the arrangements to provide computer equipment particularly favour directors. This does not mean that where an employer has provided computer equipment only for directors or their families, because only they have taken up an offer available to all employees, that the exemption cannot apply. The employer's provision of computer equipment has to be deliberately restricted to directors and their families for the exemption to be withheld. This is covered in section 156A(2) of ICTA, rewritten in this section as *subsection (6).*

1347. The definition of director in *subsection (7)(b)* derives from section 168 of ICTA. It is necessary to bring the definition into this section because this provision is not in the benefits code.

Section 321: Suggestion awards
1348. This section provides that no liability to income tax arises where awards which do not exceed the limits set by section 322 are made under a suggestions scheme.

1349. It derives from ESC A57. See *Change 78* in Annex 1.

1350. *Subsection (1)* sets out the type of scheme to which the section applies.

1351. *Subsection (2)* provides that no liability to tax arises on an encouragement award or a financial benefit award (defined in subsection (6)) which meets the three

conditions in subsections (3) to (5), to the extent that it does not exceed the limits set by section 322.

1352. *Subsection (6)* defines "encouragement award" and "financial benefit award".

Section 322: Suggestion awards: "the permitted maximum"
1353. This section provides the level, "the permitted maximum", at or below which a suggestion award is not liable to tax.

1354. It derives from ESC A57. See *Change 78* in Annex 1.

1355. *Subsection (1)* gives the permitted maximum for an encouragement award.

1356. *Subsection (2)* provides that the permitted maximum for a financial benefit award where no previous award has been made for that suggestion is the suggestion maximum or, where the award is made to more than one person, the appropriate proportion of that maximum award. The suggestion maximum is given at *subsection (4)* and "the appropriate proportion" is defined at *subsection (6)*.

1357. *Subsection (3)* provides that the permitted maximum for a financial benefit award where an award has already been made for that suggestion is the residue of the suggestion maximum or, if more than one such award has been made previously, the appropriate proportion of that residue. "The residue of the suggestion maximum" is defined at subsection (6).

1358. *Subsection (4)* gives the suggestion maximum for financial benefit awards. This is the maximum of £5,000 or the financial benefit share (defined at *subsection (5)*). The power to alter the limit in this provision is contained in section 716.

1359. *Subsection (5)* defines the "financial benefit share" as the greater of half the financial benefit likely to arise within the first year of the adoption of the suggestion or one-tenth of the financial benefit for the first five years after its adoption.

1360. *Subsection (6)* defines "the appropriate proportion" and "the residue of the permitted maximum" which are used at subsections (2) and (3). It also defines "the total previous exemption" used in the definition of "the residue of the permitted maximum".

Section 323: Long service awards
1361. This section derives from ESC A22 which concerns awards made to mark long service. Where the conditions are met the concession provides an exemption from income tax. Legislating the concession is a minor change to the law. See *Change 79* in Annex 1.

1362. The concession was introduced in the mid-1970s when employers had begun to give employees long service gifts other than the traditional clock or watch. It was restricted to tangible articles or shares of a defined kind to prevent cash payments that would properly be charged as earnings being dressed up as long service awards. In practice, the concession is applied more liberally than a strict interpretation of it would permit. For example, the provision by the employer of a holiday or a life membership to the National Trust as a long service award would be treated as covered by the concession. The scope of this section as set out in *subsection (3)* should cover all the types of award currently treated as being within the concession.

1363. When an ESC contains monetary limits, any change in those limits may be made by press release or by republishing the ESC with different amounts. This is not possible for legislation. There are a number of exemptions in the source legislation in which an amount is fixed by Treasury order and the power to alter the limit in this provision is contained in section 716.

1364. The concession does not restrict qualifying service to "the same employer" in the same way as the definition of a long service award in *subsection (2)*. However, in practice the concession is applied so that the service must be with the same employer unless there has been a change of employer of the kind described in *subsection (5)*.

1365. The definition of "group" adopted means that the minimum possible group relationship will enable the exemption to apply.

Section 324: Small gifts from third parties

1366. This section derives from ESC A70A. It provides an exemption from income tax in respect of certain small gifts from third parties. Legislating the concession is a minor change to the law. See *Change 59* in Annex 1.

1367. The conditions for the exemption are in similar terms to the entertainment exemption in section 265. The reasons for it are the same, namely to remove the compliance problems if the conditions in *subsections (2)* to *(6)* are met. Those conditions include a limit on value of the gifts which may be varied by the Treasury power in section 716.

1368. The concession also extends to non-cash vouchers and credit-tokens. That aspect is dealt with in section 270.

Section 325: Overseas medical treatment

1369. This section derives from section 155(6) of ICTA. It originated as an ESC which was enacted in FA 1981. The exemption relates to the provision of medical treatment and the provision of insurance against the cost of medical treatment.

1370. As far as the first aspect is concerned, the exemption only applies where the provision of the medical treatment falls within benefits code. There is no exemption if

the payment for the treatment is handled in such a way that chargeability arises as earnings.

1371. The same applies to the provision of insurance. It is only direct provision which is exempt, so it does not cover reimbursement of the employee's premium for overseas medical insurance.

1372. The reference to in-patient treatment is applicable to the whole section. This is to clarify that the insurance may also provide cover for in-patient treatment.

Section 326: Expenses incidental to transfer of a kind not normally met by transferor

1373. This section exempts from income tax certain paid or reimbursed expenses which arise in connection with an asset transferred by reason of the employment. This exemption will most commonly apply where an employee, benefiting from a relocation package, transfers his or her house to an employer who pays the acquisition costs.

1374. It derives from ESC A85. See *Change 80* in Annex 1.

1375. *Subsection (1)* provides that no liability to tax arises where expenses incidental to an "employment-related asset transfer" (defined at subsection (2)) are paid or reimbursed. The expenses must be wholly and exclusively incurred as a result of that transfer and not of a type normally met by the transferor. Thus the disposal costs of a house sold to an employer under a relocation package are not within the exemption as the vendor would normally be the one to meet these costs.

1376. *Subsection (2)* defines "employment-related asset transfer" as the transfer of an asset to an employer or person nominated by the employer and which arose by reason of the employment.

1377. *Subsection (3)* explains what is meant by "transfer".

Part 5: Employment income: deductions allowed from earnings

Background

1378. This Part provides for deductions allowed from earnings.

1379. The charge to tax on employment income is a charge to tax on two different categories of employment income: "general earnings" and "specific employment income" (see section 6(1)); and, in the case of "general earnings", (a term defined in section 7(3)), the amount charged to income tax is the "net taxable earnings" from the employment in the tax year (see section 9(2)). Section 11 then provides that the net taxable earnings from an employment in a tax year consist of the total amount of the taxable earnings from the employment less the total amount of any deductions allowed from those earnings (as listed in section 327(3) to (5)). And it is with this final component of "net taxable earnings" that this Part of this Act is concerned.

1380. In ICTA, the deductions provisions are very difficult to unravel. Some individual provisions are straightforward. But there are many connections between provisions. They interact in ways which are not always easy to follow. Several fictions have been adopted to make the provisions work.

1381. One major source of complexity is that the expenses of an employee may be met in several possible ways, taxed under different sections of ICTA. The mechanism for making a deduction may vary according to the circumstances.

1382. For example, consider the position of a director making a train journey to attend a meeting. The table below shows some of the various ways in which the employer might fund the trip, how the director would be taxed and how the director might obtain a deduction in respect of the expenses of the train ticket. (References to sections are to sections of ICTA.)

Employer funds trip by	*Charging provision*	*Deduction allowable under*
round sum allowance	section 19(1)1	section 198
specific expense payment	section 153	section 198
buying the ticket	section 141	section 198 via section 141(3)
providing credit card for employee to use on ticket	section 142	section 198 via section 142(3)

1383. There are other possibilities. For example, if the same director travelled to the same meeting using private transport provided by the employer, the provision of the transport would be taxed under section 154 of ICTA, with a deduction allowable under section 198 via section 156(8). And if the business journey involved foreign travel, there are further deduction provisions that may apply.

1384. Another major source of complexity is that the central provision relating to deductions, section 198 of ICTA, is used by other provisions of ICTA and is used in different ways. For example:

- under section 156(8) of ICTA, the cost of a benefit provided is allowed as a deduction under section 198, or other provisions, if it would be allowed as a deduction if paid out of emoluments;

- under section 193(3) of ICTA, certain travel expenses are treated as having been necessarily incurred in the performance of the duties of an overseas employment for the purposes of section 198(1);

- under section 193(7) of ICTA, references to section 198, and to deductions under section 198, are treated as including references to section 193(3), and to deductions under that subsection; and

- under section 200A(1) of ICTA, incidental overnight expenses are not regarded as emoluments if they would not be deductible under section 198.

1385. In this Act the number of provisions that cross-refer to other deductions provisions has been much reduced. The view has been taken that it is more helpful, in the case of each deduction provision, to set out in full the conditions that must be met. In setting out those conditions, Inland Revenue practice has been followed. As a result of this approach, sections 194(10) and 195(11) of ICTA, which provide for provisions to be construed with other provisions, have no direct successors in this Act.

Overview
1386. In this Part, in order to make each individual deduction provision as simple as possible, Chapter 1 states some general propositions about deductions. This saves those propositions having to be repeated in the individual provisions, so the deductions sections can then concentrate on the rules applying for the particular deduction in question.

1387. The provisions relating to deductions are then grouped in different chapters according to the type of deduction. So there are separate chapters for:

- deductions for employee's expenses (Chapter 2);

- deductions from benefit code earnings for costs which would have been deductible if they had been paid by the employee (Chapter 3);

- deductions for employee's expenses covered by fixed allowances (Chapter 4);

- deductions for earnings which represent expenses borne by the employer (Chapter 5); and

- deductions from seafarers' earnings (Chapter 6).

1388. Within Chapters 2 and 5, the provisions are then grouped according to the type of expense involved. For example, in Chapter 2, sections 337 to 342 deal with travel expenses.

1389. Within this Part, very many of the sections that allow deductions are drafted in accordance with the general formula that a deduction from earnings is allowed for an amount whose characteristics are then specified.

Chapter 1: Deductions allowed from earnings: general rules
Overview
1390. This is the first of six chapters dealing with deductions allowed in charging earnings to income tax.

1391. After the introductory section 327, this Chapter sets out some general propositions which are applicable to most of the deductions dealt with in the next five chapters. Those propositions relate to:

- the income from which deductions may be made (section 328);
- the general prohibition on deductions exceeding earnings (section 329);
- the prevention of double deductions (section 330); and
- the order in which deductions are to be made (section 331).

1392. This Chapter concludes with section 332, which lists "the deductibility provisions".

Section 327: Deductions from earnings: general

1393. This section sets the scene. It gives information about the contents of this Part, and places this Part within a wider context.

1394. The section is new, although it draws on material contained in section 131(1) of ICTA.

1395. *Subsection (1)* provides the essential link between this Part of this Act and section 11(1), which is in Part 2. The subsection states that this Part provides for deductions that are allowed from the taxable earnings from an employment in a tax year for the purpose of calculating the "net taxable earnings" from the employment in the tax year for the purposes of Part 2 of this Act.

1396. *Subsection (2)* sets out how two key expressions are used in this Part. References to the earnings from which deductions are allowed are references to the taxable earnings mentioned in subsection (1), and references to the tax year are references to the tax year mentioned there.

1397. *Subsection (3)* states that the deductions for which this Part provides are those allowed under Chapters 2 to 6; and the contents of those Chapters are indicated.

1398. *Subsection (4)* lists other provisions, not in this Part, which make further provision about deductions; and *subsection (5)* lists other provisions, not in this Part, which make further provision about deductions from income including employment income.

Section 328: The income from which deductions may be made

1399. This section is the first of four which sets out a general proposition relating to deductions from earnings. It deals with the income from which deductions may be made.

1400. The most important single source for this section is section 198(1) of ICTA, which includes the proposition that an amount paid "out of the emoluments of the office or employment … may be deducted from the emoluments to be assessed". This section also draws on a considerable number of other passages in Part 5 of ICTA and in section 50 of FA 1989.

1401. *Subsection (1)* sets out the general rule that deductions under this Part are allowed from any earnings from the employment in question, but not from earnings from any other employment.

1402. An example of how this rule operates in practice is given in Inland Revenue guidance in SE 31658:

> An individual is employed as a teacher and separately employed as coach to a local youth football team. As coach she is paid £100 a year but she incurs expenses of £1,000 a year in travelling to away matches. She pays the expenses herself and is not reimbursed by her employer.
>
> She is only allowed a deduction of £100 for her travelling expenses under section 198(1) of ICTA. She cannot claim a loss for the remaining £900 and nor can she deduct that amount from her teaching income.

1403. The general rule is subject to a number of qualifications. These are dealt with in the rest of this section.

1404. *Subsection (2)* deals with one case where the general rule is not wide enough. Expenses of a minister of religion (see section 351) are allowed from earnings from any employment as a minister of a religious denomination.

1405. *Subsections (3)* to *(5)* deal with cases where the general rule is too wide: for example there are some cases where the deductions are allowed only from earnings with particular characteristics – either relating to the source of the earnings or to the manner in which the earnings are charged to tax.

1406. Subsection (3) provides that deductions under section 368 are only allowed from earnings payable out of the public revenue.

1407. Subsections (4) and (5) deal with "deductions limited to specified earnings": for, in the cases of some provisions, deductions are allowed from earnings from the employment which qualify as taxable earnings under certain of the charging provisions of Chapters 4 and 5 of Part 2, but not from other earnings from the employment.

Section 329: Deductions from earnings not to exceed earnings

1408. This section is the second of four which sets out a general proposition relating to deductions from earnings. It deals with the proposition that deductions from earnings may not exceed earnings.

1409. As in the case of section 328 the most important single source for this section is section 198(1) of ICTA, which allows a deduction for an amount if "the holder of an office or employment is obliged to incur and defray [that amount] out of the emoluments of the office or employment". This section also draws on a considerable number of other passages in Part 5 of ICTA and in section 50 of FA 1989.

1410. *Subsection (1)* sets out the general rule that deductions may not exceed the earnings from which they are deductible. That general rule is then elaborated in *subsections (2)* to *(4)*.

1411. Inland Revenue guidance makes it clear that the employee does not generally have to demonstrate that an expense has literally been paid out of the emoluments rather than out of some other source of money. It is generally sufficient that the emoluments charged to tax in a particular tax year are equal to, or greater than, the deductions to be made from those emoluments. As the Inland Revenue does not generally trace the source of funds used by the employee to pay expenses, the requirement that the employee must pay the expenses out of the emoluments of the employment is not stated in general terms in this Act. See *Change 81* in Annex 1.

1412. *Subsection (5)* deals with a matter which follows on from the fact that this Act does not reproduce any general requirement that expenses must be paid out of the emoluments of the employment. This Act rewrites numerous provisions that refer to expenses that would be allowable if the employee paid them out of the emoluments of the employment. Those provisions ("the deductibility provisions") are listed in section 332. Since the general requirement in *subsection (1)* that deductions from earnings are not to exceed earnings is assumed to be met in the deductibility provisions (because of the references in them to the employee being assumed to have paid the amounts or expenses out of emoluments), this subsection provides that this section is to be disregarded for the purposes of the deductibility provisions.

1413. *Subsection (6)* provides a signpost to section 380 of ICTA, a section drafted on the basis that there may be Schedule E losses which may be set against other income of the tax year, or carried back to earlier tax years.

Section 330: Prevention of double deductions

1414. This section is the third of four which sets out a general proposition relating to deductions from earnings. It deals with the prevention of double deductions.

1415. The proposition in this section is not articulated in general terms in ICTA, although it seems true as a matter of income tax law. There are statements of this proposition in particular contexts in sections 194(9), 195(12) and 198(3) of ICTA.

1416. *Subsection (1)* sets out the general rule: a deduction from earnings under this Part is not allowed more than once in respect of the same costs or expenses.

1417. Subsection (1) is expressed to apply to "costs and expenses". These words are intended to cover all potential deductions under this Part, even though the amount of the deduction may not be computed by reference to an actual amount of expenditure – as is the case under Chapter 4 of this Part, which deals with fixed allowances for employee's expenses.

1418. *Subsection (2)* deals with the case where a cost or expense qualifies both for an allowance under Chapter 4 of this Part and for a deduction under some other provision. In such a case only one of the deductions is allowed. This provision codifies Inland Revenue practice on these topics. See *Change 82* in Annex 1.

Section 331: Order for making deductions

1419. This section is the last of four which sets out a general proposition relating to deductions from earnings. It deals with the order in which deductions may be made.

1420. *Subsection (1)* sets out the general rule that section 835 of ICTA, which provides for deductions to be allowed in the order which results in the greatest reduction of liability to income tax, applies in the present context.

1421. *Subsection (2)* qualifies the general rule. The subsection specifies two provisions which impose a requirement to consider deduction provisions in a particular order.

Section 332: Meaning of "the deductibility provisions"

1422. This Act rewrites numerous provisions that refer to amounts or expenses whose deduction would be allowed if the employee incurred and paid them out of the emoluments of the employment (or in some cases just incurred or just paid them). See *Change 81* in Annex 1.

1423. The provisions of the Act that rewrite these provisions are listed in this section, where they are defined as "the deductibility provisions".

1424. The requirement that amounts or expenses be incurred and paid out of emoluments of the employment is not, in general, being rewritten: so the deductibility provisions do not rewrite the words "out of the emoluments". Instead, they refer to amounts or expenses that would be allowed as a deduction if the employee had incurred and paid them.

1425. Since the general requirement in section 329(1) that deductions from earnings are not to exceed earnings is assumed to be met in the deductibility provisions (because of the references in them to the employee being assumed to have paid the amounts or expenses out of emoluments), section 329(5) provides that section 329 is to be disregarded for the purposes of the deductibility provisions.

1426. In the case of the deduction under section 353, where the requirement for payment out of earnings has survived, it is provided that, for the purposes of the

deductibility provisions, the expenses are to be assumed to have been paid out of the earnings in question. (See section 353(4).)

Chapter 2: Deductions for employee's expenses

Overview

1427. This Chapter deals with the most familiar situation in which deductions from earnings are allowed – where the employee has paid an expense of the employment. The Chapter also deals with the situation where someone else (usually the employer) pays the expense on the employee's behalf. The Chapter therefore deals with section 198 of ICTA, with the related provisions in Schedule 12A of that Act, and with a number of other provisions, such as sections 201, 201AA and 201A of ICTA, which allow deductions for particular expenses paid by the employee.

1428. The Chapter may be divided into the following components:

- introductory provisions (sections 333 to 335);
- the general rule governing the deduction of expenses (section 336);
- further rules allowing the deduction of particular expenses, grouped according to the type of expense involved (sections 337 to 352);
- special rules for earnings with a foreign element (sections 353 to 355); and
- rules which prohibit or restrict deductions (sections 356 to 360).

Section 333: Scope of this Chapter: expenses paid by the employee

1429. This section sets out the distinguishing condition for the deductions allowed under this Chapter: the amount in question must have been paid by or on behalf of the employee.

1430. *Subsection (1)* sets out this basic proposition.

1431. The most important single source for this section is section 198(1) of ICTA, which allows a deduction for an amount where the holder of an office or employment is obliged to "incur and defray" that amount. There are also a number of other provisions in Part 5 of ICTA which have similar wording.

1432. There is, however, another point that arises in relation to this part of section 198(1) of ICTA and other corresponding provisions. A deduction may be allowed where the employee has incurred the expense but the actual liability is met by someone else, usually the employer. Where the employee's pecuniary liability is met in this way it is an emolument. It is taxed under paragraph 1 of section 19(1) of ICTA. As the expense is met in a way that constitutes emoluments, it is accepted that it has been defrayed out of those emoluments. The employee, accordingly, is allowed a deduction if the liability met comes within the wording of section 198(1) of ICTA or

some other corresponding provision. This, in practice, is how those provisions are operated. *Subsection (1)(b)* of this section therefore provides for a deduction to be allowed for such an amount if that amount is paid on the employee's behalf by someone else and is included in the earnings. See *Note 36(A)* in Annex 2.

1433. The source legislation does not state explicitly that a deduction is allowed where the employee incurs the expense but the liability is met by someone else. *Subsection (2)* makes the position clearer by providing that the employee is treated as paying the expense where the actual liability is met by someone else and constitutes earnings of the employee.

1434. To be allowed a deduction under this Chapter, an employee must satisfy subsection (1), read, if necessary, with subsection (2), although there are some provisions where it is perhaps unlikely that subsection (2) will be in point. The inclusion of these propositions here means that it becomes unnecessary to say something to the same effect in each of the individual deduction provisions in this Chapter.

1435. *Subsection (3)* deals with the two exceptions to subsection (1). In the case of these two exceptions, subsection (2) is also disapplied.

1436. *Subsection (4)* consists of a signpost to the following Chapter. That Chapter deals with deductions from benefits code earnings for costs that would have been deductible if the employee had paid them. It therefore covers cases where an expense is met by the employer in the form of a taxable benefit.

Section 334: Effect of reimbursement etc.

1437. This section contains provisions dealing with the effect of reimbursement.

1438. Under the source legislation, a reimbursed amount is dealt with for income tax purposes in either of two ways:

- if the reimbursed amount constitutes part of the earnings from the employment, the deduction is allowed in full; or

- if the reimbursed amount does not constitute part of the earnings from the employment, the deduction of the expense is not allowed to the extent that reimbursement is made. The speeches of Lord Guest and Lord Pearce in Pook (HM Inspector of Taxes) v Owen (1969) 45 TC 571 envisage that a reimbursed amount may be dealt with in this way.

1439. Against this background, this section has been included in this Act with the object of making explicit provision for cases where an amount is reimbursed. This section is not derived directly from the source legislation, but it reflects Inland Revenue practice in cases where amounts deductible for income tax purposes are reimbursed. See *Note 36(B)* in Annex 2.

1440. This section also includes wording to ensure that the provisions of this Chapter apply where a payment is made to the employee in respect of the expenses in question, and that payment is included in the employee's earnings. This wording guards against the argument that, in such a case, it is the person making the payment to the employee who pays the amount in question, and not the employee.

1441. *Subsection (3)* provides that this section does not apply to expenses allowed under section 351 (expenses of ministers of religion).

1442. *Subsection (4)* provides that this section is disregarded for the purposes of the deductibility provisions (as defined in section 332).

Section 335: Application of deductions provisions: "earnings charged on receipt" and "earnings charged on remittance"

1443. This section provides that the availability of certain deductions under this Chapter depends on whether or not the earnings are "earnings charged on receipt" or "earnings charged on remittance".

1444. The section is new, but it draws on material in section 198(2) of ICTA.

1445. The expressions "earnings charged on receipt" and "earnings charged on remittance" are defined in *subsection (4)* for the purposes of this Part of this Act. The ambit of the expression "earnings charged on receipt" is the same as that of Cases I and II of Schedule E in paragraph 1 of section 19(1) of ICTA; and the ambit of the expression "earnings charged on remittance" is the same as that of Case III of Schedule E in section 19(1) of that Act.

Section 336: Deductions for expenses: the general rule

1446. This section states the general rule relating to deductions allowed from earnings.

1447. The section derives from section 198(1)(b) of ICTA. This provision has been the subject of much litigation.

1448. *Subsection (1)* states the general rule: a deduction from earnings is allowed for an amount if the employee is obliged to incur and pay it as holder of the employment, and the amount is incurred wholly, exclusively and necessarily in the performance of the duties of the employment.

1449. *Subsection (2)*, which is new, provides that the following sections in this Chapter contain additional rules allowing deductions for particular kinds of expenses, and rules preventing particular kinds of expenses from being deductible. This subsection, accordingly, emphasises the fact that deductions under the later sections in this Chapter do not depend on this section being satisfied first.

1450. *Subsection (3)* provides that no deduction is allowed under this section for an amount that is deductible under sections 337 to 342 (travel expenses).

Section 337: Travel in performance of duties

1451. This section allows a deduction from earnings for travel expenses if the expenses are necessarily incurred on travelling in the performance of the duties of the employment.

1452. The section is the first of two dealing with the proposition, contained in section 198(1)(a) of ICTA, that a deduction is allowed for "qualifying travelling expenses". This section deals with the part of that definition in section 198(1A)(a) of ICTA.

1453. Although the label "qualifying travel expenses" appears in section 198(1)(a) of ICTA, that label is used only at the beginning of section 198(1A) of that Act. The label is not used in this Act.

1454. *Subsection (1)* provides that a deduction is allowed from earnings for the travel expenses. In *subsection (1)(b)*, the word "incurred" has replaced the word "expended"; but the practical application of this section should be precisely the same as that of the legislation it replaces: *subsection (1)(a)* provides that the travel expenses must be both incurred and paid.

1455. *Subsection (2)* provides that this section needs to be read with section 359, which prohibits a deduction if a mileage allowance is paid or if mileage allowance relief is available.

Section 338: Travel for necessary attendance

1456. This section allows a deduction from earnings for travel expenses if the expenses are attributable to the employee's necessary attendance at any place in the performance of the duties of the employment. However, the deduction allowed by this section is not available for the expenses of "ordinary commuting" or "private travel".

1457. The section is the second of two dealing with the proposition that a deduction is allowed for qualifying travelling expenses. This section deals with the part of that definition in section 198(1A)(b) of ICTA. That provision mentions "ordinary commuting" and "private travel" in section 198(1A)(b)(ii) but those expressions are only defined in paragraph 2 of Schedule 12A to that Act. Paragraph 3 of that Schedule contains a gloss on paragraph 2 and this section also deals with that gloss.

1458. This section derives from section 198(1)(a) and (1A)(b) of ICTA and from paragraphs 2 and 3 of Schedule 12A to that Act. The statutory material has been reorganised so that the definitions of "ordinary commuting" and "private travel" are placed near the propositions to which they apply; and the gloss upon the definitions has been incorporated in the subsections setting out the effect of "ordinary commuting" and "private travel".

1459. *Subsection (6)* provides that this section needs to be read with section 359, which prohibits a deduction if a mileage allowance is paid or if mileage allowance relief is available.

Section 339: Meaning of "workplace" and "permanent workplace"
1460. This section defines the terms "workplace" and "permanent workplace", which are used in the definitions of "ordinary commuting" and "private travel" in section 338.

1461. The section derives from paragraphs 2(3) and 4 to 7 of Schedule 12A to ICTA.

Section 340: Travel between group employments
1462. This section allows a deduction from earnings for travel expenses where an employee, who has employments with more than one company in the same group, travels from a place of employment with one group company to another place of employment with another group company.

1463. The section derives from section 198(1B) of ICTA, which provides that the travel expenses are treated as necessarily expended in the performance of the duties to be performed at the destination.

1464. *Subsections (2)* to *(5)* set out all the conditions that need to be met for the deduction to be allowed. The condition that it is the holder of the employment who is obliged to incur the expenses has not been included, because the Inland Revenue does not rely on this condition before the deduction is allowed. See *Change 83* in Annex 1.

1465. *Subsection (6)* defines the term "group" for the purposes of this section. The definition is more concise than in the legislation from which this subsection derives.

1466. *Subsection (7)* does not set out the general proposition, to be found in the source legislation, that the travel expenses are necessarily expended in the performance of the duties to be performed at the destination. Instead, the operation of the provision has been confined to the two sections (mentioned in this subsection) where this proposition may have an impact.

1467. *Subsection (8)* provides that this section needs to be read with section 359, which prohibits a deduction if a mileage allowance is paid or if mileage allowance relief is available.

Section 341: Travel at start or finish of overseas employment
1468. This section allows a deduction from earnings for starting travelling expenses and finishing travelling expenses if the duties of the employment are performed wholly outside the United Kingdom.

1469. The section derives from section 193(2) and (3) of ICTA.

1470. Section 193(3) begins with the words "For the purposes of section 198(1)". This section sets out all the conditions that have to be met in each case, as opposed to referring to section 336, the successor provision to section 198(1).

1471. *Subsections (2)* to *(4)*, however, do not reproduce the condition from section 198(1) that the holder of the employment is obliged to incur and defray the expenses, because the Inland Revenue does not rely on this condition before allowing the deduction from earnings. See *Change 83* in Annex 1.

1472. *Subsection (4)* is one of the provisions that make use of the new term "foreign employer", defined in section 721 for the purposes of this Act as a whole.

1473. *Subsections (6)* and *(7)* derive from section 132(2) of ICTA. These subsections ensure that a deduction under this section is still available if duties of the employment are performed in the United Kingdom which are merely incidental to the duties of the employment performed outside the United Kingdom. See also *Change 101(B)* in Annex 1.

1474. *Subsection (8)* defines the new terms "starting travel expenses" and "finishing travel expenses", which describe travel to take up an overseas employment and travel home after it has finished. This subsection also extends the meaning of the term "employee" to include a person who is to be, or has ceased to be, an employee.

1475. *Subsection (9)* provides that this section needs to be read with section 359, which prohibits a deduction if a mileage allowance is paid or if mileage allowance relief is available.

Section 342: Travel between employments where duties performed abroad

1476. This section allows a deduction from earnings for travel expenses where an employee, who has performed duties of one employment at the place of departure, travels to perform duties of another employment at the destination, and the place of departure or the destination, or both, are outside the United Kingdom.

1477. The section derives from section 193(5) and (6) of ICTA.

1478. Section 193(6) begins with the words "For the purposes of section 198(1)". This section sets out all the conditions that have to be met in each case, as opposed to referring to section 336, the successor provision to section 198(1).

1479. *Subsections (2)* to *(7)*, however, do not reproduce the condition from section 198(1) that the holder of the employment is obliged to incur and defray the expenses, because the Inland Revenue does not rely on this condition before the deduction is allowed. See *Change 83* in Annex 1.

1480. *Subsection (7)* is one of the provisions that make use of the new term "foreign employer", defined for the purposes of this Act as a whole in section 721.

1481. *Subsection (9)* provides that this section needs to be read with section 359, which prohibits a deduction if a mileage allowance is paid or if mileage allowance relief is available.

Fees and Subscriptions
Overview
1482. The following three sections rewrite section 201 of ICTA. The sorts of fees and contributions that are covered by section 201(2) have to be paid before an employee can, lawfully, begin to practise the particular profession or occupation to which the fees relate. They do not therefore meet the "in the performance of the duties" test in section 198 of ICTA, rewritten in section 336(1)(b) of this Act. The subscriptions covered by section 201(3) are voluntary in nature, in the sense that employees do not have to join the body concerned, and so do not meet the "necessarily" test in section 198, again rewritten in section 336(1)(b).

1483. There is another distinction between the expenses allowable under those two subsections. Section 201(2) of ICTA lists the fees paid that qualify for deduction. Section 201(3) gives a general description of the sorts of bodies that are eligible to apply to the Board of Inland Revenue for approval under that subsection, by reference to their character and the activities they pursue.

1484. The names of the bodies that the Board approves are published in a booklet called "Fees and subscriptions paid to Professional Bodies and Learned Societies (List 3)". That information is also published on the Inland Revenue's web site. The vast majority of the bodies in List 3 have been approved under section 201(3). Where fees paid to a body qualify for deduction under section 201(2) their entry in List 3 normally records that fact.

Section 343: Deduction for professional membership fees
1485. This section provides for a deduction for fees paid by employees to enable them, lawfully, to pursue their professions or occupations. The section derives from parts of section 201(1), (2) and (5) of ICTA.

1486. *Subsection (1)* states the basic principle that a deduction from earnings is allowed for certain specified payments. Each such payment is described as a "professional fee". The requirement in the source legislation that, to be allowable, the payment must have been made "out of the emoluments of the employment" has not been reproduced here. Instead that general requirement is stated in the introduction to the provisions relating to deductions in Part 5 of this Act. See *Change 81* in Annex 1.

1487. *Subsection (2)* defines what is meant by "professional fee". More fees are listed there than appeared in section 201(2) of ICTA. See *Change 84* in Annex 1.

1488. This Act presents the different types of fees payable in a table. The fees are grouped by reference to the occupational sectors to which they relate.

1489. *Subsections (3)* and *(4)* together provide a new power for the Board of Inland Revenue to make an order adding a new, qualifying fee to the Table in subsection (2). See *Change 85* in Annex 1.

Section 344: Deduction for annual subscriptions

1490. This section provides for a deduction for annual subscriptions to bodies having certain specified characteristics, established for stated objects related to the advancement of knowledge, the maintenance or improvement of standards of conduct within the profession and the protection of its members against claims. The section derives from parts of section 201(1), (3), (4), (5) and (6) of ICTA.

1491. *Subsection (1)* states the basic principle of the availability of a deduction from earnings for subscriptions paid to approved bodies. As in section 343(1), the requirement in the source legislation that, to be allowable, the payment must have been made "out of the emoluments of the employment" has not been reproduced here. See *Change 81* in Annex 1.

1492. *Subsection (2)* describes the types of bodies, by reference to their activities, whose subscriptions are eligible, subject to approval of the body by the Inland Revenue, to be deducted.

1493. *Subsection (3)* provides for the Inland Revenue to approve a body of persons. This reflects the practice on the application of section 201(3) whereby the power of the Board of Inland Revenue to approve such bodies is delegated to the technical specialist. See *Change 158* in Annex 1.

1494. The requirement in *subsection (4)* that the Inland Revenue give notice of their decision on an application simply enacts the existing Inland Revenue practice. See *Change 86* in Annex 1.

1495. *Subsections (5)* and *(6)* give the Inland Revenue the power to determine the part of a subscription that is allowable under subsection (1). That reflects the existing practice on how the power of the Board of Inland Revenue to make such a determination is exercised. See *Change 158* in Annex 1.

1496. The rule in *subsection (7)* about when a payment is treated as having been made to an approved body makes clear how the Inland Revenue have always allowed such payments. See *Change 87* in Annex 1.

Section 345: Decisions of the Inland Revenue under section 344

1497. This section provides powers for the Inland Revenue to withdraw or vary any approval given to or any determination made in respect of a body. The section derives from section 201(6) and (7) of ICTA.

1498. In *subsection (1)* the power to vary a decision on the approval or otherwise of a body for the purposes of section 344 rests with the Inland Revenue as opposed to the Board in the source legislation. See *Change 158* in Annex 1.

1499. This Act requires the Inland Revenue to give notice of their decision. See *Change 88* in Annex 1.

1500. In *subsections (2)* and *(3)* the move to a straightforward appeal procedure is intended to simplify matters. Section 48(2) of TMA 1970 provides that various provisions of that Act as regards proceedings before the Commissioners apply to "appeals other than appeals against assessments" and to "proceedings…to be heard and determined in the same way as an appeal". There is therefore no real difference in law or practice in this instance between provisions that refer to an appeal and those that refer to proceedings where the Special Commissioners shall "hear and determine the matter in like manner as an appeal". See *Changes 158* and *89* in Annex 1.

Section 346: Deduction for employee liabilities

1501. This is the first of a group of five sections that give relief for payments made against liabilities arising from an office or employment. It provides for a deduction for certain employee liabilities. The section derives from section 201AA(7), (8) and (9) and part of section 201AA(1) of ICTA.

1502. *Subsections (1)* and *(2)* define the payments for which a deduction may be claimed.

1503. *Subsection (3)* defines "premium" and provides some explanatory detail.

Section 347: Payments made after leaving the employment

1504. This section provides that deductions allowable under section 346 are restricted to those relating to liabilities arising in a current employment. It also gives a signpost to the corresponding provisions that deal with payments made after the employee has ceased the particular employment in relation to which the liability to make a payment arises. The section derives from part of section 201AA(1) of ICTA.

Section 348: Liabilities related to the employment

1505. This section defines the types of liability that can give rise to payments that qualify for relief. It derives from section 201AA(2) of ICTA.

Section 349: Meaning of "qualifying insurance contract"

1506. This section defines "qualifying insurance contract". It derives from section 201AA(3)(a) to (d) and (4) of ICTA.

1507. *Subsections (2)* to *(5)* state the conditions that have to be met for an insurance contract to come within section 346(1).

Section 350: Connected contracts

1508. This section provides rules to determine whether insurance contracts are connected for the purposes of section 349. It derives from section 201AA (5) and (6) of ICTA.

1509. *Subsections (1)* to *(3)* define when insurance contracts are connected.

1510. *Subsections (4)* to *(7)* provide for such a connection to be ignored in certain circumstances.

Section 351: Expenses of ministers of religion

1511. This section allows a deduction for expenses from the earnings of a minister of religion. These include a proportion of the rent of a house used in the performance of the duties and, where premises are occupied in which a charity or ecclesiastical corporation holds an interest and those premises are used in the performance of the duties, a proportion of the expenses arising in connection with them.

1512. The section derives from section 332 of ICTA.

1513. Unlike section 332 this section does not allow an expense incurred in respect of the profession of a minister to be deducted from any income from an employment or office as a minister. Deductions are restricted to one particular class of income. See *Change 90* in Annex 1.

1514. *Subsection (1)* allows a deduction from the earnings of a minister for amounts incurred wholly, exclusively and necessarily in the performance of the duties.

1515. *Subsection (2)* allows a deduction from earnings for a quarter of the rent paid where a part of the house is used mainly and substantially in carrying out the duties of a minister. Where the part of the house so used is less than one quarter of the whole house an appropriate, lower proportion of the rent paid may be deducted.

1516. Section 332(3) allows a deduction for "such part of the rent as the inspector by whom the assessment is made allows". The inspector's decision is subject to appeal to the Commissioners. Since this rule does not fit comfortably with Self Assessment the provision in this section makes the deduction available without reference to the inspector on a just and reasonable apportionment basis. See *Change 91* in Annex 1.

1517. *Subsection (3)* provides for a deduction from earnings for part of the expenses borne by the minister in connection with premises which are owned by a charity or ecclesiastical corporation and in which he resides for the purposes of carrying out his duties.

1518. *Subsection (4)* gives the formula for the deduction allowable under the previous subsection.

1519. *Subsection (5)* defines "charity". The definition of "charity" is the same as that in section 506(1) of ICTA. See *Note 34* in Annex 2.

1520. *Subsection (6)* requires subsection (1) to be read with section 359 (disallowance of travel expenses: mileage allowances and reliefs) which prevents a deduction where mileage allowance payments are received.

Section 352: Limited deduction for agency fees paid by entertainers

1521. This section provides for a deduction for entertainers in respect of fees paid to their agents for finding them work. The section derives from part of section 201A of ICTA.

1522. Section 201A was introduced to allow entertainers who are in employment to get relief for the fees they pay to their agents for finding them work. Such fees are not deductible under the general rule for the deduction of expenses in section 198(1) of ICTA (rewritten in section 336 of this Act) for two reasons. First, they are paid to put the performer in the position to earn from the employment. They are not, therefore, expended "in the performance of the duties of the employment". Secondly, as not every entertainer uses the services of an agent, the expense does not pass the "necessarily" test.

1523. *Subsection (1)* states the basic principle that a deduction is allowed, subject to certain conditions being met.

1524. In *subsection (2)* the way the limit of 17.5% of the taxable earnings is expressed differs slightly from the source legislation. See *Change 92* in Annex 1.

1525. *Subsection (4)* defines "entertainer" for the purposes of this section.

1526. *Subsection (5)* defines "agency fees", by reference to the contract or arrangement under which the entertainer pays them. The use of the word "paid" in this subsection means that it is not sufficient for the employee only to have incurred the liability to pay the fee. The employee has to have transferred value to the agent by way of payment for the deduction to be allowed.

1527. *Subsection (6)* restricts the scope of what counts as a "co-operative society" for the purposes of the section. It also gives a signpost to the external definition of "employment agency".

1528. Section 201A(6), which contains the commencement date, has not been reproduced because it is now spent.

Section 353: Deductions from earnings charged on remittance

1529. This section deals with deductions from earnings charged on remittance, an expression defined in section 335(4).

1530. The section derives from section 198(3) of ICTA.

1531. *Subsection (1)* provides for a deduction to be allowed from earnings charged on remittance for expenses within *subsection (2)* if the condition in *subsection (3)* is met.

1532. Subsection (2) specifies the expenses to which this section applies. Paragraph (a) refers both to expenses paid by the employee out of the relevant earnings and to expenses paid on the employee's behalf by another person and included in those earnings. This wording did not appear in the source legislation, but it corresponds to the wording used in section 333 (scope of this Chapter). See *Note 36* in Annex 2.

1533. Subsection (3) states a condition that must be met before this section may operate: that the earnings would have been deductible under sections 336 to 342 if the earnings had been earnings charged on receipt in the tax year in which the expenses were incurred. (The expression "earnings charged on receipt" is defined in section 335(4)). The reference to "sections 336 to 342" derives from the reference to "subsection (1)" in section 198(3) of ICTA. Sections 341 and 342 do not derive directly from section 198(1) of ICTA, but these have been included in the new reference because the provisions from which they do derive (section 193(3) and (6) of ICTA) operate through section 198(1).

1534. *Subsection (4)*, which is a drafting addition, deals with the relationship between this section and the deductibility provisions (listed in section 332). In the case of deductions under this section the requirement for payment out of earnings has survived, so it is provided that, for the purposes of the deductibility provisions, the expenses are to be assumed to have been paid out of the earnings charged on remittance. See *Change 81* in Annex 1.

Section 354: Disallowance of expenses relating to earnings taxed on different basis or untaxed

1535. This section applies in certain cases where some of the earnings are taxed on one basis while the remainder are either taxed on a different basis or are not within the charge to income tax. This section prevents a deduction relating to earnings in the first category from being given against earnings in the second category in those cases. The section derives from provisions in section 198(2) of ICTA.

1536. *Subsection (1)* prohibits a deduction under sections 336 to 342 if the expenses relate to earnings from the employment which are either not liable to income tax or are taxed on the remittance basis under section 26.

Example

1537. Suppose that F, a Frenchman, is resident and ordinarily resident in France. He performs most of the duties of his employment in France where he receives the earnings for those duties. F does not remit any of those earnings to the United

Kingdom, so they are not chargeable to income tax in the United Kingdom. As the holder of his employment, F is also obliged, while in France, to incur expenditure wholly, exclusively and necessarily in the performance of his duties there. However, F also performs a minority of the duties of his employment in the United Kingdom where he receives earnings for these other duties. These earnings are chargeable to income tax in the United Kingdom (see section 27). This section prohibits F from deducting the expenditure incurred in France from the income chargeable to tax in the United Kingdom.

1538. *Subsection (2)* applies if the earnings from an employment for a tax year include both earnings charged on remittance under section 26 and other earnings. The subsection prohibits a deduction under section 353 from the earnings charged on remittance if the expenses in question relate to the other earnings.

1539. *Subsection (3)* provides that this section is to be disregarded for the purposes of the deductibility provisions. See *Note 37* in Annex 2.

Section 355: Deduction for corresponding payments by non-domiciled employees with foreign employers

1540. This section provides for a non-domiciled employee with a foreign employer to claim a deduction if certain conditions are met.

1541. This section derives from section 192(1) and (3) of ICTA.

1542. *Subsections (2)* to *(5*) sets out the conditions that must be met:

- The employee must not be domiciled in the United Kingdom;
- The employment must be with a foreign employer (a term defined in section 721(1));
- The employee must have made a payment out of earnings from the employment; and
- The payment did not reduce the employee's liability to United Kingdom income tax, but was made in circumstances corresponding to those in which it would do so.

1543. *Subsection (6)* provides for the deduction to be allowed.

1544. Section 192(3) of ICTA provides for a successful claim to be allowed "as a deduction in computing the amount of the emoluments"; but this section provides for the claim to be allowed "as a deduction under this Chapter". See *Change 93* in Annex 1.

Section 356: Disallowance of business entertainment and gifts expenses

1545. This section prevents a deduction from earnings of expenses incurred in providing entertainment or a gift in connection with the employer's trade, business, profession or vocation. This general prohibition is subject to the exceptions in sections 357 and 358.

1546. This section derives from section 577(1)(b), (5), (7) and (8) of ICTA and contains new drafting material.

1547. *Subsection (1)* contains the general prohibition on deducting expenses incurred in providing entertainment or a gift.

1548. This section makes it clear that the trade, business, profession or vocation to which the business entertainment expenses relate is the trade etc of the employer. See *Change 94* in Annex 1.

1549. *Subsection (2)* refers to certain exceptions from the general prohibition in subsection (1).

1550. *Subsection (3)* extends the meaning of "entertainment" and brings incidental expenses within the scope of the section.

Section 357: Business entertainment and gifts: exception where employer's expenses disallowed

1551. This section contains an exception to the general prohibition on deducting business entertainment and gifts expenses in section 356. It derives from section 577(1)(a) and (3) of ICTA and contains new drafting material.

1552. *Subsection (1)* disapplies the prohibition on deducting entertaining and gifts expenditure in section 356 where certain conditions are met and refers to further alternative conditions in subsections (2), (3) and (4).

1553. *Subsection (2)* requires that the deduction of the expense must fall to be disallowed in calculating the employer's profits because of section 577 of ICTA where the employer is carrying on a trade, profession or vocation. In practice, this condition is treated as met where the expense would have been disallowed apart from any exemption in section 505(1)(e) of ICTA (exemption from tax under Schedule D in respect of the profits of any trade carried on by a charity where the profits are applied solely to the purposes of the charity etc.) or because of another relief applying to the profits of the employer. Subsection (2) spells out this treatment.

1554. *Subsection (3)* contains an alternative requirement that the expense must fall to be disallowed in calculating the employer's expenses of management because of section 577 of ICTA. Again, it is made clear that the fact the disallowance does not operate because a relief applies is ignored.

1555. *Subsection (4)* contains the other alternative requirement that the expense would fall to be disallowed in calculating the employer's "relevant shipping profits" apart from the making by the employer of a tonnage tax election. See *Change 95* in Annex 1.

1556. *Subsection (5)* contains cross-references to Schedule 22 to FA 2000 to explain the terms used in subsection (4) relating to tonnage tax.

1557. The reference in section 577(3)(b) of ICTA to "in whole or in part" has been omitted. See *Note 38* in Annex 2.

Section 358: Business entertainment and gifts: other exceptions

1558. This section contains the other exceptions from the general prohibition on deducting business entertaining and gifts expenses in section 356. It derives from section 577(5), (7)(c) and (8) of ICTA and contains new drafting material.

1559. *Subsection (1)* provides that the general prohibition on deducting expenses in section 356 does not apply, with some exceptions, if the sums are incurred in providing entertainment or gifts for the employer's employees. But the prohibition in section 356 does still apply in the circumstances set out in paragraphs (a) and (b) of subsection (1) of section 358.

1560. *Subsection (2)* treats directors and persons engaged in the management of a company as employed by it for the purpose of this section.

1561. *Subsection (3)* provides that the general prohibition on deducting entertaining and gifts expenses in section 356 does not apply, with some exceptions, if the sums relate to the provision of a gift which incorporates a conspicuous advertisement for the employer. But the prohibition in section 356 does still apply in the circumstances set out in subsection (3)(a) or (b) of section 358.

1562. The subsection also provides that where the employer is a company, the general prohibition does not apply, with some exceptions, if the expenses are incurred in providing a gift which incorporates a conspicuous advertisement for another company which belongs to the same group as the employer. See *Change 96* in Annex 1. This exception will not apply, however, in the circumstances set out in subsection (3)(a) or (b) of this section.

1563. This subsection also removes any doubt there might be about whether an employee is excepted from the prohibition in section 356 where the terms of the exception are met. See *Change 96* in Annex 1.

1564. The word "donor" which appears towards the end of the introduction to section 577(8) of ICTA has been changed to "employer" in subsection (3) of section 358. See *Change 96* in Annex 1.

1565. The £50 limit in subsection (3)(b) of this section is fixed at that amount by the section. However, section 716(2)(h) of this Act provides that the £50 limit may be increased by an order made by the Treasury. See *Change 96* in Annex 1.

1566. *Subsection (4)* defines "group" for the purposes of subsection (3) of this section.

Section 359: Disallowance of travel expenses: mileage allowances and reliefs

1567. This section prohibits an employee from obtaining a deduction under the travel deduction provisions (defined as sections 337 to 342, 351, 370, 371, 373 and 374) if mileage allowance payments are made to the employee or mileage allowance relief is available. The section is necessary to establish the order in which the relevant provisions are to be applied and to ensure that there is no double relief.

1568. The section derives from section 198(5) of ICTA, added by Schedule 12, Part 2, paragraph 6 to FA 2001 (in so far as this section relates to the travel deductions provisions other than section 351); and from section 332(3A) and (3B) of ICTA, added by Schedule 12, Part 2, paragraph 10 to FA 2001 (in so far as this section relates to section 351).

1569. *Subsection (4)* contains the definitions of "mileage allowance payments" and "the travel deductions provisions" and contains signposts to the definitions of "company vehicle" and "mileage allowance payments". Mileage allowance relief is dealt with in section 231.

Section 360: Disallowance of certain accommodation expenses of MPs and other representatives

1570. This section prevents MPs and other representatives from obtaining a deduction from earnings for residential or overnight accommodation.

1571. The section derives from section 198(4) of ICTA.

1572. Section 198(4) is the counterpart to provisions contained in sections 200 and 200ZA of ICTA, from which sections 292 and 293 derive. Those sections provide that allowances for residential or overnight accommodation are exempt from income tax: and this present section accordingly provides that no deduction is allowed for the accommodation expenses in respect of which the allowances are paid.

1573. *Subsection (1)* provides that no deduction from earnings is allowed "under this Chapter", and may, accordingly, be contrasted with section 198(4) of ICTA, which provided that no deductions should be made "under this section". See *Change 97* in Annex 1.

Chapter 3: Deductions from benefits code earnings

Overview

1574. The sections in this Chapter allow deductions where goods or services are provided which are within the scope of the benefits code and deductions would have been allowed if the goods or services had been paid for by the employee. The sections derive from sections 141(3), 142(2), 145(3) and 156(8) of ICTA.

1575. All the sections in the Chapter refer to deductions under the whole of Chapter 2 and Chapter 5 of this Part instead of restricting them to the rewritten versions of the provisions referred to in sections 141(3), 142(2), 145(3) and 156(8) of ICTA. See *Change 99* in Annex 1.

Section 361: Scope of this Chapter: cost of benefits deductible as if paid by employee

1576. This section sets out the general proposition for a deduction to be allowed under this Chapter. A person's earnings must include an amount treated as earnings under the relevant parts of the benefits code and a deduction must have been allowable if the employee had paid the cost of the goods or services. The sections in this Chapter are a change in approach to provisions from which they are derived. The changes in sections 362, 363, 364 and 365 are explained in detail in *Changes 98* and *99* in Annex 1.

Section 362: Deductions where non-cash voucher provided

1577. This section applies where goods or services are obtained by an employee in exchange for a non-cash voucher for which an amount is treated as earnings by virtue of section 87(1). It derives from section 141(3) of ICTA. If, had the goods or services been provided by the employee, a deduction would be allowable by the provisions of Chapter 2 or 5 of this Part a deduction is allowable by virtue of this section.

1578. *Subsection (1)* sets out the conditions which must apply if a deduction from earnings is to be allowed.

1579. *Subsection (2)* quantifies the amount of the deduction. A limit is placed on the amount of the deduction allowed rather than providing the deduction is only to be set against the amount treated as earnings.

Section 363: Deductions where credit-token provided

1580. This section applies where goods or services are provided using a credit-token. A deduction may be allowed where the earnings include an amount treated as earnings under section 94(1) and the token is used to obtain goods or services. If the employee would have been allowed a deduction under Chapter 2 or Chapter 5 of this Part if he had paid for the goods or services, a deduction is allowed by this section.

1581. *Subsection (1)* sets out the conditions which must apply if a deduction from earnings is to be allowed.

1582. *Subsection (2)* quantifies the amount of the deduction, with the same limit as described for section 362.

1583. The section derives from section 142(2) of ICTA.

Section 364: Deductions where living accommodation provided

1584. This section applies where the benefit provided is living accommodation. A deduction may be allowed where the earnings include an amount treated as earnings under Chapter 5 of Part 3. If the employee would have been allowed a deduction under Chapter 2 or Chapter 5 of this Part if he had paid for the accommodation, a deduction is allowed under this section. It derives from section 145(3) and 146(9) of ICTA.

1585. A limit is placed on the deduction to be made. The deduction will be calculated on the basis that the amount paid by the employee for the accommodation is equal to the amount treated as earnings in respect of that accommodation.

1586. *Subsection (1)* sets out the conditions which must apply if a deduction from earnings is to be allowed.

1587. *Subsection (2)* quantifies the amount of the deduction.

Section 365: Deductions where employment-related benefit provided

1588. This section applies where an unspecified benefit is provided. A deduction may be due where the earnings include an amount treated as earnings under Chapter 10 of Part 3 of this Act in respect of a benefit. If the employee would have been allowed a deduction under Chapter 2 or Chapter 5 of this Part if he had paid for the cost of the benefit, a deduction is allowed under this section. It derives from section 156(8) of ICTA.

1589. *Subsection (1)* sets out the conditions which must apply if a deduction from earnings is to be allowed.

1590. *Subsection (2)* quantifies the amount of the deduction with the same limit as described for section 362.

1591. *Subsection (3)* contains an explanation of the "cost of the benefit".

Chapter 4: Fixed allowances for employee's expenses

Overview

1592. This Chapter contains provisions that allow deductions from an employee's earnings for amounts fixed by the Treasury.

Section 366: Scope of this Chapter: amounts fixed by Treasury

1593. This section sets out the scope of the Chapter – to allow deductions from earnings for a sum fixed by the Treasury by reference to the employee's employment.

Section 367: Fixed sum deductions for repairing and maintaining work equipment

1594. This section allows a deduction from the earnings of certain classes of employees for a sum fixed by the Treasury.

1595. It derives from ESC A1. See *Change 100* in Annex 1.

1596. *Subsection (1)* allows a deduction from the earnings of an employee for a sum fixed by the Treasury as representing the average annual expense in respect of the repair and maintenance of work equipment incurred by employees of the class to which the employee belongs.

1597. *Subsection (2)* sets out the terms under which the Treasury may fix a sum for a class of employees.

1598. *Subsection (3)* prevents the allowance of the fixed-sum deduction if the expense in respect of which the sum is fixed is paid or reimbursed by the employer or would be if requested.

1599. *Subsection (4)* provides that where the employer meets part of the expenses (or would do if so requested) in respect of which the fixed-sum deduction is set, the deduction is reduced by that amount.

1600. *Subsection (5)* defines "work equipment" for subsections (1) and (2).

1601. *Subsection (6)* requires the section to be read with section 330(2) (prevention of double deductions). If an expense on work equipment were deductible under Chapter 2 of Part 5, it would not be deductible under this section. See *Change 82* in Annex 1.

Section 368: Fixed sum deductions from earnings payable out of public revenue

1602. This section allows for certain descriptions of employees a deduction of a sum fixed by the Treasury from earnings paid out of public revenue.

1603. It derives from section 199 of ICTA.

1604. *Subsection (1)* allows a deduction from earnings payable out of public revenue for fixed sum expenses relating to the duties that give rise to those earnings.

1605. *Subsection (2)* defines "fixed sum expenses".

1606. *Subsection (3)* requires the section to be read with section 330(2) (prevention of double deductions). If the expense were deductible under Chapter 2 of Part 5, it would not be deductible under this section.

Chapter 5: Deductions for earnings representing benefits or reimbursed expenses

Background

1607. This Chapter deals with cases where the employer, or a third party, bears the cost of something that is taken into account as part of the employee's earnings, but the employee is entitled to a deduction from those earnings in respect of that cost.

1608. This Chapter derives from provisions in sections 193 to 195 of ICTA and in sections 50 to 52 of FA 1989. In the majority of cases dealt with, the amount of such a deduction is expressed as being "equal to so much of that cost or, as the case may be, those expenses as fall to be included in those emoluments". In the present Chapter, by contrast, it is possible to define the amount in question as "the included amount", and then to say that "the deduction is equal to the included amount".

1609. Another common thread in the provisions dealt with in this Chapter is that the amounts included in the employee's earnings are generally expressed in terms of provision being made "by or on behalf of the employer" (or similar). It has not been possible to establish the original policy reasons for limiting the scope of the deductions to provision made in this way. There may be circumstances where the provision is by or on behalf of someone other than the employer and the amount is still chargeable as part of the employee's earnings. As long as all the other conditions for the deductions are met, there seems no reason why a deduction should be withheld because the provision was made by a person other than the employer or someone acting on the employer's behalf. The words "by or on behalf of the employer" (or similar) which appear in the source legislation are therefore omitted. To the extent that this change has any practical effect, it will be in favour of the taxpayer. See *Change 101(A)* in Annex 1.

1610. This Chapter does not deal with a deduction for expenses incurred and paid by the employee without any reimbursement. That kind of deduction is dealt with in Chapter 2 of this Part.

Overview

1611. As in Chapter 2 of this Part, the sections have been grouped according to the type of expense involved. After section 369, which is introductory:

- sections 370 to 372 allow deductions for travel costs and expenses where the employee is resident and ordinarily resident in the United Kingdom, but the duties of the employment are performed abroad;

- section 373 to 375 allow deductions for travel costs and expenses where the employee is not domiciled in the United Kingdom, but the duties of the employment are performed in the United Kingdom;

- section 376 allows a deduction for costs and expenses in respect of accommodation or subsistence where the employee is resident and ordinarily resident in the United Kingdom, but working abroad;

- section 377 allows a deduction for costs and expenses in respect of personal security assets and services.

Section 369: Scope of this Chapter: earnings representing benefits or reimbursed expenses

1612. This section deals with preliminary matters relevant for this Chapter.

1613. *Subsection (1)* brings together material contained in sections 193(4), 194(1) and 195(7) of ICTA and in section 50(2) and (3) of FA 1989. *Subsections (2)* and *(3)* are drafting additions.

1614. *Subsection (1)* states the general proposition that a deduction from a person's earnings is allowed under the following provisions of this Chapter where an amount has been included in the earnings in respect of provision made for the person or expenses reimbursed by another person. See *Change 101(A)* in Annex 1.

1615. *Subsection (2)* provides that the amount described in *subsection (1)* is referred to in this Chapter as "the included amount".

1616. *Subsection (3)* is concerned with the overlap between this Chapter and Chapter 3 of this Part. If the included amount is an amount treated as earnings by virtue of the benefits code, a deduction may be available under Chapter 3; and this subsection accordingly provides a signpost to that Chapter.

Travel costs and expenses where duties performed abroad

1617. The next three sections provide for deductions to be allowed from earnings for travel costs and expenses where the employee is resident and ordinarily resident in the United Kingdom but the duties of the employment are performed abroad. These sections derive from provisions in section 194 of ICTA.

Section 370: Travel costs and expenses where duties performed abroad: employee's travel

1618. This section provides that a deduction is allowed from earnings for travel costs and expenses where the journey in question is made by the employee.

1619. The section derives from provisions in section 194(1), (3), (4), (5), (6) and (8) of ICTA.

1620. *Subsection (1)* specifies the circumstances in which a deduction from earnings is allowed. See also *Change 101(A)* in Annex 1. The deduction is allowed if:

- the employee has earnings which are taxable earnings under section 15 or 21 (which apply if the employee is resident and ordinarily resident in the United Kingdom in the tax year);

- the earnings include an amount in respect of the provision of travel facilities for a journey made by the employee, or the reimbursement of expenses incurred by the employee on such a journey; and

- the requirements specified in one of cases A to C are met.

1621. *Subsection (2)* provides that the deduction is equal to the included amount; and cases A, B and C are set out in *subsections (3), (4)* and *(5)*.

1622. In the source legislation the provisions of section 132(2) of ICTA could affect the availability of this deduction. The application of section 132(2) would mean the disallowance of a deduction under this section where the duties performed in the United Kingdom were merely incidental to the performance of the other duties of the employment outside the United Kingdom. In practice deductions are allowed in these circumstances; and, accordingly, material deriving from section 132(2) of ICTA has not been included in this section. See *Change 101(B)* in Annex 1.

Section 371: Travel costs and expenses where duties performed abroad: visiting spouse's or child's travel

1623. This section provides that a deduction is allowed from earnings for travel costs and expenses where the journey in question is made by the employee's spouse or child.

1624. The section derives from provisions in section 194(1) and (2) of ICTA.

1625. *Subsection (1)* specifies the circumstances in which a deduction from earnings is allowed. See also *Change 101(A)* in Annex 1. The deduction is allowed if:

- the employee has earnings which are taxable earnings under section 15 or 21 (which apply if the employee is resident and ordinarily resident in the United Kingdom in the tax year);

- the earnings include an amount is respect of the provision of travel facilities for a journey made by the employee's spouse or child, or the reimbursement of expenses incurred by the employee on such a journey; and

- conditions A to C are met.

1626. *Subsection (2)* provides that the deduction is equal to the included amount; and conditions A, B and C are set out in *subsections (3), (4)* and *(5)*.

Section 372: Where seafarers' duties are performed

1627. This section provides that section 40(2) (certain duties treated as performed in the United Kingdom) does not apply for the purposes of determining whether duties performed on a vessel are performed in or outside the United Kingdom for the purposes of sections 370 and 371. It derives from section 194(7) of ICTA.

Travel costs and expenses of non-domiciled employees where duties performed in UK

1628. The next three sections provide for deductions to be allowed from earnings for travel costs and expenses where the employee is not domiciled in the United Kingdom, but the duties are performed there. These sections derive from provisions in section 195 of ICTA.

Section 373: Non-domiciled employee's travel costs and expenses where duties performed in UK

1629. This section provides that a deduction is allowed from earnings for travel costs and expenses where the journey in question is made by the employee.

1630. The section derives from provisions in section 195(1), (2), (5), (7), (8) and (9) of ICTA.

1631. *Subsection (1)* specifies the circumstances in which a deduction from earnings is allowed. See also *Change 101(A)* in Annex 1. The deduction is allowed if:

- the employee is not domiciled in the United Kingdom;
- the employee receives earnings from an employment for duties performed in the United Kingdom; and
- an amount is included in the earnings in respect of the provision of travel facilities for a journey made by the employee, or the reimbursement of expenses incurred by the employee on such a journey.

1632. *Subsection (2)* provides for the deduction from earnings to be allowed if:

- the earnings are earnings charged on receipt (a term defined in section 335(4)); and
- the conditions set out in *subsections (3)* and *(4)* are met.

1633. Condition A in *subsection (3)* reflects Inland Revenue practice in linking the five year period to the date when the journey was undertaken as opposed to the date when the expenditure was incurred. See *Change 102* in Annex 1.

1634. *Subsection (5)* provides that if the journey is wholly for the purpose specified in *subsection (4)*, the deduction allowed is equal to the included amount; and

subsection (6) provides that if the journey is only partly for that purpose, the deduction allowed is only a proportion of the included amount.

1635. In section 195 of ICTA there are references to a person's "usual place of abode" and this expression is then defined (in section 195(9)) as "the country (outside the United Kingdom) in which he normally lives". The provisions in this Act take a simpler approach, referring just to "the country outside the United Kingdom in which the employee normally lives".

Section 374: Non-domiciled employee's spouse's or child's travel costs and expenses where duties performed in UK

1636. This section provides that a deduction is allowed from earnings for travel costs and expenses where the journey in question is made by the employee's spouse or child.

1637. The section derives from provisions in section 195(1), (2) and (6) to (10) of ICTA.

1638. *Subsection (1)* specifies the circumstances in which a deduction from earnings is allowed. See also *Change 101(A)* in Annex 1. The deduction is allowed if:

- the employee is not domiciled in the United Kingdom;
- the employee receives earnings from an employment for duties performed in the United Kingdom; and
- an amount is included in the earnings in respect of the provision of travel facilities made by the employee's spouse or child, or the reimbursement of expenses incurred by the employee on such a journey.

1639. *Subsection (2)* provides for the deduction from earnings to be allowed if:

- the earnings are earnings charged on receipt (a term defined in section 335(4)); and
- the conditions set out in *subsections (3)* to *(5)* are met.

1640. Condition A in *subsection (3)* reflects Inland Revenue practice in linking the five year period to the date when the journey was undertaken as opposed to the date when the expenditure was incurred. See *Change 102* in Annex 1.

1641. *Subsection (6)* provides that if the journey is wholly for the purpose specified in *subsection (5)*, the deduction allowed is equal to the included amount; and *subsection (7)* provides that if the journey is only partly for that purpose, the deduction allowed is only a proportion of the included amount.

1642. As in the case of section 373, references to an employee's "usual place of abode" have been replaced by references to the country outside the United Kingdom in which the employee normally lives.

Section 375: Meaning of "qualifying arrival date"

1643. This section explains the meaning of the expression "qualifying arrival date", which is used in sections 373 and 374. It derives from section 195(2), (3) and (4) of ICTA.

1644. *Subsection (4)* provides that if there are two or more dates in a tax year which are capable of being a "qualifying arrival date", the qualifying arrival date is the earliest of those dates.

Section 376: Foreign accommodation and subsistence costs and expenses (overseas employments)

1645. This section provides that a deduction is allowed for costs or expenses in respect of accommodation or subsistence while an employee is working abroad.

1646. The section derives from section 193(2) and (4) of ICTA.

1647. *Subsection (1)* specifies the circumstances in which a deduction from earnings is allowed. See also *Change 101(A)* in Annex 1. The deduction is allowed if:

- the duties of the employment are performed wholly outside the United Kingdom;
- the employee is resident and ordinarily resident in the United Kingdom;
- in a case where the employer is a foreign employer (see section 721(1)), the employee is domiciled in the United Kingdom; and
- the earnings include an amount in respect of the provision of accommodation or subsistence outside the United Kingdom for the purpose of enabling the employee to perform the duties of the employment, or the earnings include an amount in respect of the reimbursement of expenses incurred by the employee on such accommodation or subsistence for that purpose.

1648. *Subsection (2)* provides that if the accommodation or subsistence is wholly for the purpose of enabling the employee to perform the duties of the employment, the deduction is equal to the included amount; and *subsection (3)* provides that if the accommodation or subsistence is only partly for that purpose, the deduction allowed is only a proportion of the included amount.

1649. The expression "board and lodging" in section 193(4) of ICTA has been replaced in this Act by the expression "accommodation or subsistence". It is not

necessary for both elements mentioned in section 193(4) to be present for the deduction to be allowed.

1650. In the detail of the wording used, this section departs from the legislation it replaces to a significant extent. Some of these changes reflect the decision to dispense with the term "foreign emoluments" and to use the term "foreign employer".

1651. *Subsections (4)* and *(5)* derive from section 132(2) of ICTA. These subsections ensure that a deduction under this section is still available if duties of the employment are performed in the United Kingdom which are merely incidental to the duties of the employment performed outside the United Kingdom. See also *Change 101(B)* in Annex 1.

Section 377: Costs and expenses in respect of personal security assets and services

1652. This section provides that a deduction is allowed for costs and expenses in respect of personal security assets and services.

1653. The section derives from sections 50 to 52 of FA 1989.

1654. *Subsection (1)* specifies the circumstances in which a deduction from earnings is allowed. See also *Change 101(A)* in Annex 1. The deduction is allowed if:

- there is a special threat to the employer's personal physical security which arises wholly or mainly because of the employee's employment;
- an asset or service which improves personal security is provided for or used by the employee to meet the threat;
- the employee's earnings include an amount in respect of the asset or service because some or all of the costs are borne by the provider; and
- the provider's sole object in bearing the whole or part of the cost or reimbursing the expenses is meeting the threat.

1655. If the provider of an asset within subsection (1) intends that asset to be used solely for the purpose of improving personal physical security, a deduction equal to the included amount is allowed (*subsection (2)*). Use incidental to this purpose is ignored (*subsection (3)*). If the provider of the asset intends it to be used only partly to improve personal physical security, the deduction allowed is only a proportion of the included amount (*subsection (4)*). In determining whether or not this section applies, certain matters may be disregarded (*subsection (5)*).

1656. In the case of a service within subsection (1), if the benefit resulting to the employee consists wholly or mainly of an improvement of the employee's physical security, a deduction equal to the included amount is allowed (*subsection (6)*).

1657. *Subsection (7)* provides that the fact that an asset or a service improves the personal physical security of a member of the employee's family or household, as well as that of an employee, does not prevent a deduction being allowed under this section. In subsection (7) the expression "member of the employees' family or household" is not defined in the source legislation; but in this Act this expression is covered by the general definitions in section 721(4) and (5). See *Note 39* in Annex 2.

1658. *Subsection (8)* omits the reference to "living accommodation" in section 52(3)(b) of FA 1989 on the basis that this expression is already encompassed by the word "dwelling".

Chapter 6: Deductions from seafarers' earnings

1659. This Chapter rewrites section 192A of and Schedule 12 to ICTA. These provide a deduction, commonly called the Foreign Earnings Deduction ("FED") for seafarers against earnings for a year in which the seafarer is resident and ordinarily resident in the United Kingdom. This deduction has something of the flavour of an exemption in that the amount deductible is equal to an amount of earnings rather than any costs or expenses incurred.

Section 378: Deduction from seafarers' earnings: eligibility

1660. This section sets out the conditions for eligibility for the deduction. Broadly speaking, seafarers must spend no less than half of a qualifying period of at least 365 days outside the United Kingdom and not more than 183 consecutive days in the United Kingdom during the qualifying period.

1661. It is possible to combine various periods of absence from the United Kingdom to determine whether the test has been satisfied. Paragraph 3 of Schedule 12 to ICTA deals with this by using the terms "qualifying period", "relevant periods", "a single qualifying period", "the last qualifying period" and the "intervening period". These concepts and their various combinations are difficult to follow.

1662. So, in *subsection (2)* the new term "eligible period", which consists of either a period of continuous absence from the United Kingdom or a "combined period" (another new term which is itself defined in *subsection (3)*) has been introduced.

Section 379: Calculating the deduction

1663. This section sets out the amount of the deduction which may be allowed from the earnings attributable to the eligible period. *Subsection (1)* derives from section 192A(1) of ICTA.

1664. *Subsection (2)* derives from the rule in paragraph 3(3) Schedule 12 to ICTA concerning earnings for a period of leave immediately following an eligible period. That rule says that the emoluments for such a period of leave may be taken as attributable to the qualifying period, but only to the extent that this would not mean having to treat any emoluments for one tax year as belonging to a different tax year. Essentially this rule allows emoluments for a period of leave to be attributed to the

qualifying period to the extent that they are emoluments for the tax year during which the qualifying period ends.

1665. *Subsection (3)* makes the deduction subject to the limit contained in the following section.

Section 380: Limit on deduction where UK duties etc. make amount unreasonable

1666. This section derives from paragraph 2 of Schedule 12 to ICTA. It contains anti-avoidance provisions against attempts to manipulate the amount of the earnings to take advantage of the relief.

1667. The rules in paragraph 2(3) of Schedule 12 to ICTA for determining associated employments end with the words "but paragraph (b) above shall not be construed as requiring an individual to be treated in any circumstances as under the control of another person". These words did not appear to have any policy or practical purpose and have been omitted as unnecessary. The rules are now the same as in section 24 and rather than repeat them here *subsection (4)* contains a cross-reference to that section.

Section 381: Taking account of other deductions

1668. This section contains the rules for calculating the amount of the earnings for the purposes of this Chapter. It derives from paragraph 1A of Schedule 12 to ICTA.

1669. All the other employment income deductions are allowed against the full amount of earnings from the employment for the tax year in question. However, the deduction is only allowed in respect of the earnings from the employment which are attributable to an eligible period.

1670. This means that in some circumstances only a part of a seafarer's earnings for a year may be eligible for the deduction. If the deduction was computed and allowed by reference to the gross earnings for the eligible period, this would displace any other employment income deductions, with the effect that those other deductions, which were for a full year, would be allowed against the earnings for only part of the year.

1671. To prevent this, this section requires that the amount of the earnings for the eligible period is to be computed by first deducting all of the employment income deductions and any capital allowances from the gross earnings of the employment for the year. The net product of this calculation is then apportioned to find the earnings for both the eligible and non-eligible periods.

1672. Paragraph 1A of Schedule 12 to ICTA lists the deductions which are to be taken into account in determining the earnings for the purposes of the FED. However, this list is not complete. For example, it does not refer to deductions under sections 201AA or 201A of ICTA, or under sections 50 to 52 of FA 1989.

1673. This appears to be unintended. In practice, all the other employment income deductions and capital allowances are taken into account when calculating the earnings eligible for the FED. Accordingly the list has been extended to include all those which may be made under the appropriate employment income provisions. This is a minor change to the law. See *Change 103* in Annex 1.

Section 382: Duties on board ship
1674. This section determines whether duties performed on particular voyages are regarded as having been performed in or outside the United Kingdom. It derives from paragraph 5 of Schedule 12 to ICTA and section 132(4)(b) of ICTA.

1675. This section modifies one of the rules in section 132(4)(b) of ICTA, but only for the specific purpose of identifying the duties and earnings which are eligible for the FED. For all other purposes, the rules in section 40 are unaffected by this section.

Section 383: Place of performance of incidental duties
1676. This section derives from paragraph 6 of Schedule 12 to ICTA and sets out the rules (which apply only to the FED), regarding the performance of duties which are incidental to the main duties of the employment.

1677. Under section 132(2) of ICTA, if the duties of an employment are mainly performed outside the United Kingdom, any duties incidental to those performed in the United Kingdom are treated as being performed outside the United Kingdom. However, this rule does not apply when deciding whether or not a seafarer is absent from the United Kingdom to determine entitlement to the FED. This exception to the section 132(2) rule is in section 132(3) and has been rewritten in *subsection (4)* of this section.

Section 384: Meaning of employment "as a seafarer"
1678. This section defines what this means. It derives from section 192A(2) of ICTA. The exception for earnings from Crown employments derives from section 132(4)(a) of ICTA and ensures that those earnings do not qualify for the FED.

Section 385: Meaning of "ship"
1679. This section derives from section 192A(3) of ICTA. "Ship" takes its everyday meaning, subject to the exception in respect of an "offshore installation" as provided by the Mineral Workings (Offshore Installations) Act 1971. Further guidance on the meaning of those terms is given in the Inland Revenue Schedule E manual at paragraphs SE 33221 to 33222.

Part 6: Employment income: income which is not earnings or share-related
Chapter 1: Payments to non-approved pension schemes
Overview
1680. This Chapter sets out the charge to tax on an employee whose employer makes payments to a non-approved pension scheme. It derives from section 595 of ICTA. It is one of the free-standing Schedule E charges presently covered by paragraph 5 of

section 19(1) of ICTA and now brought into charge as "specific employment income".

Section 386: Charge on payments to non-approved retirement benefits schemes
1681. This section derives from section 595(1) of ICTA and sets out the charge to tax on an employee where the employer makes certain payments to non-approved pension ("retirement benefits") schemes. *Subsections (1), (2)* and *(3)* derive from section 595(1) and (1)(a) of ICTA.

1682. *Subsection (4)* reflects the amendment made to section 595 by paragraph 6 of Schedule 6 to FA 2002. This resolved the order of priority between section 595 and section 148 of ICTA.

1683. *Subsection (5)* derives from section 612 of ICTA. The other provisions in Chapter I of Part XIV of ICTA are not exclusively relevant to employment income and will be rewritten at a later stage. This subsection applies the definitions of "employee" and "director" which are in section 612(1).

1684. *Subsection (6)* derives from section 595(5) of ICTA. It may be noted that the reference in that subsection applies to section 595 only. In the new section the reference is applied to the whole Chapter which ensures that relief under section 596(3) of ICTA is available in cases where the benefits are intended to be provided to persons other than the employee. This is a minor change to the law. See *Change 104* in Annex 1.

1685. *Subsection (7)* acts as a signpost to the reliefs available under section 392 and section 266A of ICTA. The latter is a new provision inserted by paragraph 36 of Schedule 6 to this Act and derives from section 595(1)(b) of ICTA.

Section 387: Meaning of "non-approved retirement benefits scheme"
1686. This section defines such a scheme. It derives from section 596(1) of ICTA.

Section 388: Apportionment of payments in respect of more than one employee
1687. This section derives from section 596(4) of ICTA. It provides that where a single payment is made to a non-approved scheme in respect of more than one employee, that payment is apportioned between the employees. Each is taxed only on an appropriate share of the payment.

1688. *Subsection (2)* introduces a formula for making the apportionment.

Section 389: Exception: employments where earnings charged on remittance
1689. This section derives from section 596(2)(a) of ICTA, which provides an exception from the charge where the employee's earnings are chargeable under Case III of Schedule E. That charge is now dealt with in sections 22 and 26.

Section 390: Exception: non-domiciled employees with foreign employers
1690. This section derives from section 595(2)(b) of ICTA and provides a further exception from the charge under section 386 of this Act. This is where the earnings are (in the terminology of ICTA) "foreign emoluments" and the payment is to a retirement benefits scheme which corresponds to approved or relevant statutory schemes etc. As the term "foreign emoluments" has been dropped this section instead sets out the relevant circumstances for the exception to apply.

Section 391: Exception: seafarers with overseas earnings
1691. This section legislates the Inland Revenue's practice of exempting payments from the charge when they are made to seafarers who have no net chargeable earnings from the employment in question for the year as a result of the foreign earnings deduction set out in Chapter 6 of Part 5 of this Act. This is a minor change to the law. See *Change 105* in Annex 1.

Section 392: Relief where no benefits are paid or payable
1692. This section derives from section 596(3) and (4) of ICTA and allows an application for relief where the relevant benefits are not subsequently received from the scheme. Under this section the application is made to and considered by the Inland Revenue rather than the Board. *See Change 158* in Annex 1.

1693. The source legislation provides for an application for relief only from the employee. However, some benefits might not be due until after the employee has died. In practice the Inland Revenue have always accepted applications by the employee's personal representatives. *Subsection (3)* legislates that practice. It is a minor change to the law. See *Change 104* in Annex 1.

Chapter 2: Benefits from non-approved schemes
Overview
1694. This Chapter applies to benefits provided by non-approved retirement benefits schemes.

Section 393: Application of this Chapter
1695. This section defines the scope of the Chapter. The Chapter applies to any benefit provided by a non-approved retirement benefits scheme other than pensions and annuities within the pension income Part. *Subsection (1)* derives from section 596A(1) of ICTA. *Subsection (2)* derives from section 596A(6) of ICTA.

1696. Section 596A(7) of ICTA has not been rewritten in this Act. See *Note 40* in Annex 2.

Section 394: Charge on benefit to which this Chapter applies
1697. This section establishes the charge and the basis of assessment. It ensures that the charge has priority over all other charges in this Act.

1698. *Subsection (1)* applies if an individual receives the benefit. It derives from section 596A(2) of ICTA. The benefit counts as employment income of the individual for the tax year in which the benefit is received.

1699. *Subsection (2)* applies if a person other than an individual receives the benefit. It derives from section 596A(3) of ICTA. There is a charge under Schedule D Case VI on the scheme administrator for the tax year in which the benefit is received. This charge is not employment income. Therefore it does not need to be excluded from the definition of "PAYE employment income" in section 683.

1700. *Subsection (4)* specifies the rate of tax for the Schedule D Case VI charge. It derives from section 596A(5) of ICTA.

1701. *Subsection (5)* establishes the order of priority. The charge under this Chapter takes priority over all other charges in this Act. In its application to lump sums the section derives from section 596A(8) of ICTA. It also legislates the interpretation that the specific charge in section 596A takes priority over a general charge under Schedule E.

Section 395: Application of sections 396 and 397: general rules

1702. This section applies if the benefit received is a lump sum. It derives from section 596A(8), (9) and (15) of ICTA.

1703. The section has two functions.

1704. First, it introduces sections 396 and 397. Section 396 exempts the charge under section 394 if certain conditions are met. Section 397 modifies the charge under section 394 if certain conditions are met.

1705. Second, it sets out the condition that is common to both sections 396 and 397 and which must be met if either section is to apply.

1706. The common condition is given in *subsection (4)*. It derives from sections 596A(8) and (9) of ICTA. The employer has to have paid a contribution or contributions with a view to providing the benefit and the employee has to have been assessed to tax in respect of that contribution or contributions. The assessment may be under section 595 of ICTA or section 386(1) of this Act depending on when the contribution was made.

1707. *Subsection (5)* puts the onus on the taxpayer to show that the conditions in subsection (4) are satisfied. It derives from the assumptions in section 596A(15) of ICTA.

Section 396: Certain lump sums not taxed by virtue of section 394

1708. This section exempts lump sum benefits if:

- all the profits on the scheme investments are brought into charge to tax, and;
- the lump sum has been provided to one of the persons listed in *subsection (1)(b)*.

1709. The section derives from sections 596A(8) and (15) of ICTA.

1710. A further requirement for the exemption to apply is that the condition in section 395(4) is met; see section 395(2).

1711. In *subsection (1)(a)* the phrase "brought into charge to tax" means brought into charge to United Kingdom tax.

1712. *Subsection (2)* puts the onus on the taxpayer to show that the income and gains of the scheme are brought into charge to tax. It derives from the assumptions in section 596A(15) of ICTA.

Section 397: Certain lump sums: calculation of amount taxed by virtue of section 394

1713. This section allows a deduction from the amount of the lump sum that is charged to tax if:

- any of the profits on the scheme investments are not brought into charge to tax, and;
- the condition in section 395(3) is satisfied.

1714. The section derives from sections 591D(6) and 596A(9) to (17) of ICTA. It rewrites section 596A(9) as a free-standing provision. See *Change 106* in Annex 1.

1715. *Subsection (3)* gives the amount of the deduction. It is the total of:

- any contribution the employee has paid, and;
- any contribution the employer has paid that has been taxed on the employee.

1716. *Subsection (3)* derives from section 596A(10) and is subject to *subsection (4)*. Subsection (4) applies the formula in *subsection (6)* if any of the persons listed in *subsection (5)* has the right to receive, or expectation of receiving, a further lump sum or sums. Subsections (4), (5) and (6) derive from sections 596A(11) to (13) of ICTA.

1717. *Subsection (7)* prevents double deductions. It derives from section 596A(14) of ICTA.

1718. *Subsection (8)* derives from the assumptions in section 596A(15) of ICTA.

1719. *Subsection (9)* derives from section 591D of ICTA. It prevents a claim that the scheme funds have been brought into charge to tax because they have suffered a charge under section 591C of ICTA (cessation of approval: tax on certain schemes).

1720. *Subsection (10)* gives the meaning of "market value". It derives from section 596A(17) of ICTA and cross-refers to sections 272 and 273 of TCGA 1992. The reference to section 273 of TCGA 1992 is new. See *Note 41* in Annex 2.

Section 398: Valuation of benefits

1721. This section provides the rules for calculating the value of the benefit.

1722. It derives from section 596A(4) and section 596B of ICTA.

1723. The language in section 596A(4) and section 596B of ICTA is almost identical to that in two other provisions:

- paragraph 12 of Schedule 11 to ICTA, which deals with the valuation of benefits paid on the termination of employment; and

- paragraph 10(3) of Schedule 12 to FA 2000, which deals with the provision of services through an intermediary.

1724. Paragraph 12 of Schedule 11 to ICTA has been rewritten as section 415 of this Act. Paragraph 10(3) of Schedule 12 to FA 2000 has been rewritten as section 55 of this Act. The rewrite of the three sections reflects the similarities.

1725. *Subsection (1)* gives the rule if the benefit is paid in cash. It derives from section 596A(4)(a) of ICTA.

1726. *Subsection (2)* gives the rule if the benefit is not paid in cash. It derives from section 596A(4)(b) of ICTA.

1727. *Subsection (5)* provides that references to the employer in the benefits code include the former employer. This subsection is needed because most employees will have retired before the benefit is paid and their employer will be a former employer.

1728. *Subsection (6)* adapts the benefits code if the benefit provided is accommodation costing over £75,000 and the person receiving the benefit makes good an amount that exceeds the rental value. It overrides the rule in section 106(3) that the taxpayer is allowed to deduct only the excess amount of rent paid. The taxpayer is allowed a deduction for the full amount of the excess.

1729. In the source legislation dealing with benefits the rules for calculating the value of living accommodation costing over £75,000 do not apply if the accommodation was first occupied before 31 March 1983. This rule has been rewritten as a saving; see paragraph 21 of Schedule 7 to this Act. The rule does not apply to section 596B of ICTA. So paragraph 21 of Schedule 7 does not apply for the purposes of this Chapter.

Section 399: Employment-related loans: interest treated as paid

1730. This section applies if the benefit provided is a loan at a rate of interest lower than the official rate.

1731. It derives from section 596C of ICTA.

1732. Tax is charged on the cash equivalent of the loan. This is calculated using the official interest rate. But the cash equivalent is not in fact interest. The section treats the taxpayer as having paid interest. The taxpayer can then claim tax relief on the deemed payment if real interest would have qualified for relief. The language in section 596C of ICTA is almost identical to that in paragraph 13 of Schedule 11 to ICTA, which deals with benefits paid on the termination of employment. That provision has been rewritten as section 416 of this Act.

1733. *Subsection (4)* prevents the notional interest being treated as income of the lender or as mortgage interest payable under deduction of tax in the hands of the payer.

Section 400: Interpretation

1734. This section gives the meaning of various terms used in the Chapter.

1735. It derives from definitions in Chapter 1 of Part 14 of ICTA.

1736. *Subsection (1)* includes a clarification of the meaning of "employee" and the definitions of " administrator", "relevant benefits" and "ex-spouse".

1737. Section 611AA of ICTA defines "administrator" as follows:

> (1) In this Chapter references to the administrator, in relation to a retirement benefits scheme, are to the person who is, or the persons who are, for the time being the administrator of the scheme by virtue of the following provisions of this section.
>
> (2) Subject to subsection (7) below, where—
>
> (*a*) the scheme is a trust scheme, and
>
> (*b*) at any time the trustee, or any of the trustees, is or are resident in the United Kingdom,
>
> the administrator of the scheme at that time shall be the trustee or trustees of the scheme.

(3) Subject to subsection (7) below, where—

(*a*) the scheme is a non-trust scheme, and

(*b*) at any time the scheme sponsor, or any of the scheme sponsors, is or are resident in the United Kingdom,

the administrator of the scheme at that time shall be the scheme sponsor or scheme sponsors.

(4) At any time when the trustee of a trust scheme is not resident in the United Kingdom or (if there is more than one trustee) none of the trustees is so resident, the trustee or trustees shall ensure that there is a person, or there are persons—

(*a*) resident in the United Kingdom, and

(*b*) appointed by the trustee or trustees to be responsible for the discharge of all duties relating to the scheme which are imposed on the administrator under this Chapter.

(5) At any time when the scheme sponsor of a non-trust scheme is not resident in the United Kingdom or (if there is more than one scheme sponsor) none of the scheme sponsors is so resident, the scheme sponsor or scheme sponsors shall ensure that there is a person, or there are persons—

(*a*) resident in the United Kingdom, and

(*b*) appointed by the scheme sponsor or scheme sponsors to be responsible for the discharge of all duties relating to the scheme which are imposed on the administrator under this Chapter.

(6) Without prejudice to subsections (4) and (5) above—

(*a*) the trustee or trustees of a trust scheme, or

(*b*) the scheme sponsor or scheme sponsors of a non-trust scheme,

may at any time appoint a person who is, or persons who are, resident in the United Kingdom to be responsible for the discharge of all duties relating to the scheme which are imposed on the administrator under this Chapter.

(7) Where at any time there is or are a person or persons—

(*a*) for the time being appointed under subsection (4), (5) or (6) above as regards a scheme, and

(*b*) resident in the United Kingdom,

the administrator of the scheme at that time shall be that person or those persons (and no other person).

(8) Any appointment under subsection (4), (5) or (6) above—

(*a*) must be in writing, and

(*b*) if made after the time when the scheme is established, shall constitute an alteration of the scheme for the purposes of section 591B(2).

(9) In this section—

(*a*) references to a trust scheme are to a retirement benefits scheme established under a trust or trusts;

(*b*) references to the trustee or trustees, in relation to a trust scheme and to a particular time, are to the person who is the trustee, or the persons who are the trustees, of the scheme at that time;

(*c*) references to a non-trust scheme are to a retirement benefits scheme not established under a trust or trusts, and

(*d*) references to the scheme sponsor or scheme sponsors, in relation to a retirement benefits scheme and to a particular time, are references to any person who established the scheme and is in existence at that time or, if more than one, all such persons.

1738. Section 612(1) of ICTA provides that "employee"

(a) in relation to a company, includes any officer of the company, any director of the company and any other person taking part in the management of the affairs of the company, and

(b) in relation to any employer, includes a person who is to be or has been an employee.

1739. The definition of "ex-spouse" derives from section 659D of ICTA as inserted by section 79 and paragraph 17 of Schedule 10 to Finance Act 2000.

1740. Section 612(1) of ICTA defines "relevant benefits" as follows:

'relevant benefits' means any pension, lump sum, gratuity or other like benefit given or to be given on retirement or on death, or by virtue of a pension sharing order or provision, or in anticipation of retirement, or, in connection with past service, after retirement or death, or to be given on or in anticipation of or in connection with any change in the nature of the service of the employee in question, except that it does not include any benefit which is to be afforded solely by reason of the disablement by accident of a person occurring during his service or of his death by accident so occurring and for no other reason.

Chapter 3: Payments and benefits on termination of employment etc.

Overview

1741. This Chapter contains another of the free-standing Schedule E charges covered by paragraph 5 of section 19(1) of ICTA. It derives from section 148 of, and Schedule 11 to, ICTA. The provisions apply to charge to tax payments made and benefits provided when an employment ends or the terms of it are changed. As such payments and provision of benefits may continue for a period after the event, the charge to tax continues year by year as long as they continue.

Section 401: Application of this Chapter

1742. *Subsection (1)* derives from section 148(1) of, and paragraph 2(1) of Schedule 11 to, ICTA. It sets out the circumstances in which payments and benefits come within the provisions of the Chapter. The reference to "relative" has been expanded to make it clear that only "blood relatives" are included.

1743. "Personal representatives" is a defined term in section 721 of this Act. It is not defined in paragraph 2(1) of Schedule 11 to ICTA. This is a minor change to the law. See *Change 159* in Annex 1.

1744. Section 148(5) of ICTA has not been rewritten in this Chapter. The reason for that is explained in *Note 42* in Annex 2.

1745. *Subsection (2)* is a signpost to the exceptions which may apply.

1746. *Subsection (3)* prevents a double charge to tax in cases where there may be some doubt as to whether a benefit or payment is within this Chapter or is within another charge to tax. It also ensures that anything which is not chargeable by virtue of the provisions in Part 3 of this Act will be within the provisions of this Chapter if there is a cessation of or change in the employment. It derives from part of the end-words of section 148(1) of ICTA.

1747. *Subsection (4)* derives from section 148(6) of, and paragraph 2(2) of Schedule 11 to, ICTA. It provides that payments to people other than the employee may be within the scope of this Chapter. It also provides that throughout the provisions which this Chapter uses to determine what and how much is chargeable, any references to employee and employer include the person whose employment has terminated and his former employer. This means that those provisions do not need to refer to former employees and former employers.

Section 402: Meaning of "benefit"

1748. This section derives from section 148(2), (2A) and (3) of ICTA and includes a minor change to the law. See *Change 107* in Annex 1.

1749. *Subsection (1)* explains which benefits are within the scope of this Chapter. Subsection (1)(a) defines them as any benefits received by the employee or former employee which are received as set out in subsection (1) and which, if received as an employee for performing the duties of the employment, would be taxable earnings from the employment. This will include any benefit which would come within the definition of earnings in section 62 of this Act and any benefit for which an amount is treated as earnings by a provision in the benefits code. Subsection (1)(b) includes those benefits which would be within subsection (1)(a) but to which an "earnings-only exemption" applies.

1750. "Earnings-only exemption" is defined in section 227 of this Act. Part 4 of this Act contains most of those exemptions. Section 227(4) lists exemptions that are contained in Part 7 and apply in respect of general earnings. Some of these may be "earnings-only" exemptions. Section 227(1) and (2) may be used to identify which are "earnings-only" exemptions and which are "employment income" exemptions.

1751. Subsection (1)(b) means that the only benefits that do not come within the scope of this Chapter are those which are subject to an exemption other than an

"earnings-only exemption". These wider exemptions are labelled "employment income exemptions", defined in section 227, and serve to exempt payments and benefits from any charge under this Chapter, provided any conditions for the exemption to apply are met.

1752. There are some benefits to which an earnings-only exemption applies, but which are not to be chargeable under this Chapter in the case of a termination of the employment. These are listed in s*ubsection (2).*

1753. *Subsection (3)* identifies a benefit which is exempt from the scope of this Chapter in the case of a change in the terms or remuneration of the employment. This prevents the exempted removal benefits falling into this Chapter.

1754. Not all the benefits listed in section 148(2A) of ICTA are included in subsections (2) and (3) of this section. That is because there is no need to include those benefits that are now subject to "employment income exemptions" (which operate to exempt them from all charges under the employment income Parts of this Act).

Section 403: Charge on payment or other benefit

1755. This section contains the charge to tax on termination payments and benefits where they exceed the £30,000 threshold.

1756. *Subsections (1)* and *(4)* set out the basis of the charge, the threshold and when amounts are to be taken as exceeding it. These provisions derive from section 148(1) and (3) of, and paragraphs 7(2) and 14(1) of Schedule 11 to, ICTA. Amounts brought into charge by virtue of this section come within "specific employment income" in section 7(4) of this Act. Section 6(3) of this Act provides that the rules in Chapters 4 and 5 of Part 2 do not apply to specific employment income. That derives from section 19(1), paragraph 5 of ICTA and the case of Nichols v Gibson CA 1996 at 68 TC 611.

1757. *Subsections (2)* and *(3)* set out the rules for the timing of the charge to tax, and the time when benefits are treated as received. The rules are similar to the receipts basis for earnings. In cases where payments are made over a period of time, or benefits are provided for some time after the employment has terminated, once the £30,000 threshold has been exceeded, there will be continuing liability as long as payments continue to be made or benefits provided. These provisions derive from section 148(3) and (4) of ICTA.

1758. *Subsections (5)* and *(6)* make clear who is liable for a tax charge arising by virtue of this Chapter, both in the ordinary course of events and if a payment or benefit is received after the death of the employee or former employee. The latter circumstances are covered by subsection (5), which derives from paragraph 14(2) of Schedule 11 to ICTA. "Personal representatives" is defined in section 721 of this Act. See *Change 159* in Annex 1.

Section 404: How the £30,000 threshold applies

1759. This section deals with two aspects of the £30,000 threshold. The first concerns the payments and other benefits that are to be aggregated. The second concerns the way the £30,000 is to be allocated between payments and benefits received at different times. *Subsections (1)* to *(3)* deal with the first aspect, and derive from section 148(1) and (6) of, and paragraphs 7, 8 and 16 of Schedule 11 to, ICTA. *Subsections (4)* and *(5)* relate to the second aspect and derive from section 148(1) of, and paragraph 7 of Schedule 11 to, ICTA.

1760. *Subsection (1)(c)* sets out the circumstances in which the payments and benefits from more than one employer are aggregated. Only one sum of £30,000 is available in respect of an employment, different employments with the same employer and employments with employers who are associated.

1761. *Subsection (2)* explains when employers are "associated" for this purpose. *Subsection (3)(a)* treats the successors to the employer or the person looked at to determine control as if they were the original employer or person. Successors are not defined anywhere in the Tax Acts so the normal meaning applies, being someone who takes the place of another person to perform a like role and duties. *Subsection (3)(b)* defines the time at which one has to consider whether employers are associated to be the "termination or change date".

1762. *Subsections (4)* and *(5)* explain how the £30,000 threshold is attributed to the payments and benefits in the order in which they are received.

Section 405: Exception for certain payments exempted when received as earnings.

1763. This section provides that certain payments which would otherwise fall within this Chapter are not to be included. It derives from section 148(2A) of ICTA.

1764. *Subsection (1)* sets out the exemption which is to be taken to apply for this Chapter in the case of a termination of employment.

1765. *Subsection (2)* sets out the exemption which is to be taken to apply for this Chapter in the case of a change in the terms or remuneration of the employment.

1766. Not all the payments listed in section 148(2A) of ICTA are included in subsections (1) and (2) of this section. That is because there is no need to include those benefits that are now subject to "employment income" exemptions which operate to exempt them from all charges under the employment income Parts of this Act or those that are excluded by section 402(2) or (3) of this Act.

Section 406: Exception for death or disability payments and benefits

1767. This section provides an exception where the payment or benefit is due to death, injury or disability. It derives from paragraph 3 of Schedule 11 to ICTA.

Section 407: Exception for payments and benefits under tax-exempt pension schemes

1768. This section provides an exception where the payment is made or benefit provided through certain pension schemes and is due to a change in or termination of employment owing to ill health. This exception derives from paragraph 4 of Schedule 11 to ICTA.

1769. The payment or benefit referred to in *subsection (1)(b)* will usually be a commutation payment calculated by reference to past service.

Section 408: Exception for contributions to tax-exempt pension schemes

1770. This section derives from Inland Revenue Statement of Practice 2/1981, which excepts special contributions to approved schemes and payments for the purchase of an annuity under an approved transaction.

1771. *Subsection (1)* sets out the type of contribution which is excepted.

1772. *Subsection (2)* provides signposts to the definitions of terms used.

1773. This is a minor change to the law. See *Change 108* in Annex 1.

Section 409: Exception for payments and benefits in respect of employee liabilities and indemnity insurance

1774. This section covers the treatment of a payment or benefit received by an employee in connection with a liability arising after the employee's employment has ceased and its interaction with this Chapter. The payments or benefits in *subsection (1)* are not within this Chapter if the conditions in *subsections (3)* to *(5)* are met. The section derives from section 92(10) of FA 1995.

Section 410: Exception for payments and benefits in respect of employee liabilities and indemnity insurance: individual deceased

1775. This section covers the treatment of a similar payment or benefit to that described in respect of section 409 where the employee has died. It does not matter whether the former employee's death gave rise to the cessation of the former employment or simply occurred after that cessation. The payment is specifically excluded from any charge to tax on the personal representatives of the deceased former employee arising by virtue of this Chapter. The section derives from section 92(10) of FA 1995.

1776. "Personal representatives" is defined in section 721 of this Act. See *Change 159* in Annex 1.

Section 411: Exception for payments and benefits for forces

1777. This section provides an exception for certain payments and benefits for members of the armed forces. It derives from paragraph 5 of Schedule 11 to ICTA.

Section 412: Exception for payments and benefits provided by foreign governments etc.

1778. This section provides an exception which is limited to those employed by foreign governments and to particular circumstances. It derives from paragraph 6 of Schedule 11 to ICTA.

Section 413: Exception in certain cases of foreign service

1779. This section provides an exception for payments made in certain cases of "foreign service". The exception depends on the length of the foreign service up to the date of the termination of, or change in, employment, compared with the whole period of service.

1780. As the period involved exceeds 20 years it is necessary to define "foreign service" in a number of different ways because of the changes in the Schedule E charge over that period. This section derives from paragraphs 9 and 10 of Schedule 11 to ICTA.

1781. *Subsection (3)* deals with the period in which this Act will have effect.

1782. *Subsection (4)* deals with the period in which the "foreign earnings deduction" (in sections 192A or 193(1) of ICTA) was applicable.

1783. *Subsection (6)* deals with the period before the foreign earnings deduction became available and before the Cases of Schedule E were introduced. This ensures that all periods of overseas service are included.

Section 414: Reduction in other cases of foreign service

1784. The exception for foreign service in section 413 may not apply because the length of service is insufficient. If so, the amount charged to tax may be reduced under this section, which derives from paragraphs 9 and 11 of Schedule 11 to ICTA. The amount of the reduction depends on the length of foreign service compared with the total length of service.

1785. The reduction is applied to the amount which remains above the £30,000 threshold.

1786. There is, however, a limitation to the reduction. This is intended to ensure that where tax is deducted from a payment – for example a gift aid payment – enough tax remains in charge to satisfy the tax on the payment. *Subsection (4)* has the effect that any personal reliefs and the reduction added together must not bring the income tax payable below an amount equal to the tax on the gift aid payment.

1787. This is a change from the limit in ICTA that would "reduce the amount of income on which the taxable person is chargeable below the amount of income tax which the taxable person is entitled" to charge or deduct. It is a minor change to the law. See *Change 109* in Annex 1.

Section 415: Valuation of benefits

1788. This section sets out how to value the benefits chargeable under this Chapter. It derives from paragraph 12 of Schedule 11 to ICTA. It applies the valuation rules of the benefits code as set out in Chapters 2 to 10 of Part 3 of this Act.

1789. *Subsection (1)* provides the rule for arriving at the amount of cash benefits.

1790. *Subsection (2)* provides the same rule as that in section 64 of this Act (relationship between earnings and benefits code). The amount of any earnings is considered first, and the cash equivalent under the benefits code "tops up" the earnings with the excess. This link to the benefits code is a minor change to the law. See *Change 110* in Annex 1. The benefits are considered on the basis of what would be chargeable if section 15 of this Act applied.

1791. *Subsections (3)* to *(7)* of this section modify the valuation provisions used in the benefits code so that they can apply properly to work out the valuation of benefits brought into the charge to tax under this Chapter. These provisions derive from section 596B of ICTA.

1792. *Subsection (4)* allows the valuation of the cash equivalent to be made by reference to the person chargeable or the recipient of the benefit.

1793. *Subsection (5)* disapplies, for valuation purposes, section 401(4) which treats the employee as the recipient in certain circumstances.

1794. *Subsection (7)* applies where the benefit is living accommodation and an amount has been made good. It overrides the limitation in section 106 of this Act which restricts the deduction to the rent paid, and so allows a deduction of the whole of the amount made good for the purposes of this Chapter.

1795. One of the modifications to the benefit of provided living accommodation is that section 146(8) of ICTA does not apply for the purposes of this Chapter. This refers to accommodation first occupied by the employer before 31 March 1983. In view of the length of time since that date, the provision has been removed from section 107 of this Act. The disapplication of it has also been removed from this section. It is in paragraph 21(2) of Schedule 7 to this Act.

Section 416: Notional interest treated as paid if amount charged for beneficial loan

1796. This section is the equivalent of section 184 of this Act (interest treated as paid) in the benefits code and is written in the same terms.

1797. It allows relief in respect of the benefit of a loan which falls within this Chapter, but prevents it from being treated as real interest paid under deduction of tax.

Part 7: Employment income: share-related income and exemptions

Overview

1798. This Part contains the provisions concerning the income tax treatment of share-related remuneration. The chapters in this Part reflect the major divisions in the legislation relating to shares acquired by employees:

- Chapter 1 is introductory;
- Chapters 2 to 5 deal with topics whose principal purpose is to impose charges to tax by providing that certain share-related benefits count as employment income (see background in paragraphs 1802 to 1812); and
- Chapters 6 to 9 deal with income tax aspects of the various schemes and plans that confer tax advantages (see background in paragraphs 1813 and 1814). The sections in these Chapters are supplemented in each case by a Schedule (see background in paragraph 1815) containing the administrative provisions for the scheme or plan in question.

1799. Chapter 10 deals with a different topic: the exemption given to employees in connection with priority share allocations for employees when an offer of shares to the public is made. The material in Chapter 10 derives from section 68 of FA 1988.

1800. This Part also contains a final chapter (Chapter 11) which contains supplementary provisions relating to employee benefit trusts.

1801. This Part does not include any provisions dealing with the tax consequences of an employee acquiring employment related shares at less than market value. This topic is dealt with in section 162 of ICTA, which treats the acquisition of shares at less than market value as a notional loan to the employee, and uses the rules for beneficial loans to give a cash equivalent of the benefit. Section 162 also sets out the tax charge that arises when employment-related shares are disposed of for more than market value, treating the excess over market value as emoluments. Because of the relationship between section 162 and the rules on beneficial loans, those provisions appear, in this Act, as part of the benefits code, in Chapters 8 and 9 of Part 3, following on from the chapter concerning the treatment of employment-related loans. There are cross-references to Chapters 8 and 9 of Part 3 in section 418(1) of this Act.

Background

1802. Companies have often wished to reward employees by allowing them to acquire shares in the company on advantageous terms. As a matter of legal form, the company may achieve this objective in any one of three ways, for the employee may be given:

- shares (if the company issues its own shares direct to the employee);

- a purely monetary benefit (if the company allows the employee to acquire shares on advantageous terms); or

- an option (if the company grants the employee an option to buy shares in the company at some future date).

1803. It is well established that if an employee is given shares, or is allowed to acquire shares on advantageous terms, the amount of the advantage is chargeable to income tax as an earning from the employment. The leading case is Weight (HM Inspector of Taxes) - v - Salmon (1935) 19 TC 174 (HL), where the taxpayer took up opportunities given to him to apply for unissued shares in the company at their par value, which was always less than their market value. The House of Lords held that the difference was an emolument of the taxpayer's employment. In the words of the basic charge to income tax under Schedule E, as it stood at that time, the taxpayer, who was a person "having or exercising an office or employment of profit" had received a "profit" from that office.

1804. As a means of avoiding the charge to tax on such arrangements, established by the decision in Weight - v - Salmon, share option schemes became increasingly popular. These schemes differed: but, typically, a company granted to employees, for a nominal sum, an option to buy a stated number of shares at a stated price, which was normally their market value at the date of the grant. If the price of the company's shares rose, an employee could exercise the option and acquire shares at less than the market value then current.

1805. The efficacy of share option schemes was tested in the case of Abbott - v - Philbin (HM Inspector of Taxes) (1960) 39 TC 82 (HL), [1961] AC 352, where the House of Lords had to consider two assessments to income tax for different years of assessment. The first assessment was for the year in which the taxpayer received the option. The decision regarding that assessment was that the taxpayer did receive an emolument during that year of assessment, but that the taxpayer obtained no benefit from it at that time, because the option was to buy at what was then the market value. The second assessment was for the year in which the taxpayer exercised the option. The House of Lords held, for that later year of assessment, that the advantage that arose was not a perquisite or profit from the office or employment during the year of assessment. Instead it was an advantage which accrued to the taxpayer as the holder of a legal right that he had acquired in an earlier year. (It might well have been possible to say that the taxpayer had made a gain from the disposal of an asset - the option - but capital gains tax was only introduced by FA 1965.)

1806. Legislation to counteract the effect of the decision in Abbott - v - Philbin was enacted as section 25 of FA 1966, which imposed a charge to income tax when the option was exercised. This legislation was later re-enacted, and eventually became sections 135 to 140 of ICTA 1988. It now constitutes Chapter 5 of this Part of this Act.

1807. As a means of avoiding a charge under section 25 of FA 1966, share incentive schemes became increasingly popular. These schemes differed: but, typically, a company awarded shares subject to restrictions to employees. The restrictions might (for example) have the result that the shares carried no rights to receive dividends or to vote. The shares, consequently, might be expected to have only a low value. At a later date (or dates) the restrictions would be removed. The consequent increase in value, however, was not subject to the share option rules in section 25 of FA 1966: for the employee did not realise a gain by exercising an option to acquire shares. The shares were already owned.

1808. Legislation to counteract share incentive schemes by charging the employee to income tax on the increase in the value of the shares was introduced in FA 1972. That legislation was considerably amended over the years; and successor legislation was introduced by sections 77 to 89 of FA 1988. That legislation is rewritten in Chapter 4 of this Part of this Act.

1809. At a later stage, long-term incentive plans came increasingly to be used. These schemes also differed; but, typically, a company awarded shares to employees, at no cost or at nominal cost, in circumstances where the employee was only able to enjoy the benefit of those shares if performance conditions specified at the time of the award were met. Some time later, after the performance conditions had been met, the employee would become fully entitled to enjoy the benefit of the shares.

1810. It was initially assumed that there was no charge on the initial award of the shares, but that a charge arose when the employee became entitled to enjoy the full benefit of the shares. Prevailing practice reflected this assumption. However, the view was taken later that a charge arose on the initial award of the shares but not at the later time when the employee became fully entitled to enjoy the benefit of the shares.

1811. Legislation was accordingly introduced in section 50 of FA 1998, which provided for sections 140A to 140C to be inserted into ICTA. The new legislation broadly restored the position to the previous practice - this time on a statutory basis. This legislation now constitutes Chapter 2 of this Part of this Act.

1812. Further legislation was introduced in section 51 of FA 1998, which provided for sections 140D to 140F to be inserted into ICTA. This legislation was aimed at counteracting possible tax avoidance where there was a conversion of one class of shares into another. As a result of such a conversion it was possible to devise structures under which employees could be provided with valuable shares as a form of remuneration without the full value of the shares being brought into charge to income tax. This legislation imposed a charge to income tax at the time of conversion. This legislation now constitutes Chapter 3 of this Part of this Act.

1813. But not all of the legislation relating to employees who acquire shares or options in the companies for which they work is of the type so far described. Various

Governments have decided that they wish to confer various advantages on a range of schemes and plans. This has meant additional legislation to set out:

- the characteristics to be possessed by the scheme or plan before it may be approved;
- the tax advantages that an approved scheme or plan possesses;
- any procedure to be undertaken before the scheme or plan may be approved;
- any tax charges that will apply if the shares or options are removed from the scheme or plan (or other "inappropriate" actions are undertaken); and
- any supplementary provisions.

1814. There are currently five different schemes or plans in existence:

- Approved profit sharing ("APS") schemes. The legislation relating to these schemes was originally contained in FA 1978; and that legislation was consolidated in sections 186 and 187 of, and Schedules 9 and 10 to, ICTA. These schemes are being phased out and they are not included in this Act. There is a cross-reference to these schemes in section 418(3).
- Approved save as you earn ("SAYE") option schemes. The legislation relating to these schemes was originally contained in FA 1980; and that legislation was consolidated in sections 185 and 187 of, and Schedule 9 to, ICTA. The legislation relating to these schemes now constitutes Chapter 7 of this Part and Schedule 3.
- Approved company share option plans ("CSOPs"). The legislation relating to these schemes was originally contained in FA 1984; and that legislation was consolidated in sections 185 and 187 of, and Schedule 9 to, ICTA. These schemes were then much affected by section 114 of FA 1996. The legislation relating to these schemes now constitutes Chapter 8 of this Part and Schedule 4.
- Share incentive plans ("SIPs"). The legislation relating to these schemes is principally contained in Schedule 8 to FA 2000, under the name "Employee share ownership plans". The legislation relating to these schemes now constitutes Chapter 6 of this Part and Schedule 2.
- Enterprise management incentives ("EMI"). The legislation relating to the options that qualify as EMI is principally contained in Schedule 14 to FA 2000. That legislation now constitutes Chapter 9 of this Part and Schedule 5 to this Act.

Arrangement of material for share schemes

1815. This Act provides for a "code" for each of SIPs, SAYE schemes, CSOPs and EMIs. That "code" includes all the legislation relating to the particular scheme or plan, covering the tax advantages and any consequential tax charges together with all the rules relating to the qualification criteria and administration of the scheme or plan in question. The material in each "code" has been divided into two principal categories. The material dealing with the tax advantages and consequential tax charges has been placed in the main run of sections in this Part of this Act; but the administrative provisions have been placed in the supporting Schedules 2 to 5 to this Act.

1816. This approach is intended to highlight the legislation relating to the actual tax advantages offered, and any consequential tax charges, so that all the information with a direct impact on an employee's tax liability appears in one place in the body of this Act.

1817. The provisions relating to the qualification criteria for each code are likely to be relevant to different sets of people (e.g. the company setting up the scheme and its advisers). It therefore seems logical to separate these out and to place them in a Schedule separate from the main run of sections concerning the taxation of employment income.

Chapter 1: Introduction

Overview

1818. This short introductory Chapter consists of five sections:

- Section 417 is concerned with the scope of this Part of the Act;
- Section 418 is concerned with other provisions relating to share related income;
- Section 419 introduces the provisions that impose duties to provide information to the Inland Revenue;
- Section 420 deals with a computational matter of general application;
- Section 421 deals with the application of this Part to office-holders.

Section 417: Scope of Part 7

1819. This section, which is a drafting addition, introduces the provisions of this Part of this Act. Those provisions contain special rules relating to employees or directors who acquire shares in companies, or options relating to such shares, in connection with their office or employment (see *subsection (1)*).

1820. *Subsection (2)* then lists nearly all the chapters in this Part that follow this introductory Chapter. Of these, it may be said that Chapters 2 to 5 are primarily

concerned with charges to income tax that may arise in certain circumstances. Chapters 6 to 9 then deal with the plans and schemes under which employees and directors may be offered shares or options on advantageous terms. And, finally, Chapter 10 deals with a particular income tax exemption that arises when employees or directors benefit from a priority allocation of shares.

1821. *Subsection (3)* lists the chapters in this Part that provide for amounts to count as employment income; and *subsection (4)* lists the chapters in this Part that provide for exemptions and reliefs from income tax. *Subsection (5)* records that there is also a supplementary chapter (Chapter 11) which contains provisions about employee benefit trusts.

Section 418: Other provisions about share-related income and exemptions
1822. This section, which is another drafting addition, sets out where other provisions dealing with share related income and exemptions may be found.

1823. *Subsections (1) and (2)* list other provisions of this Act that deal with share-related income and exemptions.

1824. *Subsection (3)* deals with approved profit sharing schemes ("APS schemes"). This subsection explains that, in view of the phasing out of these schemes, the legislation relating to APS schemes has not been rewritten in this Act. That legislation will accordingly continue to apply while APS schemes continue.

1825. *Subsection (4)* preserves the effect of sections 138 to 140 of ICTA where shares or interests in shares were acquired before 26 October 1987.

Section 419: Duties to provide information
1826. This section lists the provisions in this Part that impose duties to provide information to the Inland Revenue.

1827. This section is also a drafting addition, as, once again, it provides signposts to the various sections that are relevant in this context. As these sections are all placed near the end of the chapters in which they appear, they might otherwise be given insufficient attention.

Section 420: Negative amounts treated as nil
1828. The charges to income tax for which this Part of this Act provides constitute "specific employment income" (see sections 6(1) and 7(4) of this Act). Under ICTA this income is charged to income tax under paragraph 5 of section 19(1) of that Act.

1829. In this Part of this Act, where deductions from a chargeable amount are permitted, the relevant provision signals this fact by using a formula.

1830. This section, which is new, gives effect to the general proposition that it is not possible for an allowable loss to arise under paragraph 5 of section 19(1) of ICTA.

Deductions might reduce a chargeable amount to nil; but, beyond this point, they could not be used to create a negative amount and (accordingly) an allowable loss. See *Note 43* in Annex 2.

Section 421: Application of Part 7 to office-holders

1831. The general rule is that the provisions of the employment income Parts apply equally to offices, unless the contrary is stated (see section 5(1)). But, with one exception, the legislation rewritten in this Part does not apply to office-holders. This section deals with these propositions for the whole of this Part of this Act.

Chapter 2: Conditional interests in shares

Overview

1832. Where shares are awarded to employees by reason of their employment, their value (less anything paid for them) will generally be taxable as an emolument. If the shares have restrictions attached to them so that they are subject to risk of forfeiture (typically in the event of performance criteria not being met), the Inland Revenue view until 1998 was that there was not an emolument at the time of award and that liability only arose when the risk of forfeiture was lifted. Legal advice in 1998 showed that this view was wrong. Liability arose in the normal way at the time of the award on the value of the shares taking into account the risk of forfeiture. No liability as an emolument arose at the time that the risk was lifted. Nor would the legislation in sections 77 to 88 of FA 1988 generally bite as there was no event giving rise to an immediate increase in value.

1833. The legislation introduced by sections 140A to 140C of ICTA (together with supplementary provisions in sections 140G and 140H) is intended broadly to restore the position as it existed under the earlier practice. It applies to shares acquired on or after 17 March 1998. In essence the normal income tax emoluments charge on award is removed by section 140A unless the shares can still be subject to forfeiture more than five years after acquisition. The same section then imposes a charge (whether or not there is an emoluments charge) when the employee's interest ceases to be "only conditional", a term which is defined by section 140C. A number of situations are specifically excluded from counting as "only conditional" so that in those circumstances the normal rules of a charge on acquisition apply.

1834. Sections 140G and 140H of ICTA contain supplementary provisions some of which apply solely to the provisions concerning conditional shares (sections 140A to 140C of ICTA), some of which apply solely to the provisions concerning convertible shares (sections 140D to 140F of ICTA) which were introduced at the same time and some which apply to both. In this Act the provisions on convertible shares appear in Chapter 3. This does mean that those supplementary provisions which apply to both types of share have been duplicated, but the overall result is intended to be much easier to follow.

Section 422: Application of this Chapter

1835. *Subsection (1)* of this introductory section derives from section 140A of ICTA and gives the two basic conditions for the provisions to apply. First, the shares must be acquired "as a director or employee" and that term is defined in section 423. The second condition is that the employee's interest in the shares is "only conditional" as defined in section 424. The fact that these provisions only apply to shares acquired on or after 17 March 1998 is made clear in Part 7 of Schedule 7 to this Act, to which there is also a signpost in section 418(1).

1836. *Subsection (2*) is new and sets out a number of useful labels which make for less cumbersome drafting. The fact that this Chapter applies to prospective and former directors and employees is made clear by the reference to the extended definition in section 434(1).

Section 423: Interests in shares acquired "as a director or employee"

1837. *Subsection (1)* explains the circumstances in which shares are regarded as being acquired by a person ("E") "as a director or employee". They are broadly equivalent to the circumstances in which a normal earnings charge would arise. The provision derives from section 140H(1) of ICTA. *Subsection (1)(c)* no longer says an assignment "to him" because if the assignment was to anyone else the shares would not have been acquired by E.

1838. *Subsection (2)* qualifies subsection (1) and derives from section 140H(2) of ICTA with only minor modifications.

1839. *Subsections (3)* and *(4)* are based on section 140H(4) of ICTA and explain the treatment when one conditional or convertible interest is exchanged for another.

1840. *Subsection (5)* derives from the opening words of section 140H(4) of ICTA.

1841. *Subsection (6)* contains the definition of "convertible shares".

Section 424: Meaning of interest being "only conditional"

1842. *Subsection (1)*, which derives mainly from section 140C(1) of ICTA, defines when an interest in shares is "only conditional". While section 140C of ICTA says "for the purposes of sections 140A and 140B", the definition is applied more widely by section 140H(5) of ICTA. Hence the definition is now applied "for the purposes of this Chapter".

1843. *Subsection (2)* summarises the exceptions from subsection (1) which prevent the interest being only conditional so that the normal charge as earnings applies on acquisition. The exceptions derive from section 140C (1A), (2), (3), (3A) and (4) of ICTA.

1844. *Subsection (3)* derives from section 140C(5) of ICTA and expands on the circumstances falling within subsection (1)(a). They are not regarded as including

cases where the terms on which the employee is entitled to the interest allow the employee to require a person to acquire the interest at undervalue.

1845. *Subsection (4)* relates back to subsection (1)(b) and derives from the closing words of section 140C(1) of ICTA.

1846. *Subsection (5)* is new and reflects the latest legal advice that the term "articles of association" includes foreign equivalents, thus widening the circumstances in which an interest is not "only conditional". See *Note 44* in Annex 2.

1847. *Subsection (6)* is supplementary to subsections (2)(b) and (c) and derives from parts of section 140C(3) and 140C(3A) of ICTA.

1848. *Subsection (7)* derives from section 140(6) of ICTA.

Section 425: Cases where this Chapter does not apply

1849. The two rules in this section derive from section 140H(3) of ICTA.

1850. The source legislation specifies that these provisions only apply to Case I employments. *Subsection (1)* rewrites this rule by applying the equivalent test that the earnings must be within section 15 or 21.

1851. *Subsection (2)* explains that the test in subsection (1) is to be applied to the final year of employment in cases where the right or opportunity to acquire the shares is conferred or offered after the employment has ceased.

Section 426: No charge in respect of acquisition of employee's interest in certain circumstances

1852. This section concerns the five year rule and derives from section 140A(3) of ICTA. In the typical case the conditions apply for less than five years at which point the employee has an indefeasible interest in the shares. In those circumstances no charge as an emolument arises on acquisition but this does not affect any charges that may arise under section 135 of ICTA (where the shares are acquired by exercising an option) or section 162 of ICTA (where the shares are acquired at undervalue). In this Act those provisions are in section 476 and Chapter 8 of Part 3 respectively.

Section 427: Charge on interest in shares ceasing to be only conditional or on disposal

1853. *Subsections (1) to (3)* derive from section 140A(4) of ICTA which imposes a tax charge when the risk of forfeiture is lifted or on the earlier disposal of the shares.

1854. *Subsection (4)* is new and acts as a signpost to a provision removing the charge for shares awarded under an approved SIP.

Section 428: Amount of charge
1855. This section concerns the calculation of the taxable charge under section 427. It derives from section 140(5), (7), and (9) of ICTA. A formula has been introduced in *subsection (1)* to make the provisions more user-friendly.

1856. The deductible amount provided by section 140A(7)(b) of ICTA is any amount chargeable in respect of the acquisition of the interest. It is not immediately clear what is meant by that phrase and the approach adopted here is to specify what is allowable. The three charges that are relevant are detailed in paragraphs (b), (c) and (d) of *subsection (2*). See *Note 45* in Annex 2.

1857. *Subsection (3)* provides that charges under sections 449 and 453 are deductible. It derives from section 140A(7)(c) of ICTA. The opportunity has been taken to make it clear that a charge taken under these provisions is not a deductible amount if it is generated by the same event which gives rise to the charge under this Chapter. This is because the FA 1988 provisions, from which sections 449 and 453 derive, are subject to section 140A of ICTA so that the latter takes priority.

Section 429: Amount or value of consideration given for employee's interest
1858. This section derives from section 140B(1) to (6) of ICTA. Section 140B(7) has been taken to a separate section. This section determines, for the purposes of section 428, the amount allowable as the cost of the shares.

Section 430: Amount or value of consideration given for right to acquire shares
1859. This section derives from section 140B(7) of ICTA which is concerned with calculating the allowable cost where an original option has been exchanged for a replacement option. Section 140B(7) simply refers to the workings of section 136 of ICTA which are not easy to follow. This section spells out what the allowable cost is and the wording follows section 485 which derives from section 136. See *Change 125* in Annex 1.

Section 431: Application of this Chapter where employee dies
1860. This section derives from section 140A(8) of ICTA which gives rules which apply when the employee dies holding the conditional shares. There is a deemed disposal immediately before death and a special market value rule applies.

Section 432: Duty to notify provision of conditional interests in shares
1861. This section derives from those parts of section 140G of ICTA concerning information requirements on the initial award of the conditional shares. Section 140G(1)(b)(i) has been omitted as unnecessary because the original award of the shares cannot itself result in any charge under section 140A of ICTA. Accordingly this section simply focuses on the possibility of there being subsequent events that may result in a charge.

1862. The time limits for providing information throughout Chapters 2 to 5 of Part 7 have been standardised at 92 days after the end of the year in which the matter arose

or after the event concerned. In the source legislation for this section the time limit was 30 days after the end of the tax year in which the interest is provided. In addition where a time limit runs from the end of the tax year it is now expressed as "before 7th July" to give greater clarity. See *Change 111* in Annex 1.

Section 433: Duty to notify events resulting in charges under section 427

1863. This section derives from those parts of section 140G of ICTA concerning information requirements on the occurrence of any of the three events (death, disposal of shares, lifting of restrictions) which may result in a charge under section 140A of ICTA. The time limit for providing information has been extended from 30 to 92 days after the end of the tax year in which the event occurred and expressed differently. See *Change 111* in Annex 1.

Section 434: Minor definitions

1864. This section brings together the definitions in section 140H of ICTA and elsewhere in the provisions and adds some new labels for terms used in section 422. In the definition of "terms" the word "include" in section 140H(6) of ICTA has been replaced by "means" to make better sense of the additional words "or in any other way".

1865. The definition of shares (which comes from section 136(5)(d) of ICTA, as applied with modifications by section 140H(8) of ICTA) includes stock "in so far as the context permits". This rider has been omitted as unnecessary since there does not appear to be anywhere in this Chapter where the context would not so permit.

Chapter 3: Convertible shares

Overview

1866. Sections 140D to 140F of ICTA (together with supplementary provisions in sections 140G and 140H) were introduced by FA 1998 and apply to shares acquired on or after 17 March 1998. The provisions are concerned with countering possible avoidance in the award of convertible shares by reason of employment. Such shares could be issued having a low value but be later converted to shares of a different class with a higher value. The emoluments charge on award of the shares would be measured by reference to the initial low value and without these provisions the uplift in value on conversion would escape taxation.

1867. The legislation imposes a charge to tax on the market value of the shares immediately after conversion as reduced by sums paid on acquisition or conversion and by any amounts already charged to tax in respect of those shares. No charge arises if all the shares of one class are converted to shares of a new single class and immediately before conversion the company was either controlled by outside shareholders or was employee-controlled.

1868. Sections 140G and 140H of ICTA contain supplementary provisions some of which apply solely to the provisions concerning convertible shares (sections 140D to 140F of ICTA), some of which apply solely to the provisions concerning

conditional shares (sections 140A to 140C of ICTA) which were introduced at the same time and some which apply to both. In this Act the provisions on conditional shares appear in Chapter 2. This does mean that those supplementary provisions which apply to both types of share have been duplicated, but the overall result should be much easier to follow.

Section 435: Application of this Chapter

1869. *Subsection (1)* derives from section 140D(1) of ICTA and gives the basic condition that the shares must be acquired "as a director or employee" and that term is defined in section 436. The reference to interests in shares as well as shares themselves throughout the Chapter derives from section 140F(6) of ICTA. The fact that these provisions only apply to shares acquired on or after 17 March 1998 is made clear in Part 7 of Schedule 7, to which there is also a signpost in section 418(1).

1870. *Subsection (2)* is mainly derived from section 140D(2) of ICTA (but also parts of section 140G(6) and section 140H(5) of ICTA) and defines the meaning of "convertible".

1871. *Subsection (3)* derives from section 140F(2) of ICTA.

1872. *Subsection (4)* is new and sets out a number of useful labels which make for less cumbersome drafting. The fact that this Chapter applies to prospective and former directors and employees is made clear by the reference to the extended definition in section 446(1).

Section 436: Shares acquired "as a director or employee"

1873. This section derives from subsections (1), (2), (4) and (7) of section 140H of ICTA. It expands on what is meant by shares (or an interest in shares) acquired by a person "as a director or employee".

Section 437: Cases where this Chapter does not apply

1874. This derives from section 140H(3) of ICTA. It limits the application of this Chapter to cases where the earnings from the employment are within section 15 or 21 and reproduces the restriction in the source legislation to Case I employments.

Section 438: Charge on conversion of shares

1875. This is the charging provision for this Chapter. It derives from section 140D(3) and (4) of ICTA and imposes a charge when the shares are converted to shares of a different class.

Section 439: Amount of charge

1876. This section concerns the calculation of the taxable charge under section 438. It derives from section 140D(5) and (6) of ICTA. A formula has been introduced to make the provisions more user-friendly. As with section 428 the approach now adopted is to specify precisely what deductions are allowable in respect of amounts chargeable in respect of the acquisition of the interest. The three charges that are

relevant are detailed in paragraphs (c), (d) and (e) of *subsection (2)*. See *Note 45* in Annex 2.

1877. *Subsection (3)* provides that charges under the provisions derived from sections 78 and 79 of FA 1988 are deductible. It derives from section 140D(6)(d) of ICTA. In contrast to section 428, there is no need to refer to "a different event" here since the conversion itself does not give rise to a charge under the FA 1988 provisions.

1878. *Subsection (5)* gives the meaning of "market value", the definition of which is not found in ICTA until section 140F(3).

1879. *Subsection (6)* derives from the definition of "taxable conversion" in section 140D(7) of ICTA.

1880. *Subsection (7)* is new. It meets the point that there should be no reason why a charge arising at the end of the seven-year period in section 79 of FA 1988 should not be a deductible amount. This is a minor change to the law. See *Change 112* in Annex 1.

Section 440: Case outside charge under section 438: conversion of entire class

1881. In ICTA the main exemption from the charge on conversion is tucked away in subsections (8) and (9) of section 140D with related definitions in section 140F. The exemption is now in a separate section and the definitions are in *subsections (4)* and *(5)*.

Section 441: Case outside charge under section 438: acquisition of conditional interest

1882. This section provides that no charge arises under this Chapter if the new shares are within the scope of Chapter 2. This ensures that where a conditional interest in shares is acquired on the conversion of other shares and under section 426 of the Act there is no charge in respect of the acquisition of the interest, there will not be a charge under this Chapter in respect of the conversion of the other shares. The section derives from section 140D(10) of ICTA.

Section 442: Amount or value of consideration given for shares or conversion

1883. This section derives from section 140E(1) to (6) of ICTA. Section 140E(7) has been taken to a separate section. It determines, for the purposes of section 439, the amount allowable as the cost of the shares or the cost of conversion.

Section 443: Amount or value of consideration given for right to acquire shares

1884. This section derives from section 140E(7) of ICTA which is concerned with calculating the allowable cost where an original option has been exchanged for a replacement option. That section simply refers to the workings of section 136 of ICTA which are not easy to follow. In order to assist readers, this section sets out

what the allowable cost is and the wording follows section 485 which derives from section 136 of ICTA. See *Change 125* in Annex 1.

Section 444: Conversion in consequence of employee's death
1885. This section derives from section 140F(1) of ICTA which deems certain conversions within 12 months of death to have occurred immediately before death.

Section 445: Duty to notify conversions of shares
1886. This section derives from those parts of section 140G of ICTA concerning the information requirements when shares are converted and may result in a charge under this Chapter. The time limit for providing information has been extended from 30 to 92 days after the tax year in which the conversion takes place and expressed differently. See *Change 111* in Annex 1.

Section 446: Minor definitions
1887. This section brings together the definitions in section 140H of ICTA and elsewhere in the source legislation and adds some new labels for expressions used in section 435. In the definition of "terms" the word "include" in section 140H(6) of ICTA has been replaced by "means" to make better sense of the additional words "or in any other way".

1888. The definition of shares (which comes from section 136(5)(d) of ICTA, as applied with modifications by section 140H(8) of ICTA) includes stock "in so far as the context permits". This rider has been omitted as unnecessary since there does not appear to be anywhere in this Chapter where the context would not so permit.

Chapter 4 – Post-acquisition benefits from shares
Overview
1889. This Chapter is concerned with the income tax charges which may arise in respect of shares (or an interest in shares) which have been awarded by reason of an individual's office or employment.

1890. The initial award of the shares may have given rise to a Schedule E charge as an emolument or benefit or taxed as general earnings under this Act. This Chapter is not concerned with that initial charge. Instead it provides for a charge to tax in certain circumstances on the increase in value of those shares and in respect of any special benefits which are received by virtue of ownership of those shares. The increase in value charges do not apply where the shares have been issued under one of the share schemes approved by the Inland Revenue, but the special benefits charge may still apply.

1891. The provisions in this Chapter derive from sections 77 to 88 of FA 1988. They apply to shares acquired on or after 26 October 1987 and replace legislation in sections 138 and 139 of ICTA which had a similar, though rather more wide-ranging, effect. Sections 138 and 139 of ICTA, together with the interpretation provisions in section 140 of ICTA still apply to shares acquired before 26 October 1987 and that

legislation remains on the statute book although it has not been rewritten. Paragraphs 55 to 57 in Part 7 of Schedule 7 to this Act contain the appropriate savings and also rewrite the transitional provisions in section 88 of FA 1988 that are still relevant.

1892. Section 84 of FA 1988 is a capital gains tax provision and is duplicated in section 120(1) of TCGA 1992. As it is not intended to include the provision in this Act, the section has not been rewritten. Amendments to section 120 of TCGA 1992 are made by paragraph 210 of Schedule 6 to this Act.

1893. The 1988 anti-avoidance legislation contains three distinct charges in sections 78, 79 and 80 of FA 1988. That ordering of the charges has been followed in this Act with the corresponding charges now in sections 449, 453 and 457. Other than that, however, much of the material has been moved to present it in a logical and more helpful order. One broad intention is that in respect of each charge the legislation sets out in the following order

- The scope of the charge
- The calculation of the charge
- The exceptions from the charge

Section 447: Application of this Chapter

1894. This section sets out the scope of the Chapter. *Subsection (1)* derives from the rule at the end of section 77 of FA 1988 that the provisions are concerned with acquisitions of shares in a company by a director or employee of that or any other company. The fact that these provisions only apply to shares issued on or after 26 October 1987 is made clear in Part 7 of Schedule 7 to which there is also a signpost in section 418(1).

1895. *Subsections (2)* and *(3)* are new. They spell out what subsequent references to "the acquisition" and "the shares" are references to. The fact that this Chapter applies to prospective and former employees is made clear by the reference to the extended definition in section 470. The definition of "the employer company" is designed to avoid some rather tortuous references to it elsewhere in this Chapter.

1896. *Subsection (4)* derives from the rules in section 77(1) and in section 87(4) of FA 1988 which explain that the Chapter is concerned both with shares acquired by the employee directly and with shares first issued to another person and then assigned to the employee.

1897. *Subsection (5)* derives from section 83(1) of FA 1988. That provision ensures that where the shares are issued to a connected person because the opportunity was offered to that person rather than the employee himself, the acquisition is treated as having been made by the employee. The charges in the Chapter generally operate by

reference to beneficial interests and it is not expressly provided in section 83(1) of FA 1988 that the deeming provision applies to beneficial ownership although that is the way the subsection has always been interpreted. This section clarifies the general understanding that the opening words "For the purposes of this Chapter" imply that the shares are deemed to have been acquired by the employee as a director or employee. This clarification is explained in detail in *Note 46* in Annex 2.

Section 448: Cases where this Chapter does not apply

1898. *Subsection (1)* derives from section 77(2) of FA 1988. It limits the scope of the Chapter to cases where the earnings from the employment are within section 15 or 21 reproducing the restriction in the source legislation to Case I employments. See *Note 47* in Annex 2.

1899. *Subsection (2)* derives from section 77(3) of FA 1988 and is an exemption for public offers.

1900. *Subsections (3) and (4)* derive from section 77(4) of FA 1988 and extend the public offer exemption to certain other offers which are made to employees separate from a public offer.

Section 449: Charge on occurrence of chargeable event

1901. This is the first of the charging provisions and derives from parts of section 78(1) and (3) of FA 1988. The meaning of chargeable event, the calculation of the charge and the exceptions appear in separate sections. *Subsection (5)* acts as a signpost to the provisions which remove the charge under various approved schemes.

Section 450: Chargeable events

1902. This section defines what is and is not a chargeable event and derives from section 78(2), (5), (6) and (7) of FA 1988. It will be noted that a new label "outside shareholders" is used as shorthand for the persons within section 78(6)(a) of FA 1988 and the term is defined in section 469.

1903. The words in section 78(6)(c) of FA 1988 "which is not a dependent subsidiary" have been omitted in new subsection (4)(c) on the grounds that they are unnecessary. It is already clear from section 78(1)(b) of FA 1988 that no charge arises if the company is a dependent subsidiary.

1904. *Subsection (6)* derives from section 78(7) of FA 1988. The term "are references to such" has been used instead of "include" to make better sense of the additional words "or in any other way".

Section 451: Amount of charge

1905. This section, which derives from section 78(3) of FA 1988, specifies the amount of the charge under section 449. The FA 1988 subsection is rather complex and so this section separates out the various ideas to make the provision easier to grasp.

Section 452: Cases outside charge under section 449
1906. This section brings together the various exceptions in sections 77 and 78 of FA 1988.

1907. *Subsection (2)* ensures that if a charge is taken under section 427 in respect of an event then no charge is taken under this section. It derives from the opening words of section 77(1) of FA 1988 which give priority to the charge on conditional shares in section 140A of ICTA (rewritten in Chapter 2 of this Part).

1908. *Subsection (3)* derives from section 78(4) of FA 1988 which contains the let-out if the employee has not been a director or employee of the company or an associated company within the seven years ending with the chargeable event. The source legislation uses the term "the person who acquired the shares" rather than the "employee". However, since shares acquired by connected persons are treated as acquired by the employee, the effect is the same.

1909. *Subsection (4)* derives from section 78(1)(b) of FA 1988. Shares in dependent subsidiaries are excluded from the charge under section 449 because they are instead subject to a charge under section 453. For the sake of clarity this section replaces the word "at" in the phrase "at the time of the chargeable event" with "immediately before". See *Note 48* in Annex 2.

Section 453: Charge on increase in value of shares of dependent subsidiary
1910. This is the second of the charging provisions and derives from section 79(1) and (4) of FA 1988. Again, matters concerning what is chargeable, the calculation of the amount and the exceptions have been taken to separate sections.

1911. Subsection (3) derives from section 79(4) of FA 1988 and specifies the year of charge.

1912. *Subsections (4)* and *(5)* are new. Subsection (5) acts as a signpost to the provisions which remove the charge under various approved schemes.

Section 454: Chargeable increases
1913. This section derives from section 79(2) and (3) of FA 1988 and determines the period over which any rise in the value of the shares is measured in order to be an increase subject to charge.

Section 455: Amount of charge
1914. This section brings together all those parts of section 79 of FA 1988 which concern the calculation of the charge and in particular it makes clear what deductions should be made from the rise in value of the shareholding.

1915. *Subsection (1)* introduces a formula and *subsection (2)* specifies the items that are allowable deductions. *Subsection (3)* derives from section 79(6) of FA 1988 and is concerned with certain cases where the employee receives less than market value for

the shares. The aim is to ensure that the employee is only charged on the difference between base value and the actual proceeds. That provision produces the right result where the chargeable increase is calculated by reference to the value of the shares at acquisition, but not where it is calculated by reference to the value of the shares at the later time that the company becomes a dependent subsidiary. The section produces the right result in both situations. It is a minor change to the law. See *Change 113* in Annex 1.

1916. *Subsection (4)* derives from the final two lines in section 79(4) of FA 1988.

Section 456: Cases outside charge under section 453

1917. *Subsection (2)* reflects the opening words of section 77(1) of FA 1988 "subject to section 140A of the Taxes Act 1988". It ensures that if a charge is taken under section 427 (conditional interests in shares) then no charge is taken under section 453. This is because if a disposal potentially gives rise to a charge under section 453 (which is more general in its application) and under section 427 then the latter charge has priority.

1918. *Subsection (3)* derives from section 79(7) of FA 1988 and provides a let-out if the employee has not been a director or employee of the company or an associated company in the seven years before the time that the company becomes a dependent subsidiary. As with section 452, the phrasing has been changed to produce a true exception and the reference is to "the employee" rather than "the person who acquired the shares".

Section 457: Charge on other chargeable benefits from shares

1919. This is the third of the charging provisions and derives from section 80 of FA 1988. The term "chargeable benefit" in *subsection (1)* has replaced "special benefit" in order to be consistent with "chargeable event" and "chargeable increase" in the other charging provisions in this Chapter.

1920. An amount in respect of benefits attaching to shares may be charged on the employee, not only when the shares are owned by the employee (section 80(1) of FA 1988), but also when owned by other persons (section 83(1) and (4) of FA 1988). *Subsection (2)* brings together and clarifies how these rules are considered to operate and remedies the deficiencies in the wording of the source legislation. See *Change 114* in Annex 1.

Section 458: Chargeable benefits

1921. This section derives from the rather complex rules in section 80 of FA 1988 giving further conditions as to when a benefit is a chargeable benefit.

1922. *Subsection (2)* introduces the following three subsections. The approach adopted is to define what are chargeable benefits, replacing the approach in FA 1988 of saying that all benefits are chargeable benefits unless paragraphs (a) and (b) of section 80 apply. This makes the rules easier to understand.

1923. *Subsection (3)* derives from section 80(2)(a) of FA 1988.

1924. *Subsection (4)* derives from section 80(1A) of FA 1988.

1925. *Subsection (5)* introduces the conditions in *subsection (6)* which derive from section 80(3) of FA 1988. Subsection (6)(a) uses the new term "outside shareholders" which was first introduced in section 450.

1926. *Subsection (7)* contains two definitions which apply solely for the purposes of this section. The definition of "the company" is new and clarifies which company is being referred to in subsections (4) and (6). The other definition derives from section 87(1) of FA 1988.

Section 459: Amount of charge
1927. This section specifies the amount of the chargeable benefit. It derives from section 80(4) of FA 1988 and the definition of "value" in section 87(1) of FA 1988.

Section 460: Cases outside charge under section 457
1928. This section derives from section 80(5) of FA 1988 which contains the let-out where the employee has not been a director or employee of the company or an associated company in the seven years before the benefit is received. There are two points to note. Section 80(5)(a) of FA 1988 refers to the company in subsection (1) when that subsection contains no reference to a company. It clearly means the company whose shares are mentioned in subsection (1). See *Change 115* in Annex 1. Also, in section 80(5) of FA 1988 the test is expressed to apply to the person receiving the benefit. But by virtue of the connected persons rules in section 83(4) of FA 1988 the test effectively applies to the employee himself. Accordingly, the test is applied directly to the employee in this section.

Section 461: Related acquisitions of additional shares
1929. This section derives from section 82 (1) and (2) of FA 1988 and concerns the treatment of additional shares received by the employee in respect of an original holding which had been acquired by virtue of the employment. The effect is to treat the new shares as within the Chapter and as having been acquired at the same time as the original shares.

1930. An award of additional shares may give rise to a chargeable benefit within section 457. This section makes it clear that the timing rule in section 82(2)(b) of FA 1988 does not affect the date on which the charge under section 457 is taken. See *Change 116* in Annex 1.

Section 462: Company reorganisations etc.
1931. This section derives from section 82(3) of FA 1988 and concerns exchanges of shares under company reorganisations. The main effect is to adopt the capital gains tax rule under which new holdings are treated as acquired as the original shares were.

1932. *Subsections (3) and (4)* derive from section 82(3)(b) and (c) of FA 1988. Subsection (3)(b) reflects what is meant by the rather obscure phrase "as is mentioned in section 128(1) and (2)" in section 82(3)(b).

Section 463: Disposals of shares to connected persons etc. ignored

1933. This section derives from section 83(2) and (3) of FA 1988. It is reasonably plain what section 83(2) of FA 1988 is trying to do, namely to ignore disposals which are not at arm's length or are to a connected party so that the employee is deemed to retain the beneficial interest. However it is not clear whether the wording of that subsection achieves that result where the shares were originally issued to a connected party and so have already been subject to the deeming provision in section 83(1) of FA 1988. This has been made clear in this section by specifying that the employee retains the interest. It is a minor change to the law. See *Change 114* in Annex 1.

Section 464: Application to interests in shares

1934. This section derives from section 81 of FA 1988 (which applies for the purposes of charges under sections 79 and 80 of FA 1988). It sets out the supplementary rule that where a person's interest in shares is increased or reduced it is treated as the acquisition or disposal of a separate interest proportionate to the increase or reduction.

Section 465: Duty to notify acquisitions of shares or interests in shares

1935. This section derives from section 85 of FA 1988 which is the information requirements provision.

1936. The section makes explicit what is implicit in section 85 that the time limit runs by reference to the year in which the additional shares are acquired. This is a minor change to the law. See *Change 116* in Annex 1.

1937. *Subsection (3)* provides that the particulars must be given to the Inland Revenue instead of to the inspector. See *Change 158* in Annex 1.

1938. *Subsection (4)* rewrites the 92-day time limit by requiring the information to be provided before 7 July. This is in line with the new practice in Chapters 2 to 5 of this Part.

1939. *Subsection (5)* is new and ensures that notification of an acquisition need be made only once. This is a minor change to the law. See *Change 116* in Annex 1.

Section 466: Duty to notify chargeable events and chargeable benefits

1940. This section also derives from section 85 of FA 1988 and contains the information requirements where certain charges arise.

1941. *Subsection (2)* provides that the particulars must be given to the Inland Revenue instead of to the inspector. See *Change 158* in Annex 1.

1942. The time limit of 60 days has been extended to 92 days. See *Change 111* in Annex 1.

Section 467: Meaning of "dependent subsidiary"
1943. This section derives mainly from section 86 of FA 1988. For ease of use *subsection (1)* is now introductory and the various conditions have been placed into four separate subsections. In *subsection (4)* the directors' certificate is now to be given to the Inland Revenue rather than the inspector. See *Change 158* in Annex 1.

1944. The definition of "period of account" in *subsection (8)* derives from section 86(3) of FA 1988. That definition was repealed by FA 2002 and a new definition was inserted into section 832(1) of ICTA. In relation to a company the definitions are effectively the same.

Section 468: Meaning of "employee-controlled"
1945. This section derives from section 87(2) of FA 1988. The definitions of "connected persons" and "control" in ICTA are applied by sections 718 and 719 respectively.

Section 469: Shares "held by outside shareholders"
1946. This section explains the new shorthand term which is used in sections 450 and 458. The definition derives from sections 78(6)(a) and 80(3)(a) of FA 1988.

Section 470: Minor definitions
1947. This section picks up the remainder of the definitions in section 87(1) of FA 1988 which are not included elsewhere. The meaning of "interest in shares" has been expanded to make it clear that it excludes a right to acquire shares eg options. See *Change 117* in Annex 1.

Chapter 5: Share options
Overview
1948. This Chapter is concerned with the income tax charges which may arise in respect of a share option granted to any person by reason of an individual's office or employment.

1949. The case of Abbott v Philbin (1960) 39 TC 82 (HL), [1960] 2 All ER 763, established that under general Schedule E rules, the only occasion of charge is on the grant (or assignment) of the option. The source of any gain arising on the later exercise of the option is the option itself, not the employment.

1950. The effect of this decision was largely reversed by legislation introduced in 1966 and now in sections 135 to 140 of ICTA. The underlying purpose of that legislation is to replace the charge on grant with one on exercise. Indeed that was what the original legislation achieved. However in 1972 the charge on grant was reintroduced for longer-term options to prevent liabilities being pushed too far into the

future. At the same time the value of the grant was defined and provision made for any tax paid on grant to be deducted from the tax payable on exercise.

1951. The charging provision, section 135 of ICTA, does three main things.

- It provides that the gain on exercise (or on assignment, release or otherwise turning to account) is chargeable to tax under Schedule E provided the employee is in an employment within Case I of Schedule E.

- If any gain on exercise would be chargeable then it removes the charge on grant, except where the option can be exercised more than ten years after grant.

- It provides rules regarding the computation of charges that arise on grant and on exercise.

1952. The charges on grant and on exercise are removed where the options are issued under one of the schemes approved by the Inland Revenue. The legislation regarding these schemes has been rewritten in Chapters 7, 8 and 9 of this Part. Those provisions do impose charges to tax in certain circumstances.

1953. The rewritten legislation sets out the scope of the Chapter in the opening sections. It then adopts a logical order by first considering the taxation issues that arise in respect of the receipt and then the issues that arise on exercise, assignment or release. The rules in section 187A of ICTA and in section 4 of the Social Security Contributions (Share Options) Act 2001 which give a deduction to the employee when under an agreement or election he meets some or all of the employer's secondary or special national insurance contribution have been incorporated.

1954. Two provisions in the source legislation have not been rewritten.

- Section 136(4) of ICTA excludes from the charge that part of any gain that arises before 3 May 1966. It only applies to options granted before that date. The provision is regarded as spent and it is not being preserved.

- Section 137 of ICTA allows for payment of tax under section 135 by instalments. It only applies to options granted before 6 April 1984. The provision is regarded as spent and it is not being preserved.

Section 471: Share options to which this Chapter applies

1955. This section sets out which share options come within the scope of the Chapter. It introduces the term "share option" in place of the cumbersome "right to acquire shares". In fact, although the title of section 135 of ICTA includes the words "share options", that term is not used at all in the source legislation.

1956. *Subsection (1)* makes it clear at the outset that the options concerned are those granted by reason of a person's office or employment. It derives from parts of section 135(1) and (6) and section 140(1) of ICTA.

1957. *Subsection (2)* makes it clear that the shares over which the option is granted can be shares in any body corporate. The normal case, of course, will be the grant of options over shares in the employing company, but the legislation can apply even if the body corporate is totally unconnected with the employment.

1958. *Subsection (3)* makes it clear that the option may be granted to someone other than the director or employee. It derives from section 140(1) of ICTA.

1959. *Subsection (4)* sets out two definitions which help to make the legislation easier to read. For example, the term "the employee" is used instead of "the director or employee of the company". Also, the fact that this Chapter applies to prospective and former employees is made clear by the reference to the extended definition in section 487(1).

Section 472: Introduction to taxation of share options

1960. This is a new introductory section. *Subsection (1)* derives from the Abbott v Philbin decision. It makes clear that unless a charge is imposed by this Chapter on exercise, then the only possible charge is when the option is received. If there is a charge on grant or assignment then it arises by virtue of Chapter 1 of Part 3 as earnings or under Chapter 10 of Part 3 as a taxable benefit.

1961. *Subsection (2)* acts as a signpost to the major exemption from the charge in respect of receipt, ie where the options expire within ten years of being obtained.

1962. *Subsections (3*) and *(4)* draw attention to charges that may arise when the option is exercised, assigned or released and *subsection (5*) to the different rules that apply for options received under an approved scheme or under the EMI code.

Section 473: Share options to which this Chapter does not apply

1963. This section explains which offices and employments come within the scope of these provisions. *Subsection (1)* brings to the fore the idea that the Chapter is only concerned with options granted in respect of an office or employment the earnings from which fall within sections 15 or 21. This is derived from the restriction in section 140(1) of ICTA, that the legislation only applies to Case I offices and employments, although the exact scope of that restriction was not clear. Clarifying the scope of the restriction is a minor change to the law. See *Change 118* in Annex 1.

1964. *Subsection (2)* derives from section 140(1) of ICTA and makes it clear that the legislation applies to options granted after the employment has ceased if the employment is within sections 15 or 21 in the last tax year in which the employment was held. This section makes it clear that a charge can arise where an option is granted to another person after the employment has ceased. See *Note 49* in Annex 2.

Section 474: No charge in respect of receipt of shorter-term option

1965. This section derives from section 135(2) of ICTA which gives an exemption in respect of receipt of options which expire within ten years provided that any gain on exercise of the option would be chargeable. The proviso is not expressly stated in this section. It follows from the fact the reference to "share option" imports the conditions in sections 471 and 473 and therefore limits the scope of the exemption to options within the Chapter and potentially chargeable on exercise.

1966. *Subsection (2)* also highlights the point, referred to rather obliquely by the opening words of section 135(2) of ICTA, that charges can arise on grant under an approved CSOP scheme in certain circumstances. Other than this instance, it follows that a charge in respect of the receipt can only arise where:

- the award is of a longer-term option; or
- the circumstances are such that a charge could not arise on exercise. Examples of this would be that the employment (considered at the time of grant) is not within sections 15 or 21, or the holder of the option is an office-holder who is not a director or employee.

Section 475: Value of longer-term option for purposes of liability to tax in respect of receipt

1967. This section derives from the rule in section 135(5)(b) of ICTA regarding the valuation of a longer-term option for the purposes of a charge to tax in respect of the receipt of the option. Section 135(5)(b) says that the value of the option is not less than the current market value of the option shares reduced by whatever the employee has to pay for the shares. In practice, a higher value is never used. Accordingly, the "not less than" part of the rule has been left out. This is a minor change to the law. See *Change 119* in Annex 1.

1968. *Subsection (2)* derives from section 135(5)(b) of ICTA and resolves an ambiguity if the option shares carry conversion rights. It is not clear in the source legislation in such a case whether the value of the option shares or the value of the shares obtained on their conversion should be the basis of the charge. This section resolves the ambiguity by taking the higher value. This is a minor change in the law. See *Change 120* in Annex 1.

1969. The definition of "market value" in *subsection (3)* derives from section 140(3) of ICTA. It is reasonably plain from the wording of section 140(3) that the intention is to have the same rules about market values as apply in TCGA 1992 although only section 272 is mentioned. The new definition refers to Part 8 of TCGA 1992 rather than just section 272 and is now the same as in Schedules 2, 3, 4 and 5 to this Act. This change in approach is explained in more detail in *Note 23* in Annex 2.

Section 476: Charge on exercise, assignment or release of option by employee

1970. In ICTA, the rules that apply in situations where another person (rather than the employee) realises the gain are in the middle of section 135 surrounded by other material dealing with the more common case in which the gain is realised by the employee personally. In this Act the rules have been separated, this section being concerned with gains realised by the employee and section 477 with gains realised by other persons.

1971. *Subsection (2)* provides that an amount is to count as employment income of the employee. It derives from section 135(1) of ICTA. Such an amount is specific employment income (see section 7(4) of this Act) which replaces the free-standing Schedule E charge. It does not depend on the residence status of the employee at the time of exercise. The charge applies whether the option was originally granted to the employee or to another person and then assigned to the employee; see section 471(3) of this Act. The amount that is to count as employment income (the taxable amount) is determined under section 478.

1972. *Subsection (3)* is new and simply specifies the year for which the taxable amount counts as employment income. It is Inland Revenue practice to apply section 135 of ICTA to charge the gain in the year of exercise etc. See *Note 3* in Annex 2.

1973. *Subsection (4)* refers to the exceptions that apply if the options were granted under an approved scheme or under the EMI code.

Section 477: Charge on employee where option exercised, assigned or released by another person

1974. This section derives from section 135(6) and (7) of ICTA which imposes a charge on the employee where the gain is realised by another person. *Subsection (1)* sets out clearly the three circumstances where an amount is to count as employment income of the employee. The amount that is to count as employment income (the taxable amount) is calculated under section 478.

1975. *Subsection (3)* is new and specifies the year for which the taxable amount counts as employment income. See *Note 3* in Annex 2.

1976. *Subsection (4)* is new. It legislates the present practice of not charging the personal representatives or beneficiaries when the option is exercised following the death of the person to whom the option was granted. See *Change 121* in Annex 1.

1977. *Subsection (5)* derives from section 135(7) of ICTA and contains an exemption where the employee was divested of the share option by operation of law. The reference in section 135(7) of ICTA to "on his bankruptcy or otherwise" has been left out as it adds nothing.

1978. *Subsection (6)* provides that where subsection (5) applies, the gain is chargeable under Schedule D, Case VI. The subsection also removes ambiguity by making it clear that any person charged under Case VI is entitled to the reduction derived from the closing words of section 135(6) of ICTA. This is a minor change to the law. See *Change 122* in Annex 1.

Section 478: Amount of charges

1979. This section identifies those deductions which are made from the amount of the gain (calculated under section 479 or 480) in arriving at the taxable amount.

1980. *Subsection (2)(a)* and *(b)* reflects the amendments made to section 135 of ICTA by paragraph 1 of Schedule 6 to FA 2002. That changed the rule about giving relief where there had been an earlier charge in respect of the receipt of the option. The amount that is charged to tax in respect of the receipt is now deducted in calculating the taxable amount instead of giving relief in terms of tax. In strictness, a deduction is only due where the option is exercised, assigned or released by the employee. However, in practice it is appropriate to give the deduction where the option is exercised by another person, so long as the same amount is not deducted twice. The section makes any amount charged to tax in respect of the receipt of an option a deductible amount in calculating the taxable amount for the purposes of section 477 (charge where option exercised by another person), but *subsection (3)* prevents double deductions. This is a minor change to the law. See *Change 123* in Annex 1.

1981. *Subsection (2)(c)* allows a deduction in calculating the taxable amount for the amount of any allowable national insurance contributions met by the employee. It derives from section 187A(4) of ICTA.

Section 479: Amount of gain realised by exercising option

1982. This section brings together the parts of section 135(3) and (6) of ICTA which provide the rules regarding the computation of the gain on exercise and a further rule in section 185(8) of ICTA. That rule allows a deduction in calculating the amount of the gain for any charge to tax under section 185(6) of ICTA in respect of the grant at a discount of a share option under an approved CSOP scheme. Those parts of section 135(3) of ICTA which relate solely to the gain on an assignment or release appear in a separate section. The method adopted leads to some repetition between this section and section 480, in order to assist the reader.

1983. *Subsection (1)* introduces a formula for calculating the gain.

1984. *Subsection (2)* specifies the items which are deductible costs in calculating the gain.

1985. *Subsection (3)* derives from the closing words of section 135(4) of ICTA and ensures that the amount paid for the option is deducted only once. It should be noted

that section 135(9) of ICTA replicates the effect of section 135(4) of ICTA and has not been separately rewritten. This removes unnecessary material.

1986. *Subsection (4)* provides a signpost to the EMI provisions which modify the calculation of the amount of the gain.

Section 480: Amount of gain realised by assigning or releasing option

1987. This section mirrors section 479 and sets out the rules which apply to the computation of the gain when the option is assigned or released. As the EMI provisions do not apply when an option is assigned or released no signpost is required here.

Section 481: Deductible amount in respect of secondary Class 1 contributions met by employee

1988. Section 187A of ICTA, introduced by section 56(1) of FA 2000, provides relief against a gain chargeable under section 135 of ICTA for amounts of employer's Class 1 National Insurance contributions payable in respect of the gain and met by the employee under arrangements set out in social security legislation. The relief has now been written as a deduction in calculating the taxable amount and does not affect the amount of the gain. It is the amount of the gain (rather than the taxable amount) that is relevant for the purposes of section 120(4) of TCGA 1992 and national insurance provisions. It is therefore not necessary to reproduce the rule in section 187A(5) of ICTA which prevented relief under section 187A from being taken into account for those purposes.

1989. *Subsection (4)* derives from section 4(3) of the Social Security Contributions (Share Options) Act 2001. Its effect is that one cannot get a deduction under both this section and under section 482 (special contributions).

Section 482: Deductible amount in respect of special contribution met by employee

1990. This section derives from section 4 of the Social Security Contributions (Share Options) Act 2001. That Act enabled the employer or employee as appropriate to cap exposure to employer's Class 1 National Insurance contributions by instead paying a special contribution calculated by reference to any increase in value of the shares subject to the option on 7 November 2000. Although any special contributions had to be paid by 11 August 2001 the relief is due when the gain is realised which may not be for several years.

1991. For the same reasons as explained above in the notes on section 481, the provisions of section 187A(5) of ICTA have not been reproduced in this section. It is not necessary to prohibit a deduction made in calculating the taxable amount and not in calculating the amount of the gain.

Section 483: Extended meaning of "assign" and "release"
1992. This section brings together the two rules regarding the extended meaning of "assign" and "release" to include other situations where options are turned to account. It derives from section 135(8) and section 136(5)(a) of ICTA.

Section 484: Amount or value of consideration given for grant of share option
1993. This section contains supplementary rules for determining the amount allowable as a deduction in respect of the cost of the option in calculating the amount of the gain.

1994. *Subsection (2)* derives from the rule at the end of section 135(3) of ICTA regarding the apportionment of a single sum paid for both the share option and something else. The wording in that subsection is a "just" apportionment. This has been amended to "just and reasonable" to align the wording with that used in sections 429 and 442. This is a minor change to the law. See *Change 124* in Annex 1.

1995. *Subsection (3)* derives from section 135(4) and provides that no account is taken of the value of the duties of the employment performed by the employee. As mentioned in the explanatory note to section 479, section 135(9) of ICTA has not been rewritten as it replicates the effect of the rule in the final part of section 135(4), that the cost of the option can only be deducted once. That rule is rewritten in sections 479(3) and 480(3).

Section 485: Application of this Chapter where share option exchanged for another
1996. This section derives from what is probably the most complex part of the source legislation. Section 136(1) to (3) of ICTA are concerned with creating a form of rollover treatment which applies when a right to acquire shares is effectively swapped for another such right. The effect is to ignore the swap for section 135 purposes and apply the Chapter to the replacement option. Any consideration received which is not represented by the new option is taken into account in calculating the gain in the normal way.

1997. The prevention of the early crystallisation of the charge in the case of a straightforward exchange also has an anti-avoidance effect. In the absence of the provision it could be arranged that a valuable option is exchanged for an option with an apparently lower value (thus generating an immediate, but low tax charge), and there would be no charge on exercise because the new option would not have been issued by reason of employment, but to the employee as option-holder.

1998. Section 136(1) of ICTA is not easy to follow partly because it says that the cost of the new option excludes some things, but includes others; and partly because those rules are in the same long sentence detailing other rules not concerned with working out the allowable cost of the new option. These ideas have been separated and in order to make the provision easier to use *subsection (4)* specifies what is in fact the consideration for the grant of the new option. *Subsections (5)* and *(6)* extend the

rollover treatment to cases where the swap is achieved indirectly under arrangements described in section 136(2) and (3) of ICTA.

1999. It may be noted that section 136(2)(b) of ICTA refers to tax "chargeable under this section". This makes no sense because tax is not chargeable under section 136, but under section 135 of ICTA. The problem stems from consolidation. Previously section 136(2) was part of the same section as section 135. When that section (section 186 of ICTA 1970) was split in two on consolidation the relevant amendment to section 136(2)(b) was missed. This error has been corrected in section 485(5)(b). See *Change 125* in Annex 1.

Section 486: Duty to notify matters relating to share options
2000. This section derives from section 136(6) to (8) of ICTA. The time limit of 92 days after the end of the year of assessment has been rewritten as "before 7th July" in line with the new practice in Chapters 2 to 5 of this Part. The particulars are now to be given to the Inland Revenue rather than to the inspector. See *Change 158* in Annex 1.

Section 487: Minor definitions
2001. This section brings together minor definitions from section 136(5) of ICTA and others from section 187A of ICTA in connection with the deductions for National Insurance contributions.

2002. The definition of shares in section 136(5)(d) of ICTA includes stock "in so far as the context permits". This rider has been omitted as unnecessary since there does not appear to be anywhere in this Chapter where the context would not so permit.

Chapter 6: Approved share incentive plans
Background
2003. This Chapter, together with Schedule 2, derives from the legislation relating to share incentive plans (or "SIPs" for short). SIPs were previously known as employee share ownership plans (or "ESOPs" for short). The SIPs legislation is the result of a policy designed to bring share ownership in a company to the whole of that company's workforce.

2004. Nearly all the SIPs legislation is contained in Schedule 8 to FA 2000 (introduced by section 47 of that Act). Schedule 8 to FA 2000 was amended, to a certain extent, by Schedule 13 to FA 2001 (introduced by section 61 of that Act), and also by section 95 of that Act. Further amendments to Schedule 8 of FA 2000 were made by section 39 of FA 2002 and also by the Employee Share Schemes Act 2002.

2005. The new legislation relating to SIPs, the majority of which is contained in this Chapter and Schedule 2, is called "the SIP code": a term introduced in section 488.

2006. The core of the SIP code is that a company establishing a share incentive plan must offer either "free shares" or "partnership shares" (or both) to its employees. Two other types of shares - "matching shares" and "dividend shares" - are dealt with in the

SIP code; and either or both of these may also be offered to employees - although this is not essential. And if a SIP is to be "approved" for the purposes of the legislation (and thus obtain the tax advantages available to an approved SIP), there are general requirements to be met, and also further requirements relating to the eligibility of individuals, to the types of shares that may be awarded, and to the trustees.

2007. The SIP code, accordingly, has a number of distinguishable components:

- it specifies requirements that a SIP must meet before it may be "approved" for the purposes of the SIP code;
- it deals with the procedural aspects relating to the approval of plans and the withdrawal of approval;
- it specifies the tax advantages that an approved SIP possesses;
- it specifies the tax charges that may arise in certain circumstances (for example, when shares cease to be subject to the plan); and
- it deals with supplementary matters (including interpretation).

2008. Of the components listed in the last paragraph, this Chapter deals with the tax advantages that an approved SIP possesses, and with the tax charges that may arise.

2009. Schedule 2 deals with the other components listed in that paragraph. After the introduction (in Part 1), that Schedule deals with the requirements that a SIP must meet before it may be "approved" for the purposes of the SIP code (in Parts 2 to 9); with the approval of plans and the withdrawal of approval (in Part 10); and with supplementary matters (in Part 11).

2010. Schedule 8 to FA 2000 also contained other provisions relating to corporation tax, capital gains tax and stamp duty. These other provisions are dealt with in Schedule 6 to this Act (consequential amendments). Schedule 7 to this Act includes provisions designed to avoid any transitional problems arising from the replacement of Schedule 8 by the provisions contained in this Act.

Overview

2011. In this Chapter, after an introductory section (section 488), the first major topic dealt with is the tax advantages that an approved SIP possesses (in sections 489 to 499). The second major topic dealt with is the tax charges that may arise (in sections 500 to 508). The provisions relating to each major topic have been arranged to deal with the award of shares, then with the holding of shares, and then, finally, with shares ceasing to be subject to the plan. This Chapter concludes with provisions dealing with the making of PAYE deductions in connection with the tax charges that may arise (in sections 509 to 514), and with a section referring to the other provisions in the Tax Acts that deal with SIPs (in section 515).

Section 488: Approved share incentive plans (SIPs)
2012. This section is introductory. It indicates the main components of the SIP code, and defines some terms of general application.

2013. *Subsection (1)* is new, and indicates the main topics dealt with in the SIP code. *Subsection (2)*, which is also new, then indicates which of those topics are dealt with in Schedule 2.

2014. *Subsection (3)* contains the definition of "the SIP code". This definition is also new.

2015. *Subsection (4)* defines terms used generally in the SIP code. Of these terms:

- the definition of an "approved" plan may be deduced from the definition of "approved employee share ownership plan" in paragraph 129(1) of Schedule 8 to FA 2000; but, in this Act, the definition is now followed by a new provision, stating that the word "approval" has a corresponding meaning;

- the definition of a "PAYE deduction" generalises the partial definitions in paragraphs 95(10) and 96(5) of Schedule 8 to FA 2000; and

- the definition of a "share incentive plan" derives from the definition of an "employee share ownership plan" in paragraph 1(1) of Schedule 8 to FA 2000.

2016. *Subsection (5)* draws attention to the fact that there is an index relating to the SIP code at the end of Schedule 2. Expressions contained in that index have the meanings that are indicated there.

The tax advantages
2017. Sections 489 to 499 relate to the first major topic dealt with in this Chapter: the tax advantages possessed by an approved SIP.

Section 489: Operation of tax advantages in connection with approved SIP
2018. This section is introductory, being concerned with the general scope of the tax advantages applying to an approved SIP. Those advantages do not apply to an individual who is not chargeable to tax under Part 2 in respect of the eligible employment (as defined) (see *subsection (2)*).

2019. This section is the first of two that derive from paragraph 77 of Schedule 8 to FA 2000 (the other being section 500).

2020. *Subsections (2)* and *(3)* are derived from paragraph 77(2) of Schedule 8 to FA 2000. The material in that sub-paragraph has been divided to make it easier to understand; and the definition of "the eligible employment" is new.

Section 490: No charge on award or acquisition of shares: general
2021. This section is the first of four that deal with the tax advantages connected with the award of shares. It contains the basic proposition that the employee is not liable to income tax on the value of the beneficial interest in the plan shares that passes to the employee at the time those shares are acquired.

2022. This section derives from paragraph 78(1) of Schedule 8 to FA 2000, a sub-paragraph that has now been divided into two subsections.

Section 491: No charge on award of shares as taxable benefit
2023. This section is the second of four that deal with the tax advantages connected with the award of shares. It provides that an employee is not liable to income tax under Chapter 8 of Part 3. That Chapter forms part of the benefits code, and provides for income tax liabilities to arise on acquisitions of shares.

2024. This section derives from paragraph 78(2) of Schedule 8 to FA 2000. That sub-paragraph contains a second sentence stating that any charge to tax under section 162(6) of ICTA remained unaffected. As the provision is expressed in this section in a form that does not impinge in any way on the provisions rewriting section 162(6) of ICTA (in Chapter 9 of Part 3), this second sentence has been omitted on the basis that it is unnecessary.

Section 492: No charge on partnership share money deducted from salary
2025. This section is the third of four that deal with the tax advantages connected with the award of shares. It provides that an employee is not liable to income tax under Part 2 where partnership share money is deducted from the employee's salary under a partnership share agreement. The expressions "partnership share agreement" and "partnership share money" are defined in Schedule 2 (in paragraphs 44 and 45 respectively); and these expressions may also be found in the index of defined expressions in paragraph 100 at the end of that Schedule.

2026. This section derives from paragraph 83 of Schedule 8 to FA 2000.

Section 493: No charge on acquisition of dividend shares
2027. This section is the last of four that deal with the tax advantages connected with the award of shares. It provides that a scheme participant is not liable to income tax on the amount applied by the trustees in acquiring dividend shares on the participant's behalf.

2028. This section derives from paragraph 89 of Schedule 8 to FA 2000. *Subsection (1)* reorganises the material in paragraph 89(1); in *subsection (2)* the word "amount" replaces the words "amounts of dividends"; and *subsections (3)* to *(5)* vary the order of material drawn from paragraph 89(3) and (4) of Schedule 8 to FA 2000.

Section 494: No charge on removal of restrictions applying to shares
2029. This section is the first of three that deal with the tax advantages connected with the holding of shares. *Subsections (1)* and *(2)* apply where a participant's plan shares are subject to provision for forfeiture, and that provision is varied or removed. In these circumstances a participant is not liable to income tax by virtue of sections 427 or 449. Those sections may be found, respectively, in Chapters 2 and 4 of this Part. *Subsection (3)* provides that a participant is not liable to income tax by virtue of section 449 when the holding period comes to an end. The expressions "provision for forfeiture" and "holding period" are defined in Schedule 2, in paragraphs 99(1) and 36 respectively.

2030. This section derives from paragraph 80(1) and (2) of Schedule 8 to FA 2000. There is a new subsection (1), setting out the circumstances in which subsection (2) applies.

Section 495: No charge on increase in value of shares of dependent subsidiary
2031. This section is the second of three that deal with tax advantages connected with the holding of shares. It provides that a participant is not liable to income tax by virtue of section 453 (charge on increase in value of shares of dependent subsidiary) in respect of any of the participant's shares that are subject to the plan when the chargeable increase is determined for the purposes of that section.

2032. This section derives from paragraph 80(3) of Schedule 8 to FA 2000. In order to make that provision easier to understand, the rewritten legislation now consists of two subsections.

2033. *Subsection (1)* makes a minor change to the law. If plan shares are sold while they are still in the plan it is not the practice of the Inland Revenue to attempt to charge income tax under the dependent subsidiary charge in section 79 of FA 1988. However, there is a problem with the wording in paragraph 80 in that if the "appropriate time" for the purposes of that section is the time of sale it is debatable whether at that point the shares are still subject to the plan. In order to make it clear that no charge to income tax arises under section 453 in such circumstances, the words "or immediately before" have been added before the words "the appropriate time" at the end of this subsection. See *Change 126* in Annex 1.

Section 496: No charge on cash dividend retained for reinvestment
2034. This section is the last of three that deal with the tax advantages connected with the holding of shares. It provides that a participant is not liable to income tax in respect of the amount of a cash dividend that is not reinvested but is carried forward and held by the trust with a view to reinvestment at a later date. It derives from paragraph 91 of Schedule 8 to FA 2000.

Section 497: Limitations on charges on shares ceasing to be subject to plan
2035. This section is the first of two that deal with the tax advantages connected with shares ceasing to be subject to approved SIPs. It provides that liability to income tax

only arises in specified limited circumstances when shares cease to be subject to the plan.

2036. This section brings together three general propositions contained in paragraphs 81(7), 86(6) and 93(6) of Schedule 8 to FA 2000 respectively. The opportunity has been taken to bring these three sub-paragraphs into better alignment. All three subsections now refer to "income tax" (as opposed to "tax"); and in *subsection (2)* the reference to "the employee" has been omitted. Paragraph 77(1) of Schedule 8 to FA 2000 may be relied on for the change to the use of the term "income tax".

Section 498: No charge on shares ceasing to be subject to plan in certain circumstances

2037. This section is the second of two that deal with the tax advantages connected with shares ceasing to be subject to approved SIPs. It provides that a participant is not liable to income tax on shares ceasing to be subject to the plan if the shares so cease because the participant ceases to be in relevant employment in the circumstances specified in subsection (2). The meaning of a participant ceasing to be in relevant employment is explained in paragraph 95 of Schedule 2 to this Act.

2038. This section derives from sub-paragraphs (1) and (2) of paragraph 87 of Schedule 8 to FA 2000. *Subsection (2)(d)* reorganises the material to be found in paragraph 87(3)(d) of Schedule 8.

2039. That paragraph concludes by providing two definitions. The first definition (that of "redundancy") has now been placed in paragraph 99(1) of Schedule 2 to this Act; and the second (which appears in the rewritten legislation as a definition of "the specified retirement age") has now been placed in paragraph 98 of Schedule 2.

2040. The material set out in *subsection (2)* of this section is also set out in full in paragraph 32(2) of Schedule 2. This duplication should assist the reader.

Section 499: No charge in respect of incidental expenditure

2041. This section is concerned with incidental expenditure incurred in operating the plan; and provides that an employee is not liable to income tax in respect of such expenditure of the trustees, the company that established the SIP or the employee's employer.

2042. The section derives from paragraph 78(3) of Schedule 8 to FA 2000, which was added by paragraph 4 of Schedule 13 to FA 2001.

2043. This section makes a minor change to the law in that it is now provided that there is also no liability to income tax for incidental expenditure incurred by the company which established the plan. See *Change 127* in Annex 1.

The charges to tax

2044. Sections 500 to 508 relate to the second major topic dealt with in this Chapter: the consequential tax charges that may arise in certain circumstances.

Section 500: Operation of tax charges in connection with approved SIP

2045. As in the case of section 489, this section is introductory, being concerned with the general scope of the tax charges applying to an approved SIP. Those charges do not apply to an individual who is not chargeable to tax under Part 2 in respect of the eligible employment (as defined) (see *subsection (2)*).

2046. This section is the second of two that derive from paragraph 77 of Schedule 8 to FA 2000 (the other being section 489).

2047. As in the case of section 489, *subsections (2)* and *(3)* are derived from paragraph 77(2) of Schedule 8 to FA 2000. Once again the material in that sub-paragraph has been divided to make it easier to understand; and the definition of "the eligible employment" is new.

Section 501: Charge on capital receipts in respect of plan shares

2048. This section is the first of three that impose tax charges connected with the holding of shares. It imposes a charge to income tax if a capital receipt is received by a participant in respect of plan shares which have been held for less than five years (three years in the case of dividend shares). The meaning of the term "capital receipt" is dealt with in the following section.

2049. This section is the first of two that derive from paragraph 79 of Schedule 8 to FA 2000. This section derives from sub-paragraphs (1) and (5) of that paragraph, and deals with the matters directly relevant to the charge. *Subsections (1)* to *(5)* of this section are all derived from paragraph 79(1) of Schedule 8 to FA 2000, which has been divided to make it easier to understand; and *subsection (6)* simplifies the wording of paragraph 79(5) of Schedule 8 to FA 2000.

Section 502: Meaning of "capital receipt" in section 501

2050. This section follows on from section 501, and deals with the definition of the term "capital receipt". The term is given a very wide definition.

2051. This section is the second of two that derive from paragraph 79 of Schedule 8 to FA 2000. This section derives from the definitional provisions in sub-paragraphs (2) to (4) of that paragraph.

2052. In order to emphasise the provision that will apply most often in practice, *subsection (2)* begins with the words "The general rule".

2053. In *subsection (5)* the words "pursuant to a direction" have been changed to "as a result of a direction".

Section 503: Charge on partnership share money paid over to employee
2054. This section is the second of three that impose tax charges connected with the holding of shares. The section imposes a charge to income tax if an amount is paid over to an individual under any of the provisions in Schedule 2 that are listed in this section.

2055. This section derives from paragraph 84 of Schedule 8 to FA 2000.

Section 504: Charge on cancellation payments in respect of partnership share agreement
2056. This section is the last of three that impose tax charges connected with the holding of shares. The section imposes a charge to income tax if an individual receives any money in respect of the cancellation of a partnership share agreement.

2057. This section derives from paragraph 85 of Schedule 8 to FA 2000; but the wording of this section differs very substantially from the wording of that paragraph.

2058. As in the case of other sections in this Chapter, the year that is "the relevant tax year" is specified. The point at which the tax charge arises is not specified in Schedule 8 to FA 2000; but the point has been dealt with explicitly in *subsection (3)*. See *Note 3(B)* in Annex 2.

Section 505: Charge on free or matching shares ceasing to be subject to plan
2059. This section is the first of three that impose tax charges connected with shares ceasing to be subject to SIPs. This section is the main charging provision for free and matching shares; and it provides for the charge to vary with the length of the period for which the shares have been held. If the shares have been held for more than five years, there is no income tax liability under this section.

2060. This section derives from sub-paragraphs (1) to (6) of paragraph 81 of Schedule 8 to FA 2000.

2061. *Subsection (1)* introduces two new terms, "the award date" and "the exit date". These two terms are then deployed in *subsections (2)* to *(5)*. *Subsection (5)*, by providing that the "relevant tax year" is the tax year in which the exit date falls, has the effect that any charge to tax will arise in that year. See *Note 3(B)* in Annex 2.

2062. *Subsection (6)* combines material at present contained in sub-paragraphs (5) and (6) of paragraph 81.

Section 506: Charge on partnership shares ceasing to be subject to plan
2063. This section is the second of three that impose tax charges connected with shares ceasing to be subject to SIPs. This section is the main charging provision for partnership shares; and, as in the case of section 505, it provides for the charge to vary with the length of the period for which the shares have been held. If the shares have

been held for more than five years, then once again there is no income tax liability under this section.

2064. This section derives from sub-paragraphs (1) to (5) of paragraph 86 of Schedule 8 to FA 2000.

2065. *Subsection (1)* introduces a new term, "the exit date". This term is then deployed in *subsections (2)* to *(5)*.

2066. As in the case of other sections in this Chapter, the year that is "the relevant tax year" is specified. The point at which the tax charge arises is not specified in Schedule 8 to FA 2000; but as there can be little doubt about the answer, the point has been dealt with explicitly in *subsection (5)*. See *Note 3(B)* in Annex 2.

Section 507: Charge on disposal of beneficial interest during holding period

2067. This section is the last of three that impose tax charges connected with shares ceasing to be subject to SIPs. It applies if a participant disposes of the beneficial interest in free or matching shares during the holding period in breach of the obligations imposed by paragraph 36(1)(b) of Schedule 2 to this Act.

2068. This section derives from paragraph 82(1) of Schedule 8 to FA 2000. (Paragraph 82(2) of Schedule 8 to FA 2000 was repealed by paragraph 5 of Schedule 13 to FA 2001.) *Subsection (1)(a)* contains additional wording to emphasise that this section applies if free or matching shares cease to be subject to the plan during the holding period applying to those shares.

2069. As in the case of other sections in this Chapter, the year that is "the relevant tax year" is specified. As in the case of those other sections, the point at which the tax charge arises is not specified in Schedule 8 to FA 2000; the point is dealt with explicitly in *subsection (3)*. See *Note 3(B)* in Annex 2.

Section 508: Identification of shares ceasing to be subject to plan

2070. This section contains provisions for identifying shares that cease to be subject to SIPs.

2071. This section derives from paragraph 122(6) of Schedule 8 to FA 2000, which is one of the supplementary provisions in Part 13 of that Schedule. It is more convenient to deal with this topic here, alongside the provisions dealing with the tax charges connected with shares ceasing to be subject to SIPs.

2072. Paragraph 122(6) of Schedule 8 is drafted in terms of shares being "awarded" to a participant; but, while it is appropriate to speak of an award of free shares, partnership shares or matching shares, it is not clear that such terminology is appropriate for dividend shares. It is, however, the intention that all shares in the trust for a particular employee should be pooled, and that shares should come out of the

trust on a first in first out basis. *Subsection (2)* has been added to this section to deal with this point. See *Change 128* in Annex 1.

PAYE implications

2073. Sections 500 to 508 deal with the various charges to income tax as employment income that may arise under the SIP code. Sections 509 to 514, which derive from paragraphs 94 to 96 of Schedule 8 to FA 2000 (as amended), deal with the circumstances in which PAYE may be applied to those payments.

Section 509: Modification of section 696 where charge on shares ceasing to be subject to plan

2074. This section, with its reference to section 696, has the effect of providing that where there is an amount that counts as employment income as the result of shares ceasing to be subject to an approved SIP, and where the shares in question are readily convertible assets, PAYE is to be applied on the amount likely to count as employment income under the SIP code.

2075. This section derives from paragraphs 94 and 128 of Schedule 8 to FA 2000, two paragraphs since amended by section 39(2) and (6) of FA 2002.

2076. This section has the consequence that the employer has to use his best estimate of the amount that will be chargeable: there is no requirement that PAYE has to be operated on the precise amount that will eventually count as employment income.

Section 510: Payments by trustees to employer company on shares ceasing to be subject to plan

2077. This section applies where any plan shares cease to be subject to the plan; where there is an amount that counts as employment income of the participant; and where there is an obligation to deduct PAYE in respect of that amount. In these circumstances the principal obligation to account for any PAYE due is that of the employer company (an expression defined in *subsection (7)*). The plan may require the participant to pay sufficient money to the employer company in order to meet the PAYE liability; but, to the extent that it does not do so, this section provides for the trustees to pay sums to the employer company.

2078. This section is the first of three that derive from paragraph 95 of Schedule 8 to FA 2000. That paragraph is long; and it has been thought advantageous to divide it. This section derives from sub-paragraphs (1) to (6) of paragraph 95.

2079. *Subsection (7)* takes account of the amendment made to paragraph 95(6) of Schedule 8 to FA 2000 by section 39(3) of FA 2002.

Section 511: PAYE deductions to be made by trustees on shares ceasing to be subject to plan

2080. This section is relevant where any plan shares cease to be subject to the plan and as a result there is an amount that counts as employment income of the

participant. In such a case if either there is no employer company or the Inland Revenue are of the opinion that a PAYE deduction is impracticable, and direct that this section is to apply, the trustees have to account for the PAYE as if the participant were a former employee of the trustees. The practical effect of this is that the trustees have to deduct income tax at the basic rate.

2081. This section is the second of three that derive from paragraph 95 of Schedule 8 to FA 2000. This section derives from sub-paragraphs (7) and (8) of paragraph 95.

Section 512: Disposal of beneficial interest by participant
2082. This section provides for sections 510 and 511 to apply in a modified form where a participant disposes of his beneficial interest in any of his plan shares.

2083. This section is the last of three that derive from paragraph 95 of Schedule 8 to FA 2000. This section derives from sub-paragraph (9) of paragraph 95.

Section 513: Capital receipts: payments by trustees to employer company
2084. This section and section 514 apply where the trustees receive money which gives rise to a capital receipt that counts as employment income in the hands of the participant (see section 501). This section then applies to deal with the "basic" case that arises in these circumstances. The trustees are to pay over an amount equal to the amount of employment income to the employer company (an expression defined in *subsection (5)*), and the employer company is then to account for the PAYE and to pay the balance to the employee.

2085. This section is the first of two that rewrite paragraph 96 of Schedule 8 to FA 2000. This section derives from sub-paragraphs (1) and (2) of paragraph 96. *Subsection (5)* takes account of the amendment made to paragraph 96(2) of Schedule 8 to FA 2000 by section 39(4) of FA 2002.

Section 514: Capital receipts: PAYE deductions to be made by trustees
2086. Section 513 and this section apply where the trustees receive money which gives rise to a capital receipt that counts as employment income in the hands of the participant (see section 501). This section applies in circumstances where either there is no employer company or the Inland Revenue are of the opinion that a PAYE deduction is impracticable, and direct that this section is to apply. In these circumstances, and when making the capital payment to the participant, the trustees are to make a PAYE deduction as if the participant were a former employee of the trustees. The practical effect of this is that the trustees have to deduct income tax at the basic rate.

2087. This section is the second of two that rewrite paragraph 96 of Schedule 8 to FA 2000. This section derives from sub-paragraphs (3) and (4) of paragraph 96.

Section 515: Tax advantages and charges under other Acts
2088. This is a new section, explaining where the remaining provisions in the SIPs code are to be found. The majority are to be found in ICTA *(subsection (1))*; but others are to be found in TCGA 1992 *(subsection (2)(a))*, or in FA 2001 *(subsection (2)(b))*.

Chapter 7: Approved SAYE option schemes
Overview
2089. This Chapter tells an employee receiving or exercising a share option whether or not the option is within the Save-as-You-Earn ("SAYE") rules and what the tax consequences are. A SAYE option scheme is defined in section 516. This label has not been used in the statute up to now. The name in the source legislation is "savings-related share option scheme" and these schemes are commonly referred to as SAYE share option schemes or simply SAYE schemes in practice.

2090. The label SAYE denotes a SAYE option scheme in these notes.

2091. Unlike in sections 185 and 187 of and Schedule 9 to ICTA, in this Act SAYE has been separated from the CSOP schemes in an attempt to make these rules easier to read and understand.

2092. The rules for APS schemes (profit sharing schemes approved under Schedule 9 to ICTA) are not rewritten in this Act. These rules will therefore still be found in sections 186 and 187 of and Schedules 9 and 10 to ICTA. There is reference to this in section 418(2) and in Part 8 of Schedule 7 to this Act.

2093. The redrafting of the SAYE and CSOP schemes has been influenced by the way the newer schemes, Enterprise Management Incentives ("EMI") and Share Incentive Plans ("SIP"), were drafted in FA 2000. This is a matter of style and also part of an attempt to achieve consistency across the share schemes where possible. Codes have been introduced for each scheme or plan as explained in the notes on the introduction to this Part.

2094. Each section of this Chapter and each paragraph of Schedule 3 has a heading to help explain its contents and there are several examples of both sections and paragraphs containing introductory material.

2095. The requirements for the initial and continuing approval of the scheme are now contained in paragraphs 40 to 44 of Schedule 3. There are transitional provisions in Schedule 7 to ensure that a scheme approved under Schedule 9 to ICTA is treated as a SAYE option scheme approved under this Act.

Section 516: Approved SAYE option schemes
2096. This section sets out what is contained in this Chapter and in Schedule 3. It sets the scene: SAYE is a scheme which requires prior approval by the Inland Revenue and which enables the option-holder to benefit from income tax relief.

2097. There are references in the SAYE code in several places to the Inland Revenue, where in ICTA these refer to the Board. This reflects practice and is in line with the approach in FA 2000 to the EMI and SIP codes. The Inland Revenue is defined in section 720 as "any officer of the Board of Inland Revenue". See *Change 158* in Annex 1.

2098. In *subsection (3)(c)* there is a cross-reference to Part 2 of Schedule 7D to TCGA 1992 which covers the capital gains tax angle (see Schedule 6 to this Act).

2099. Share options are described as being granted rather than obtained in most contexts and especially where the timing of the grant is significant. This ties in with the terminology in EMI and perhaps gives a clearer indication of the exact date of the occasion.

2100. The definitions derive from section 187 of ICTA. There are minor definitions and a new index of defined expressions, at the end of Schedule 3 to this Act. This is based on the approach in the tax-relieved share schemes, introduced by FA 2000. The definition of "share option" matches the one used for EMI in FA 2000 (and in the EMI code). In section 516 there is also a fuller definition of the SAYE option scheme itself than in ICTA.

Section 517: Share options to which this Chapter applies
2101. This is an introductory section, which derives from section 185(1) of ICTA. This Chapter applies to an individual who obtains an option in accordance with the provisions of an approved scheme by reason of his or her employment. This phrase in section 185(1) matches the expression in the benefits code. The rules in paragraph 10 of Schedule 3 to this Act govern the particular employment.

2102. The reference to a commencement date in section 185(1) of ICTA is spent and is not rewritten.

Section 518: No charge in respect of receipt of option
2103. This derives from section 185(2) of ICTA. Here, as elsewhere, the phrase "no liability to income tax arises" expresses this type of exemption.

Section 519: No charge in respect of exercise of option
2104. This and the following section derive from section 185(3) and (4) of ICTA and explain the conditions for relief from income tax on the exercise of an option and on post-acquisition benefits.

2105. The relief and the exceptions are set out in a more straightforward way and in a positive framework. No liability to income tax arises in the circumstances set out in this section (subject to the two conditions in *subsections (2) and (3)*) on the exercise of an option in accordance with the approved provisions of the scheme. Under condition A, the option is exercised after three years from the date on which it is granted. This period between grant and exercise is the norm for a SAYE scheme.

2106. There are a number of circumstances however for an early (pre-three year) exercise which are catered for in SAYE schemes. Rules about these appear in Schedule 3 to this Act. Following on from section 185(4) of ICTA, this section identifies those circumstances for which tax relief is provided. But under condition B the position is expressed positively, although the formulation makes reference to the circumstances where tax relief is not available on the early exercise of an option.

2107. There is a clarification of the time limit in section 185(4) of ICTA, which refers to the exercise of an option within three years of its being obtained in subsections (2) and (3)(a). This section confirms that the period is inclusive of the date of the grant. So, if granted an option on 1 January 2002, an employee can be confident that it can be exercised on the same date three years later and the exercise will qualify for income tax relief. See *Change 129* in Annex 1.

2108. There are similar clarifications in the CSOP code and there are references to time limits elsewhere in the notes on the approved schemes. These are instances where, to a greater or lesser extent, doubt may exist as to whether or not the "trigger date", from which a period is measured, is to be included in the period. As the law ignores fractions of a day when computing periods of this nature, the start date for the various periods has been identified.

2109. The Inland Revenue practice under which the charge on the exercise, assignment and release of unapproved share options is lifted after the death of an option holder has now been given statutory effect in section 477(4). There is a cross-reference to this section in *subsection (4)*. Also, to make it clear that the operation of section 477 acts in conjunction with the approved share scheme rules, which concern the time when a share option lapses after death, there is also a signpost to paragraph 32 of Schedule 3 to this Act in *subsection (5)(a)*.

2110. In *subsection (5)(b)* there is a direct signpost to paragraph 42(3) of Schedule 3 to this Act, under which, for SAYE, the option holder is protected against the possibility of approval being withdrawn from an approved scheme.

Section 520: No charge in respect of post-acquisition benefits

2111. This section mirrors the previous section and gives relief in the same circumstances from income tax on specified charges on an increase in the value of shares acquired by way of a tax-relieved exercise.

2112. There is a signpost in *subsection (3)* to paragraph 42(3) of Schedule 3 to this Act under which, for SAYE, the option holder is protected against the possibility of approval being withdrawn from an approved scheme.

Chapter 8: Approved CSOP schemes

Overview

2113. This Chapter tells an employee receiving or exercising a share option whether or not the option is within a CSOP scheme and what the tax consequences are. A

CSOP scheme is defined in section 521. The acronym CSOP stands for a company share option plan. This label has not been used in the statute up to now but it is commonly used in practice.

2114. The label CSOP denotes a CSOP scheme in these notes.

2115. Unlike in sections 185 and 187 of and Schedule 9 to ICTA, in this Act CSOP has been separated from the SAYE schemes in an attempt to make these rules easier to read and understand.

2116. The rules for APS scheme (profit sharing schemes approved under Schedule 9 to ICTA) are not being rewritten in this Act. These rules will therefore still be found in sections 186 and 187 of and Schedules 9 and 10 to ICTA. There is reference to this in section 418(2) and in Part 8 of Schedule 7 to this Act.

2117. The redrafting of the CSOP and SAYE schemes has been influenced by the way the newer schemes, Enterprise Management Incentives ("EMI") and Share Incentive Plans ("SIP"), were written in FA 2000. This is a matter of style and also part of an attempt to achieve consistency across the share schemes where possible. Codes have been introduced for each scheme or plan as explained in the notes to the introduction to this Part.

2118. Each section of this Chapter and each paragraph of Schedule 4 has a heading to help explain its contents and there are several examples of both sections and paragraphs containing introductory material.

2119. The requirements for the initial and continuing approval of the scheme are now contained in paragraphs 28 to 32 of Schedule 4. There are transitional provisions in Schedule 7 to ensure that a scheme approved under Schedule 9 to ICTA is treated as a CSOP scheme approved under this Act.

Section 521: Approved CSOP Schemes

2120. This section sets out what is contained in this Chapter and in Schedule 4 to this Act. It sets the scene: CSOP is a scheme which requires prior approval by the Inland Revenue and which enables the option-holder to benefit from income tax relief. There is also provision here for amounts to count as employment income in certain circumstances.

2121. There are references in the CSOP code in several places to the Inland Revenue, where the relevant provisions in ICTA referred to the Board. This reflects practice and is in line with the approach in FA 2000 to EMI and SIP codes. The Inland Revenue is defined in section 720 as "any officer of the Board of Inland Revenue". See *Change 158* in Annex 1.

2122. In *subsection (3)(c)* there is a cross-reference to Part 3 of Schedule 7D to TCGA 1992 which covers the capital gains tax angle (see Schedule 6 to this Act).

2123. Share options are described as being granted rather than obtained in most contexts and especially where the timing of the grant is significant. This ties in with the terminology in EMI and perhaps gives a clearer indication of the exact date of the occasion.

2124. The definitions derive from section 187 of ICTA. There are minor definitions and a new index of defined expressions, at the end of Schedule 4 to this Act. This is based on the approach in the tax-relieved share schemes, introduced by FA 2000. The definition of "share option" matches the one used for EMI in FA 2000 (and in the EMI code). There is for the first time a definition of the CSOP scheme in section 521.

Section 522: Share options to which this Chapter applies
2125. This is an introductory section, which derives from section 185(1) of ICTA. This Chapter applies to an individual who obtains an option in accordance with the provisions of an approved scheme by reason of his or her employment. This phrase in section 185(1) matches the expression in the benefits code. The rules in paragraph 8 of Schedule 4 to this Act govern the particular employment.

2126. The reference to a commencement date in section 185(1) of ICTA is spent and is not being rewritten. This is also the case with section 185(9) of ICTA, which is specific to CSOP.

Section 523: No charge in respect of receipt of option
2127. *Subsection (1)* derives from section 185(2) of ICTA. Here as elsewhere the phrase "no liability to income tax arises" expresses this type of exemption.

2128. *Subsection (2)* also derives from section 185(2) of ICTA.

Section 524: No charge in respect of exercise of option
2129. This and the following section bring together section 185(3) and (5) of ICTA and incorporate paragraph 27(3) of Schedule 9 to ICTA, which was formerly referred to in section 185(3).

2130. These two sections explain the conditions for relief from income tax on the exercise of an option and on post-acquisition benefits. As with the SAYE provisions, this section makes the circumstances of relief and the exceptions more straightforward, expressing them in a positive form.

2131. No liability to income tax arises in the circumstances set out in the condition in *subsection (2)*. The option has to be exercised between three years and ten years after receipt and three years after a previous exempt exercise, as defined in *subsection (3)*.

2132. There are therefore three dates crucial to this relief. The three year period in *subsection (2)(a)(i)* begins with the day on which the option is granted. There is a

minor change in relation to the exercise on the tenth anniversary of the grant in *subsection (2)(a)(ii)*. See *Change 129* in Annex 1.

2133. In *subsection (2)(b)* the rule makes it clear that the period is inclusive of the exercise of the current option. (In section 185(5)(b) of ICTA the period looks back to the date of an earlier exercise.) The effect is that if there is an exempt exercise of an option on 1 January 2002, an employee can be confident that a further exercise on the same date three years later will qualify for income tax relief.

2134. There are similar clarifications in the SAYE code and there are references to time limits elsewhere in the explanatory notes on the approved schemes. These are instances where it might be open to doubt whether or not the trigger date, from which a period is measured, is to be included in the period. As the law ignores fractions of a day when computing periods of this nature, this section identifies the start date for the various periods.

2135. The Inland Revenue practice under which the charge on the exercise, assignment and release of unapproved share options after the death of an option holder is lifted has now been given statutory effect in section 477(4). There is a new cross-reference to this section in *subsection (4).* Also, to make it clear that the operation of section 477 acts in conjunction with the approved share scheme rules, which concern the time when a share option lapses after death, there is a signpost to paragraph 25 of Schedule 4 in *subsection (5).*

Section 525: No charge in respect of post-acquisition benefits

2136. This section mirrors the previous section and also derives from section 185(3) and (5) of ICTA. It gives relief in the same circumstances from income tax on specified charges (post-acquisition charges under section 449 and section 453) on an increase in the value of shares acquired by way of a tax-relieved exercise. The exercise has to meet the condition set out in section 524. See *Note 50* in Annex 2.

Section 526: Charge where option granted at a discount

2137. This section derives from section 185(6) and (8) of ICTA. Section 185(7) of ICTA which covers the capital gains tax consequences (relief against a double charge) is now in Part 3 of Schedule 7D to TCGA 1992 (see Schedule 7 to this Act).

2138. The section imposes a charge in the rare case that the total of any consideration given for the grant of the option and the amount payable on exercising the option is less than the market value of the shares at the time the option is granted. The option has to be granted at a price which is not manifestly less than the market value at that date (which is the rule in paragraph 22 of Schedule 4, formerly paragraph 29 of Schedule 9 to ICTA). Therefore this charge can only occur where there has been an agreement to fix the value earlier than the date of the grant or a mistake is made on the valuation.

2139. The language of *subsections (2)* and *(4)* reflects the new approach to expressing "charge".

2140. In response to a suggestion made in the consultation process leading up to this Act, "the price" in *subsection (1)(b)* has been changed to "the amount payable" since price implies an amount payable per share. A further clarification has also been introduced. This is the reference to "the maximum number of shares" that can be acquired under the option, which specifies the number of shares in the frame in order to make the comparison required.

2141. The reference to the discount being earned income has been dropped, as this has no continuing effect.

2142. Under *subsection (4),* "knock-on" relief is given against further income tax charges on the same shares. This is a signpost only now; the way the relief is given is included in sections 194, 479 and 480.

Chapter 9: Enterprise management incentives

Overview

2143. This Chapter contains the information that an employee needs in order to be able to establish the tax consequences of receiving or exercising a share option that is within the enterprise management incentives ("EMI") rules.

2144. A code has been introduced for EMI options as for SAYE, CSOP and SIPs as explained in the notes on the introduction to this Part.

2145. Those parts of the EMI code that determine which options are within the scope of the scheme are separated out and appear in Schedule 5. Schedule 5 refers to "share options", where appropriate, so as to align this phraseology with SAYE and CSOP. There is a definition of "share option" in section 527.

2146. The requirements for a qualifying option, deriving from Schedule 14 to FA 2000, are now contained in Schedule 5 to this Act. There are transitional provisions in Schedule 7 to ensure that where a share option was a qualifying option under Schedule 14 to FA 2000, it is treated as a qualifying option for the purposes of the EMI code.

Section 527: Enterprise management incentives: qualifying options

2147. This section sets out what is contained in this Chapter and in Schedule 5. As well as being a new scene-setting section, it includes material drawn from paragraph 1(1) of Schedule 14 to FA 2000 about what is a qualifying option.

2148. In *subsection (3)(c)* there is a cross-reference to Part 4 of Schedule 7D to TCGA 1992 which covers the capital gains tax angle, (see Schedule 7 to this Act).

Section 528: No charge on receipt of qualifying option
2149. This section prevents tax being chargeable on receipt of a qualifying option. It derives from paragraphs 42(1) and 43 of Schedule 14 to FA 2000.

Section 529: Scope of tax advantages: option must be exercised within 10 years
2150. This section explains that the tax advantages described in the following sections only apply if the option is exercised within ten years of it being granted. If the option being exercised is a replacement for a previous option, it must be exercised within ten years from when the original option was granted in order to qualify for the tax advantages. This derives from paragraph 42 of Schedule 14 to FA 2000.

2151. The words "the date of the" have been added before "grant" in subsection (2)(b) to clarify the effect of the rule in paragraph 42 which provides for a ten year period exclusive of the date of the grant.

Section 530: No charge on exercise of option to acquire shares at market value
2152. This section, which derives from paragraph 44 of Schedule 14 to FA 2000, deals with the situation where an employee is granted an option with an exercise price not less than the market value of the shares at the time the original option is granted. In this situation, there is no charge on the exercise of the option (or a replacement option) under section 476. This provision is subject to section 532 which outlines what happens if a disqualifying event takes place.

Section 531: Limitation of charge on exercise of option to acquire shares below market value
2153. This section sets out how to calculate the amount chargeable under section 476 when a qualifying option (or replacement option) is exercised to acquire shares for less than their market value when the option was originally granted. It derives from paragraph 45 of Schedule 14 to FA 2000.

2154. This provision is subject to section 532 which outlines what happens if a disqualifying event takes place.

2155. There are formulae to aid understanding of the text in this and in the succeeding section, which provide the basis for the calculation of the charges.

2156. There is no successor to paragraph 46 of Schedule 14 to FA 2000 (exercise of option to acquire shares at nil cost). This is redundant in that it is a variation of the situation in this section. Small changes have been made to sections 531 and 532 to ensure that the whole picture is preserved. In subsection (1) of section 531 there is a new "(or at nil cost)" and in both subsection (2) of this section and subsection (4) of section 532, a reference to "if any" in the definition of "ACS".

2157. There is a further point affecting both this and the next section. The source legislation includes a provision that stating that if the section 476 gain was nil there is no liability to income tax. Sections 531 and 532 now use a formulaic approach and a

more general solution has been found to deal with negative results. Section 420 provides for the position where a formula in Part 7 would produce a negative result. The result is to be taken to be nil.

Section 532: Modified tax consequences following disqualifying events

2158. This section sets out what happens where there has been a disqualifying event and the option had not been exercised within 40 days of that event. The 40-day period of grace is in recognition of the fact that the option-holder may have no control over a disqualifying event.

2159. This provision derives from paragraph 53 of Schedule 14 to FA 2000. The section now has a more comprehensive heading and is in a more prominent position before the sections describing the various types of disqualifying event. This draws out the impact of such an event on income tax relief.

2160. The broad effect of an amendment in paragraph 11 of Schedule 14 to FA 2001 was that this set of rules wholly replaces those included in paragraphs 44 and 45 of Schedule 14 to FA 2000 (rewritten in sections 530 and 531), if a disqualifying event occurs. There is a slight change in the wording to reflect this, referring to the option being "within", for example, section 530, rather than section 530 applying.

2161. The effect of the provision is to separate out and relieve the gain in the value of the share option accruing over the period up to the disqualifying event, leaving any gain accruing between the disqualifying event and the date of exercise fully chargeable. There is of course the usual deduction for anything paid for the grant of the option.

2162. As noted in relation to the preceding section there is no successor to paragraph 46 of Schedule 14 to FA 2000. Another small change has been made to this section to ensure that the whole picture is preserved. In *subsection (4)* there is an added reference to "if any" in the definition of "ACS".

2163. The provision in sub-paragraph (2D) of paragraph 53 of Schedule 14 to FA 2000, has not been reproduced. This was a provision that stated that if the section 476 gain was nil there is no liability to income tax. This and the preceding section now use a formulaic approach and a more general solution has been found to deal with negative results. Section 420 provides for the position where a formula in Part 7 would produce a negative result. The result is to be taken to be nil.

2164. *Subsection (6)* contains a clearer exposition of the rule in paragraph 53(3) of Schedule 14 to FA 2000 from which it derives. This ensures that the operation of this section does not result in a higher taxable amount than would be charged under section 476, if the EMI provisions did not apply. In this situation no part of either this section or of sections 530 and 531 apply (and so the amount is counted as income under section 476).

Section 533: Disqualifying events
2165. This is a new provision, which provides the reader with a list of the possible disqualifying events and notes where they are described in full.

Section 534: Disqualifying events relating to relevant company
2166. This section sets out those events that can happen to the company whose shares are the subject of a qualifying option that would lead to that share option ceasing to qualify under EMI. These are "disqualifying events". It derives from paragraph 47(1) and (2) and paragraph 48 of Schedule 14 to FA 2000.

2167. The word "being" has been changed to "becoming" in *subsection (1)(b)* to better match the wording and meaning of subsection (1)(a).

2168. The definition of "control" is covered by section 840 of ICTA, see *Note 51* in Annex 2.

2169. In *subsection (4)*, which derives from paragraph 47(2) of Schedule 14 to FA 2000*,* the reference to the "original" option has been dropped from the phrase "when the option was granted". There is no scope in paragraph 47(2)(b)(ii) of Schedule 14 to FA 2000 to refer to any option other than the qualifying option, mentioned in paragraph 47(2)(a) (in subsections (3) and (4)(a) of this section). This could be either an original or a replacement option. Also the words "of a group" no longer follow "parent company" in subsection (4)(b).

2170. To clarify the position if there has been a replacement option, there is a cross-reference to paragraph 41(5) (b) of Schedule 5.

2171. The words "from the grant" in the source legislation have been changed to "the period of two years after the date" of the grant in *subsection (5)* to clarify the rule. This new wording provides for a period exclusive of the date of the grant.

Section 535: Disqualifying events relating to employee
2172. This section sets out the disqualifying events that can occur in relation to an employee. These result in the share option held by that employee ceasing to qualify under EMI. It derives from paragraphs 47(1) (part), (3), and 52(1), (2) and (6) of Schedule 14 to FA 2000 and relates to provisions in Schedule 5 to this Act. It picks up on some new expressions introduced in paragraph 26 of that Schedule to set out more clearly the requirement on working time.

2173. First there is the employment requirement in *subsection (1)(a)*. Next, under *subsection (1)(b),* there is a disqualifying event if, on the facts of the arrangement between employer and employee (usually the contract), the employee ceases to meet the requirement as to commitment of working time, contained in paragraph 26 of Schedule 5 to this Act.

2174. Finally, and the different nature of this test is emphasised by the words "in addition" in *subsections (2)* to *(5)*, there is what is known as the "working time rule". This takes into account the time actually spent by the employee on work in the relevant employment.

2175. The provisions in paragraphs 47 and 52 of Schedule 14 to FA 2000 are cumbersome to operate, do not work satisfactorily in all circumstances and could impact harshly on employees working flexi-time. Under *subsections (2)* to *(5)* there is a much simpler "working time rule". See *Change 130(A)* in Annex 1.

2176. There is another minor change to the law in *subsection (3)*. This corrects an omission in the source legislation, by providing a cross-reference to paragraph 26(3) of Schedule 5 to this Act. See *Change 130(B)* in Annex 1.

Section 536: Other disqualifying events
2177. This section lists the other events that can result in a share option ceasing to qualify under EMI. It derives from paragraphs 47(1) and 51 of Schedule 14 to FA 2000.

Section 537: Alterations of share capital for purposes of section 536
2178. Among the disqualifying events in section 536 are certain kinds of alteration of the company's share capital. Section 537 sets out what kind of alteration comes into play for the purposes of section 536(1)(b) and (c). It derives from paragraphs 47(1) and 49 of Schedule 14 to FA 2000.

2179. There is a change in the wording in *subsection (4)* compared to the final paragraph of paragraph 49(1). "References to restrictions ... or to rights … *include*", followed by an interpretation, is replaced by "any reference to a restriction … or a right … *is a reference to such a restriction ... or right*", followed by the same interpretation. This rephrasing makes better sense of the final words in the sentence, "or in any other way".

Section 538: Share conversions excluded for purposes of section 536
2180. Among the disqualifying events in section 536 is a conversion of the shares, to which the option relates, into a different class. Section 538 prevents a share conversion being a disqualifying event if it meets certain conditions as set out in subsections (2) and (3). This section derives from paragraph 50 of Schedule 14 to FA 2000.

Section 539: CSOP and other options relevant for purposes of section 536
2181. Among the disqualifying events in section 536 is the grant of a CSOP option if, after this grant, the total value of the shares for which the employee holds unexercised employee options under EMI or CSOP exceeds £100,000. This section explains the meaning of CSOP options and employee options for those purposes. It derives from paragraph 51(1) to (4) of Schedule 14 to FA 2000.

2182. There is a new definition of a group of companies, in contexts where there is no reference to the parent company, in paragraph 58 of Schedule 5 to this Act.

Section 540: No charge on acquisition of shares as taxable benefit
2183. This section prevents there being a charge to tax under Chapter 8 of Part 3 in respect of shares acquired by the exercise of a qualifying option, if the employee is resident and ordinarily resident in the United Kingdom. This derives from paragraph 54 (1) of Schedule 14 to FA 2000.

2184. The wording of the source legislation suggests that the residence tests apply at the time the option is exercised. In practice the Inland Revenue applies the test at the time of the grant of the option. In this section it has been made clear that the tests can be applied at the time of the grant or at the time of the exercise of a qualifying option. See *Change 131* in Annex 1.

2185. The content of paragraph 54(2) of Schedule 14 to FA 2000 is in section 541, rather than in this section, since it relates to a charge under Chapter 9 of Part 3 which is not affected by the EMI provisions.

Section 541: Effects on other income tax charges
2186. The fact that a share option may be a qualifying share option under EMI does not prevent the ordinary operation of certain other income tax provisions. This section sets out what those provisions are. This includes a reference to the possibility of a charge under section 453 in *subsection (1)(c)*. This last subsection derives from section 79 of FA 1988 and, though not immediately relevant since an EMI option cannot be granted over shares in a subsidiary, can apply to shares acquired on exercise of the option if there is a subsequent take-over.

2187. The section also describes what relief may be available as a deductible amount from a charge to tax under sections 427 or 438 in respect of shares acquired under the option.

2188. This section derives from paragraphs 54 (2) and 55 of Schedule 14 to FA 2000.

Chapter 10: Priority share allocations
Overview
2189. This Chapter derives from section 68 of FA 1988 which applies to offers made on or after 23 September 1987. That section exempts the benefit derived by directors and employees from a priority allocation of shares.

2190. Section 68 of FA 1988 starts by granting a complete exemption from the charge as emoluments in respect of any benefit derived from an entitlement to a priority allocation of shares. Then, in some circumstances, the legislation brings back into charge any discount enjoyed by employees. It does so by excluding the relevant

amount from the initial exemption. The rules for calculating this amount are different from the normal rules for calculating emoluments.

2191. When section 68 of FA 1988 was enacted, it only dealt with relatively straightforward offers where there was a single public offer under which both members of the public and directors and other employees applied for shares including any priority shares.

2192. Successive amendments catered for more complex share offers. These included offers where, because of legal and other technical issues, the priority shares for directors and employees were subject to a separate employee offer. Each new tranche of legislation was "bolted on" to what had gone before. This was done by imposing the fiction that the separate public and employee offers were in fact a single offer – "the offer".

2193. This led to some rather dense and convoluted legislation – particularly in the rules for the limits on the number of priority shares and the "similar terms" condition. In order to try to make the provisions easier to understand, that fiction has been abandoned and the Act instead uses the following structure: sections 542 and 543 deal with single share offers; sections 544 and 545 deal with share offers with separate public and employee offers; and sections 546 to 548 deal with supplementary material that is common to both.

2194. It should be noted that section 68(4) of FA 1988 (dealing with the capital gains aspects) does not appear in this Chapter. Instead, paragraph 212 of Schedule 6 to this Act inserts a new section 149C in TCGA 1992. In addition, section 68(6) of FA 1988, the original commencement provision, is omitted on the grounds that it is spent.

Section 542: Exemption: offer made to public and employees

2195. This section is concerned with offers which are open to both the public and employees. *Subsection (1)* derives from section 68(1) of FA 1988 and introduces the basic conditions for the exemption. The exemption itself is found in *subsection (2)* and is from liability to income tax as earnings. It follows that the exemption does not apply to a benefit received in connection with a change or termination within Chapter 3 of Part 6 of this Act which derives from section 148 of ICTA.

2196. *Subsections (3) to (6)* derive from sections 68(2), (2A) and (2B) of FA 1988 and give the detailed conditions which must be satisfied in order for the exemption to apply. In contrast to the source legislation, dealing with the conditions one by one should be clearer.

2197. *Subsection (7)* introduces section 543 which excludes certain discounts from the exemption in this section.

Section 543: Discount not covered by exemption in section 542
2198. This section derives from section 68(1A) of FA 1988 and excludes from the exemption in section 542 the benefit of certain discounts enjoyed by a director or employee in acquiring the priority shares. The discount therefore remains taxable as earnings. In calculating the taxable discount the amount of any registrant discount (see section 547) is disregarded.

Section 544: Exemption: different offers made to public and employees
2199. This section is concerned with cases where there are separate offers to the public and employees. *Subsection (1)* derives mainly from section 68(1ZA) of FA 1988 and introduces the basic conditions for the exemption. The exemption itself is found in *subsection (2)* and is from liability to income tax as earnings. It follows that the exemption does not apply to a benefit received in connection with a change or termination within Chapter 3 of Part 6 of this Act which derives from section 148 of ICTA.

2200. *Subsections (3)* to *(6)* derive from sections 68(1ZB), (2), (2A), (2B) and (2C) of FA 1988 and give the detailed conditions which must be satisfied for the exemption to apply. Subsection (3) requires the case of each company whose shares are subject to the employee offer to be considered. In the FA 1988 provisions, the fiction that the public offer and the employee offer are a single offer means that, reading subsections 68(2)(a) and 68(2C) together, a company whose shares are *only* subject to the public offer also has to be considered. In such a case, the limit on the number of shares allocated to employees, imposed by section 68(2)(a), will never be exceeded. These companies are not therefore mentioned. See *Note 52* in Annex 2.

2201. *Subsection (7)* introduces section 545 which excludes certain discounts from the exemption in this section.

Section 545: Discount not covered by exemption in section 544
2202. This section derives from section 68(1) of FA 1988 and excludes from the exemption in section 544 the benefit of any discount (disregarding the registrant discount) enjoyed by a director or employee in acquiring the priority shares. The discount therefore remains taxable as earnings.

2203. *Subsections (3)* to *(6)* derive from the rather complex provisions in section 68(5B) and (5C) of FA 1988 which determine the "appropriate notional price" of the shares in the offer. Generally this is the notional price, but in some circumstances it is a proportion of the notional price. A formula has been introduced to make the basis of the calculation clearer.

Section 546: Meaning of being entitled "on similar terms"
2204. This section derives from sections 68(3) and (3A) of FA 1988 and explains the condition that entitlement to a priority allocation of shares must be on "similar terms".

2205. *Subsections (3)* to *(6)* only apply where the allocation of shares in a company for directors and employees of the company is different from the allocations for directors and employees of other companies.

Section 547: Meaning and amount or value of "registrant discount"
2206. This section derives from section 68(5A) of FA 1988 which defines "registrant discount". Section 68(5A)(b) requires at least 40% of shares which are allocated to members of the public *other than employees and directors* to be allocated to individuals entitled to the discount. It is not made explicit what this phrase means. *Subsection (4)* has been drafted to make clear that the intention is to exclude employees and directors who are entitled to a priority allocation. This change in approach is explained in detail in *Note 53* in Annex 2.

2207. In this section the label "subscribing employee" has been used to describe those directors and employees who subscribe for shares under the offers and who comply with the same registration requirements as members of the public.

Section 548: Minor definitions
2208. This section contains the definitions used in this Chapter and mainly derives from section 68(5) of FA 1988. That legislation does not define "director" (except to include prospective and former directors) or "shares". The definitions introduced here are discussed in *Change 132* in Annex 1.

Chapter 11: Supplementary Provisions about employee benefit trusts
Background
2209. Chapters 6, 7, 8 and 9 of this Part set out the provisions for the four types of share scheme: share incentive plans ("SIPs"), Save As You Earn option schemes ("SAYE"), company share ownership plans ("CSOPs") and enterprise management incentives ("EMIs").

2210. Each of those schemes includes a number of requirements that the employee must meet. One of the conditions common to each of the schemes is that the employee must not have a "material interest" in the company whose shares are subject to the scheme. A "material interest" means entitlement to more than a certain percentage of the relevant company's share capital.

2211. In determining whether or not the "material interest" test is satisfied, the entitlement of the individual to any of the company's shares includes any such entitlement held by any "associates" of the individual.

2212. One kind of associate could be a trustee of a settlement of which the individual is a beneficiary. And one kind of trust that may well exist in the context of a company that is running share incentive schemes is an employee benefit trust. An employee wishing to participate in the share scheme may therefore need to know whether or not to count the trustees of the employee benefit trust as "associates" for the purposes of the "material interest" test.

2213. Each of the four types of share scheme mentioned in paragraph 2209 includes provisions directed to the issue whether the trustees of an employee benefit trust should be counted as associates. The provisions are to the same effect, and state, in each case, that the general rule is that the trustees are not counted as associates if neither the individual in question (with or without associates) nor any associate of the individual (with or without associates) controls more than a stated percentage of the ordinary share capital of the company.

Overview

2214. This Chapter contains provisions relating to employee benefit trusts. It deals with two issues.

2215. The first issue dealt with is the obvious question "What is an employee benefit trust?". In the source legislation an employee benefit trust is stated, in the case of each of the four schemes, to have the same meaning as in paragraph 7 of Schedule 8 to ICTA. That Schedule is not being re-enacted, as it relates to profit-related pay schemes which will be effectively spent by the time that this Act takes effect. It will therefore no longer be possible to refer to the meaning of "employee benefit trust" as used in the legislation relating to profit related pay schemes. That definition, instead, is set out in this Chapter. The definition, in sections 550 and 551, derives from paragraph 7 of Schedule 8 to ICTA.

2216. The second issue dealt with relates to the general rule mentioned in paragraph 2213: for there are cases where the general rule is supplemented by further rules. In these cases, which depend upon the employee or an associate receiving a payment from the employee benefit trust, the employee (or the associate) is treated as owning the "appropriate percentage" of the ordinary share capital of the company, in addition to any percentage of that share capital actually owned. These provisions, in sections 552 to 554, derive from paragraph 7(9) to (12) of Schedule 8 to ICTA.

Section 549: Application of this Chapter

2217. This section sets out the ambit of this Chapter. *Subsections (1)* to *(3)* are drafting additions, while *subsection (4)* derives from material in paragraph 7(3) and (12) of Schedule 8 to ICTA.

2218. In *subsection (4)(b)*, the words "the company which are subject to" have been added near the end of this provision. Although these words do not form part of paragraph 7(12), it is thought that they should have been included, and that the legislation is easier to understand if they are included. See *Note 54* in Annex 2.

2219. *Subsection (5)* provides that, in this Chapter, the term "employee" includes the holder of an office. This general proposition holds good for the employment income Parts (see section 5), but was disapplied for the purposes of Part 7 in section 421. However, the provisions of this Chapter are governed by the definition of the term "employment" in section 169(1) of ICTA, which includes an office, so the general proposition that an "employee" includes an office-holder has been reinstated.

Section 550: Meaning of "employee benefit trust"
2220. This section sets out the basic ingredients of an employee benefit trust, as follows:

- all or most of the employees of the company must be eligible to benefit; and
- apart from certain exceptions, there have been no disposals of property subject to the trust since 13 March 1989.

2221. This section derives from paragraph 7(5) of Schedule 8 to ICTA.

2222. *Subsection (4)* provides more information about the exceptions to the "no disposals since 13 March 1989" rule. Disposals that do not prevent the trust from being an employee benefit trust are either those made in the ordinary course of the management of the trust or "qualifying disposals", as defined in section 551.

Section 551: "Qualifying disposals" for purposes of section 550
2223. This section sets out that a "qualifying disposal" can be of any of the ordinary share capital of the company, or money paid outright, provided one of three conditions is met. This section derives from paragraph 7(6) and (7) of Schedule 8 to ICTA.

2224. The conditions mentioned are set out in *subsections (2), (4)* and *(5).*

2225. *Subsection (3)* is new. Although *subsection (2)* refers to "employees of the company", it is Inland Revenue practice to extend the benefit of this provision to employees of a subsidiary company (a subsidiary company being taken to mean a company under another company's control, with the word "control" taking the meaning in section 840 of ICTA). Subsection (3) reflects that Inland Revenue practice. See *Change 133* in Annex 1.

Section 552: Attribution of interest in company to beneficiary or associate
2226. This section sets out that in certain circumstances the individual (or an associate of the individual) is treated as owning the "appropriate percentage" of the company's ordinary share capital. It derives from paragraph 7(9) of Schedule 8 to ICTA.

2227. The relevant circumstances are that the individual in question (or an associate) has received a payment from the employee benefit trust since 13 March 1989 and the property subject to the trust included any ordinary share capital of the company at any time during the three years preceding that payment.

2228. The "appropriate percentage" of the company's ordinary share capital that the individual (or associate) is treated as owning in those circumstances is specified in section 553.

Section 553: Meaning of "appropriate percentage" for purposes of section 552
2229. This section sets out how the "appropriate percentage" is to be calculated. It derives from paragraph 7(10) of Schedule 8 to ICTA.

2230. There are a number of factors to be taken into account in working out the "appropriate percentage" of the company's ordinary share capital for the purposes of section 552. The main calculation consists of a straightforward fraction using "P" and "D" to signify the numbers to be fed into that fraction. The expressions "P" and "D", however, take rather more explaining.

2231. "P" is either the total of any payments received by the individual or associates from the trust during the 12 months up to and including the day the relevant payment is made (*subsection (2)*) or, if smaller, the distributions made by the company to the trustees of the employee benefit trust during the period of three years up to and including the day the relevant payment is made (*subsection (3)*).

2232. "D" is the aggregate distributions made during the three years preceding the relevant payment, divided by the number of years in which such distributions were actually made (*subsection (4)*).

2233. It is difficult to express the ideas in this calculation in simpler terms than those used in paragraph 7(10) of Schedule 8 to ICTA; but the section includes a mini method statement for the calculation of "D".

Section 554: Attribution of further interest in company
2234. This section sets out in that in certain circumstances the individual (or an associate of the individual) is treated as owning, not only the "appropriate percentage" of the company's ordinary share capital determined under section 552 but an additional percentage as well. It derives from paragraph 7(11) of Schedule 8 to ICTA.

2235. The "appropriate percentage" may be increased if the individual (or associate) receives payments from other trusts that own shares in the company. This section sets out in what circumstances the appropriate percentage may be so increased, and how to work out the total percentage of the company's share capital that the individual (or associate) is treated as owning.

2236. *Subsection (3)* sets out material that has no precise counterpart in ICTA; but its inclusion in this Act should make the legislation clearer.

Part 8: Former employees: deductions for liabilities
Overview
2237. This Part contains provisions that give relief for payments made against liabilities arising from a former office or employment. To qualify for relief those payments must be made in the run-off period defined in the provisions. This Part derives from the provisions in section 92 of FA 1995 but subsections (6) to (8) are

dealt as consequential amendments in paragraphs 217 and 219(2) of Schedule 6 to this Act. Subsection (10) is dealt with in sections 409 and 410 of this Act.

2238. In most instances there will not be any income from the relevant employment against which to set the payment incurred because that employment must have ceased. Relief for the payment is therefore given against total income. That contrasts with the corresponding provisions for similar payments incurred in an ongoing office or employment, found in sections 346 to 350 in Chapter 2 of Part 5 of this Act, which derive from section 201AA of ICTA. Under those provisions the payment can only be set against earnings from the employment that gives rise to the liabilities that led to the payment being incurred.

2239. Section 92 of FA 1995 operated by importing concepts from section 201AA of ICTA. This Part does not follow that approach and instead is as self-contained as possible.

Section 555: Former employee entitled to deduction from total income
2240. This section sets out the circumstances under which entitlement to a deduction arises. It derives from parts of section 92(1) and (5) of FA 1995.

Section 556: Deductible payments made outside the time limits allowed
2241. This section gives the start and finish dates of the run-off period referred to in the overview above. It derives from section 92(2)(a) of FA 1995.

2242. *Subsection (1)* is more precise than the source legislation about when the payment must be made. See *Change 134* in Annex 1.

Section 557: Deductible payments wholly or partly borne by the former employer etc.
2243. This section gives a method for determining the amount of any deduction due to a former employee in one of two circumstances where that employee has not paid or borne the whole of the cost of the payment personally. It derives from parts of section 92(4) and (5) of FA 1995.

2244. The first circumstance is that the former employer (as defined in section 563) of this Act has borne some or all of the cost involved. The second circumstance is that the cost has been met from the proceeds of a contract of insurance against the risk(s) that gave rise to the need to make the payment. A deduction for the payment involved is available only to the extent that the former employee has been treated as having received a relevant retirement benefit or post-employment earnings.

Section 558: Meaning of "deductible payment"
2245. This section derives from section 201AA(1), (7), (8) and (9) of ICTA and from section 92(2)(b) of FA 1995. It describes the different sorts of payments that can qualify as a deduction under this Part.

Section 559: Liabilities related to the former employment
2246. This section describes the types of liability that can give rise to payments that are eligible for relief. It derives from section 201AA(2) of ICTA and from section 92(2)(b) of FA 1995.

Section 560: Meaning of "qualifying insurance contract"
2247. This section describes the conditions that have to be met if an insurance contract is to fall within the scope of this Part. It derives from section 201AA(3)(a) to (d) and (4) of ICTA and from section 92(2)(b) of FA 1995.

2248. *Subsections (2)* to *(5)* state the conditions that have to be met for an insurance contract to come within section 558(1).

Section 561: Connected contracts
2249. This section describes what determines whether insurance contracts are connected with one another. It derives from section 201AA (5) and (6) of ICTA and from section 92(2)(b) of FA 1995.

2250. *Subsections (1)* to *(3)* define when insurance contracts are connected.

2251. *Subsections (4)* to *(7)* provide for that connection to be ignored in certain specified circumstances.

Section 562: Meaning of "former employee" and "employment"
2252. This section defines what is meant by a "former employee", giving some non-exhaustive examples of the sort of posts covered. It is based on and developed from the definition of "employment" in section 4 of this Act. It is sufficiently wide in scope to include what are commonly described as "shadow directors", as defined in the full out words of section 67(1) of this Act. See *Note 1* in Annex 2.

Section 563: Other interpretation
2253. This section contains definitions of some terms used throughout this Part. It derives from section 92(4) (part) and (9) of FA 1995.

2254. In particular this section has an extended definition of "former employer". See *Note 1* in Annex 2.

Section 564: Application of this Part to office-holders
2255. The provisions in this Part are written in terms of the "former employee". This section extends the provisions so that they apply equally to former office-holders. It echoes the provisions in section 5 of this Act. The section derives from part of section 92(4) and (9) of FA 1995. See *Note 1* in Annex 2.

Part 9: Pension Income
Overview
2256. This Part identifies the income that is taxed as pension income.

2257. The Part charges income described as a pension in the source legislation. It also charges other income that is in the nature of pension income but is not described as a pension in the source legislation.

2258. Different Chapters in the Part identify the various forms that pension income can take and set out the rules governing each form. For each category of income the Chapters specify the person liable to tax and the basis of the charge.

2259. There is no statutory definition of "pension" for tax purposes, although voluntary pensions are specifically included. So "pension" has its ordinary meaning. That is a very wide meaning. The definition of "pension" fills almost three columns of the Oxford English Dictionary.

2260. The Part sets out the exemptions that apply to income that would otherwise be chargeable. It also sets out the deductions that are allowed in calculating taxable pension income; payroll giving donations and the 10% deduction for certain overseas government pensions. The 10% deduction for foreign pensions is dealt with by cross-reference to section 65(2) of ICTA.

Chapter 1: Introduction
Overview
2261. This Chapter sets out the structure of the pension income Part.

Section 565: Structure of Part 9
2262. This is the only section in the Chapter. It is new.

2263. Chapter 2 imposes the charge and explains how exemptions and deductions are dealt with.

2264. Chapters 3 to 15 identify:

- what is chargeable - "pension income";
- how to calculate the amount chargeable - "taxable pension income"; and
- who is chargeable - the person liable for the tax.

2265. Chapters 16 to 18 identify a number of exemptions. All the exemptions apply for all income tax purposes and not just for the purposes of this Part.

Chapter 2: Tax on pension income
Overview
2266. This Chapter imposes the charge on "net taxable pension income" and explains how to calculate "net taxable pension income". There are four steps in the process:

- **Step one** - identify the income as pension income;
- **Step two -** exclude any exempt income;
- **Step three -** calculate the amount of "taxable pension income"; and
- **Step four -** calculate "net taxable pension income" by allowing certain deductions from "taxable pension income".

2267. These steps are carried out for each source of pension income separately; see paragraph 2275.

2268. The Chapter also includes a signpost to the various provisions that identify the person liable for any tax charged.

Section 566: Nature of charge to tax on pension income and relevant definitions
2269. This section identifies the different forms of pension income that are chargeable. It is new.

2270. "Pension income" is identified in *subsection (2).* Pension income includes not only pensions and annuities but other types of income that are in the nature of a pension. The types of pension income are listed in *subsection (4).* The length of the list reflects the variety of forms that pension income takes and the different ways in which those forms are treated for tax purposes.

2271. *Subsection (1)* provides that the charge on "pension income" does not apply to any exempt income. "Exempt income" is defined in *subsection (3)* to mean any income that is exempted from income tax by one of the sections in Chapters 16 to 18 of the pension income Part. This means that "exempt income" is included in the definition of "pension income" but is not taxed as pension income. This point is reinforced in section 567(4). See paragraph 2277.

2272. For example, section 641 (wounds and disability pensions) gives an exemption to various types of war pension. Those pensions fall within the ordinary meaning of United Kingdom pension in section 569 so they are included in "pension income" but because of the exemption they are not charged to tax.

Section 567: Amount charged to tax
2273. This section imposes the charge to tax and explains how the charge is calculated. It is new.

2274. *Subsection (1)* imposes the charge.

2275. *Subsection (2)* provides that the charge is imposed on "net taxable pension income". Each pension, annuity or other item of pension income is treated separately in the calculation of net taxable pension income. So, if a taxpayer receives two

occupational pensions, net taxable pension income is calculated for the income from each pension.

2276. *Subsection (4)(a)* explains that the amount of "taxable pension income" is given in the relevant section in Chapters 3 to 15. Each of those Chapters has a section entitled "taxable pension income". Those sections give the rules for calculating the amount of the "taxable pension income" for the income dealt with in the Chapter.

2277. *Subsection (4)(b)* makes it clear that "taxable pension income" does not include any exempt income. The definition of "exempt income" is in section 566(3).

Section 568: Person liable for tax
2278. This section is a signpost to the sections in Chapters 3 to 15 that identify the person liable to pay the tax charged. It is new.

Chapter 3: United Kingdom pensions: general rules
Overview
2279. This Chapter applies to United Kingdom pensions.

Section 569: United Kingdom pensions
2280. This section identifies pensions paid by or on behalf of a person who is in the United Kingdom as pension income. It derives from paragraph 3 of Schedule E (section 19(1) of ICTA) but it also covers payments taxed by paragraph 2 of Schedule E and section 133 of ICTA.

2281. *Subsection (1)* applies to any pension paid by or on behalf of a person who is in the United Kingdom. It derives from paragraph 3 of Schedule E (section 19(1) of ICTA). The territorial scope in this section is mirrored by section 573 (in Chapter 4), which taxes foreign pensions. That section applies to a pension paid by or on behalf of a person who is outside the United Kingdom. Together these two provisions ensure that all pensions paid by or to persons in the United Kingdom will be taxed.

2282. *Subsection (2)* limits the scope of the section. It applies only to pensions not identified by one of the specific provisions of the pension income Part. This gives the section the character of a sweep-up provision. Normally a sweep-up provision would come after the specific provisions. But that would not be the right approach here.

2283. One of the objectives of the pension income Part is to remove the overlap that exists in ICTA. Paragraph 3 of Schedule E (section 19(1) of ICTA) imposes a general charge on United Kingdom pensions. But there are also two provisions that impose a specific and overlapping charge on a United Kingdom pension. Section 597 of ICTA imposes a specific charge on pensions paid by approved retirement benefits schemes and paragraph 2 of Schedule E (section 19(1) of ICTA) imposes a specific charge on pensions paid by the Crown.

2284. To remove any overlap the pension income Part needs to identify discrete forms of pension income. The general provision in section 569 is subject to the sections that identify specific forms of pension income. This results in the sweep-up nature of section 569. But despite its sweep-up nature section 569 will apply to many taxpayers. For example, nearly all public sector pensions will be within this section. If the position of the section in the Part is to reflect its importance it needs to come before the sections that apply to specific types of pension income. Also, making the section the first of the provisions that identify pension income gives a natural opening to the pension income Part. It is immediately obvious that all United Kingdom pensions are to be taxed.

2285. *Subsection (3)* is a signpost to Chapter 4, which gives the general rules for foreign pensions. It is not possible for a pension to be a United Kingdom pension as defined in section 569(1) and a foreign pension as defined in section 573. This is because the qualifying conditions are mutually exclusive.

2286. The pension income Part does not rewrite paragraph 2 of Schedule E (section 19(1) of ICTA). That provision applies to annuities, pensions and stipends payable by the Crown or out of the public revenue. All these forms of income will be taxed in the general charge on United Kingdom pensions in section 569.

2287. "Annuity" in paragraph 2 of Schedule E (section 19(1) of ICTA) is used in the sense of a regular income payment rather than a purchased annuity. Given the wide meaning of "pension" an annuity payable by the Crown is a pension. So it is not necessary for this Act to rewrite a specific charge on annuities payable by the Crown.

2288. The charge on annuities in paragraph 2 of Schedule E (section 19(1) of ICTA) does not apply to any annuity taxed by paragraph (c) of Schedule D Case III (section 18(3) of ICTA). As the pension income Part has not rewritten the charge on annuities in paragraph 2 of Schedule E the reference to paragraph (c) of Case III is redundant. So it is not necessary for this Act to rewrite the reference to paragraph (c) of Schedule D Case III (section 18(3) of ICTA).

2289. Paragraph 2 of Schedule E (section 19(1) of ICTA) imposes a specific charge on a pension payable by the Crown or out of the public revenue. The pension income Part does not retain this specific charge. Either the payment is a pension or it is not. The fact that the payment is made by the Crown cannot make it a pension. A pension paid by or on behalf of a person in the United Kingdom will be taxed by section 569. It is not necessary for this Act to rewrite the specific charge on a pension payable by the Crown or out of the public revenue.

2290. Paragraph 2 of Schedule E (section 19(1) of ICTA) imposes a specific charge on a stipend payable by the Crown or out of the public revenue. A stipend paid by the Crown does not need particular identification. If a payment described as a stipend represents earnings as defined in section 62 it will be taxed as employment income. If the payment described as a stipend is not earnings it will fall within the ordinary

meaning of "pension". So it is not necessary for this Act to rewrite the specific charge on a stipend payable by the Crown or out of the public revenue.

Section 570: "Pension": interpretation
2291. This section ensures the charge applies to voluntary pensions. It derives from section 133(2) of ICTA.

2292. The scope of section 133(2) of ICTA has been considered in two tax cases. In Johnson v Holleran [1988] 61 TC 433 and Johnson v Farquhar [1991] 64 TC 395 it was held that section 133(2) of ICTA applies for all the purposes of Schedule E and not merely for the purposes of section 133(1).

2293. The effect of the section is that any pension paid by or on behalf of a person in the United Kingdom will be taxed even if there is no contractual right to receive the pension.

Section 571: Taxable pension income
2294. This section sets out the basis of assessment. It identifies the amount of taxable pension income, which feeds into the computation of net taxable pension income in section 567.

2295. The section derives from section 41 of FA 1989. That section provides that income taxed by paragraphs 2 and 3 of Schedule E (section 19(1) of ICTA) and section 133 of ICTA is charged on the amount accruing in the tax year. This means that the charge is calculated on the amount accruing from day to day without regard to when the income is actually paid.

Section 572: Person liable for tax
2296. This section identifies the person chargeable. It is new.

2297. The pension income Part includes income that ICTA taxes under Schedule E and income that ICTA taxes under Schedule D. For income taxed under Schedule D section 59(1) of ICTA identifies the person chargeable as the person "receiving or entitled" to the income.

2298. There is no equivalent of section 59(1) of ICTA for pensions that ICTA taxes under Schedule E. It would be inconsistent to identify a person chargeable for some but not all pension income. The pension income Part avoids this inconsistency. It makes the person liable for tax on pension income the person receiving or entitled to the income in all cases where ICTA did not specify the person chargeable. See *Change 135* in Annex 1.

Chapter 4: Foreign Pensions: general rules
Overview
2299. This Chapter applies to pensions paid by or on behalf of a person who is outside the United Kingdom.

Section 573: Foreign pensions

2300. This section identifies pensions paid by or on behalf of a person who is outside the United Kingdom as pension income. Taken together with section 569 this section ensures that all pensions paid by or to persons in the United Kingdom are taxed. It derives from sections 18(3) and 58(1) of ICTA, both of which create a charge under Schedule D Case V.

2301. *Subsection (1)* identifies the income that is within the section. It includes the restriction that the section applies only if the pension is paid to a person resident in the United Kingdom. As is the case for United Kingdom pensions there is no definition of "pension". The word has its ordinary meaning.

2302. *Subsection (2)* limits the scope of the section. The section applies only to pensions not identified in one of the specific provisions of the pension income Part. This is a similar structure to section 569 which covers pensions paid by or on behalf of a person who is in the United Kingdom. There are two reasons why the general charge on foreign pensions is subordinate to the specific charging provisions of the pension income Part.

2303. First, as for United Kingdom pensions, each section should identify a discrete source of pension income. To achieve this it is necessary to remove the overlap of the charging provisions in ICTA.

2304. Second, there are two sorts of pension paid by or on behalf of a person who is outside the United Kingdom that ICTA taxes under Schedule E rather than Schedule D Case V. The pension income Part has to deal specifically with those pensions in order to maintain the effect of ICTA. The two sorts affected are those taxed by section 580 (approved retirement benefits schemes) and section 615 (certain overseas government pensions).

2305. It is possible for an approved retirement benefits scheme to be operated by or on behalf of a person outside the United Kingdom. A pension or annuity paid by such a scheme is taxed by section 580. The payer is obliged to operate PAYE. The 10% deduction in section 65(2) of ICTA is not available for these pensions.

2306. Section 615 applies to a pension paid in the United Kingdom by or on behalf of certain overseas governments for service to those governments. In practice these pensions are paid by the Crown Agents. The Crown Agents operate PAYE when paying the pensions.

2307. *Subsection (3)* is a signpost to Chapter 3, which gives the general rules for United Kingdom pensions. It is not possible for a pension to be a foreign pension as defined in section 573(1) and a United Kingdom pension as defined in section 569(1). This is because the qualifying conditions are mutually exclusive.

Section 574: "Pension": interpretation
2308. This section ensures the charge applies to voluntary pensions. It derives from section 58(2) of ICTA.

2309. *Subsection (1)* identifies voluntary pensions using the same language that section 570 uses to identify United Kingdom voluntary pensions. But the rules for foreign voluntary pensions are slightly different from the rules for United Kingdom voluntary pensions. For a foreign voluntary pension there is no equivalent of section 133(2) of ICTA (see paragraph 2291). A foreign pension paid on a voluntary basis will be taxable only if it meets the conditions in section 58(2) of ICTA.

2310. *Subsections (2) and (3)* set out the conditions in section 58(2) of ICTA. The effect of the Interpretation Act 1978 is that the reference to "widow" in section 58(2)(b) of ICTA includes "widower". Subsection (2)(b) makes this effect explicit.

2311. *Subsection (4)* gives the meaning of "office". It applies section 5 in Part 2 (Employment Income: charge to tax).

Section 575: Taxable pension income
2312. This section deals with the basis of assessment. It identifies the amount of taxable pension income, which feeds into the computation of net taxable pension income in section 567. The section invokes sections 65, 68, 584 and 585 of ICTA. It is new.

2313. In ICTA the basis of assessment for a foreign pension is given by the rules of Schedule D Case V. The pension income Part does not repeat those rules but cross-refers the reader to them. The rules are in section 65 of ICTA and include the remittance basis. Section 65 is modified by the rules for Irish income in section 68 of ICTA. Sections 584 and 585 of ICTA are also relevant. Section 584 gives relief for income taxed on an arising basis if that income cannot be remitted to the United Kingdom. Section 585 gives relief for income taxed on a remittance basis if the remittances are delayed. There is a specific reference to retrospective payments of pension income in section 585(2) of ICTA.

Section 576: Person liable for tax
2314. This section identifies the person chargeable. It derives from section 59(1) of ICTA.

Chapter 5: United Kingdom social security pensions
Overview
2315. This Chapter identifies certain social security benefits as pension income. These are pensions that are paid in the form of social security benefits.

Section 577: United Kingdom social security pensions
2316. This section identifies the six United Kingdom social security benefits taxed as pension income.

2317. ICTA does not impose a specific charge on these social security benefits. They are taxed either by section 617 of ICTA as social security benefits or by paragraph 2 of Schedule E (section 19(1) of ICTA) as a pension.

2318. The charge on industrial death benefit and graduated retirement benefit derives from paragraph 2 of Schedule E (section 19(1) of ICTA). The charge on the other benefits derives from section 617(1) of ICTA.

2319. *Subsection (2)* describes each of the benefits by reference to the relevant provisions of the National Insurance Act 1965, the Social Security Contributions and Benefits Act 1992 and their Northern Ireland equivalents.

2320. The subsection includes all three categories of state retirement pension. Category A pensions are paid in respect of a person's own contributions. Category B pensions are paid in respect the person's spouse's contributions. Category D pensions are payable to persons over 80 years of age who do not qualify for a Category A or B pension.

Section 578: Taxable pension income
2321. This section sets out the basis of assessment. It identifies the amount of taxable pension income, which feeds into the computation of net taxable pension income in section 567.

2322. The section derives from section 41 of FA 1989. That section provides that income taxed by paragraph 3 of Schedule E (section 19(1) of ICTA) and section 617(1) of ICTA is charged on the amount accruing in the tax year. This means that the charge is calculated on the amount accruing from day to day without regard to when the income is actually paid.

Section 579: Person liable for tax
2323. This section identifies the person chargeable. It is new.

2324. In ICTA this income is taxed under Schedule E. It does not identify the person chargeable. This section identifies the person liable for tax on the benefits within Chapter 5 as the person receiving or entitled to the income. See *Change 135* in Annex 1.

Chapter 6: Approved retirement benefits schemes
Overview
2325. This Chapter identifies the payments made by approved retirement benefits schemes that are charged to tax as pension income.

Section 580: Pensions and annuities
2326. This section applies to pensions and annuities paid by an approved retirement benefits scheme.

2327. It derives from section 597 of ICTA.

2328. *Paragraph (a)* applies to pensions and annuities paid on retirement. It derives from section 597(1) of ICTA. The word "pension" in section 597(1) is subject to the interpretation rule in section 612(1) of ICTA that pension includes annuity. It also covers income drawdowns.

2329. *Paragraph (b)* derives from section 597(3) of ICTA, which deals with bought-out annuities. This paragraph applies to a number of annuities that are purchased through the operation of an approved retirement benefits scheme. For example, deferred annuities that satisfy the approval requirements in section 591(2)(g) of ICTA or annuities written on the winding-up of a scheme or to discharge a pension sharing order.

2330. It does not cover the case where a member of the scheme transfers the value of the benefits to an approved personal pension scheme and takes an annuity or income withdrawals from that scheme. Such an annuity or income withdrawal would be taxed by Chapter 8 of the pension income Part (Approved personal pension schemes).

2331. This section does not rewrite section 597(2) of ICTA. That provision is a transitional measure introduced when the basis of assessment switched from Schedule D Case III to Schedule E. It allows the Board to authorise the pension payer to continue to treat the annuity as if it were taxed under Schedule D Case III. This is to give the payer time to set up a PAYE scheme. This power is no longer needed.

2332. The section applies to all approved schemes as defined in section 586 including United Kingdom approved schemes operated by or on behalf of a foreign employer. There is no territorial restriction in section 597 of ICTA. So there is no territorial restriction on the operation of the section.

Section 581: Taxable pension income
2333. This section deals with the basis of assessment. It identifies the amount of taxable pension income, which feeds into the computation of net taxable pension income in section 567.

2334. The section derives from section 41 of FA 1989. That section provides that income taxed by section 597 of ICTA is charged on the amount accruing in the tax year. This means that the charge is calculated on the amount accruing from day to day without regard to when the income is actually paid.

Section 582: Person liable for tax
2335. This section identifies the person chargeable. It is new.

2336. In ICTA this income is taxed under Schedule E. It does not identify the person chargeable. The section identifies the person liable for tax on pensions and annuities within section 580 as the person receiving or entitled to the income. See *Change 135* in Annex 1.

Section 583: Unauthorised payments

2337. This section applies to unauthorised payments made by approved retirement benefits schemes. It derives from sections 599A(9) and 600 of ICTA.

2338. *Subsection (2)* prevents the section applying if the payment has been taxed by section 623 as a return of surplus funds from an additional voluntary contributions scheme. It derives from section 599A(9) of ICTA.

2339. *Subsection (3)(a)* identifies the type of scheme to which the section applies. It derives from section 600(1) of ICTA. The scheme must be approved when the unauthorised payment is made. The section applies to schemes approved under Chapter 1 of Part 14 of ICTA or its predecessor Chapter 2 of Part 2 of FA 1970.

2340. The pension income Part does not repeat the reference to schemes approved under Chapter 2 of Part 9 of ICTA 1970. These are former approved superannuation schemes that lost their approval in 1980. It is not necessary for this Act to rewrite the reference to these schemes.

2341. Paragraph (c) of section 600(1) of ICTA refers to schemes approved under section 208 of ICTA 1970. These are also former approved superannuation schemes that lost their approval in 1980. But they may still enjoy the advantages that come from approval if they satisfy the conditions in section 608 of ICTA. Section 608 has been rewritten in Chapter 7 of this Part (Former approved superannuation schemes). The charge on unauthorised payments made by those schemes is dealt with in that Chapter rather than here.

2342. *Subsection (3)(b)* gives the condition that the payment is not authorised by the scheme rules or made as a consequence of paragraph 33 of Schedule 6 to FA 1989. Paragraph 33 of Schedule 6 to FA 1989 applies to the return of employee additional voluntary contributions. It deems the rules of an additional voluntary contributions scheme to include a requirement to repay surplus funds whether or not such a payment is authorised by the scheme rules. The charge on the return of these funds is dealt with in Chapter 13 of this Part (Return of surplus additional voluntary contributions).

2343. *Subsection (4)* prevents the section applying to a pension or annuity. This avoids any overlaps with section 580.

2344. *Subsection (6)* prevents a double charge if the unauthorised payment is either a repayment of the employee's contributions or a commutation of the pension. If these payments exceed the benefits authorised by the scheme rules this Chapter will tax

them as unauthorised payments. Subsection (6) is needed to prevent the payments being taxed again by sections 598 or 599 of ICTA. Those provisions impose specific charges on the repayment of the employee's contributions or the commutation of the pension. The regulations referred to in subsection (6) apply to superannuation funds approved before 6 April 1980. These regulations are not yet obsolete.

2345. *Subsection (7)* clarifies the meaning of "payment". It derives from section 600(4) of ICTA.

Section 584: Taxable pension income

2346. This section sets out the basis of assessment for unauthorised payments. It identifies the amount of taxable pension income, which feeds into the computation of net taxable pension income in section 567.

2347. The section derives from sections 600(2) and (4) of ICTA.

Section 585: Person liable for tax

2348. This section identifies the person chargeable. It derives from section 600(2) of ICTA.

2349. The person liable for tax is the employee or the ex-spouse, no matter who received the payment.

Section 586: Meaning of "retirement benefits scheme" etc.

2350. This section invokes various definitions in ICTA.

2351. It derives from the interpretations in Chapter 1 of Part 14 of ICTA.

2352. *Subsection (1)* defines "retirement benefits scheme" and "approved".

2353. "Retirement benefits scheme" is defined in section 611 of ICTA as follows:

> In this Chapter **"retirement benefits scheme"** means, subject to the provisions of this section, a scheme for the provision of benefits consisting of or including relevant benefits, but does not include -
>
> (a) any national scheme providing such benefits; or
>
> (b) any scheme providing such benefits which is an approved personal pension scheme under Chapter IV of this Part.

2354. The definition of "approved" includes a reference to Chapter 2 of Part 2 of FA 1970. This is the legislation that introduced the new code for approved retirement benefits schemes. That code is now in Chapter 1 of Part 14 of ICTA.

2355. *Subsection (2)* deals with third party arrangements. It derives from section 612(2) of ICTA. It makes it clear that a pension or annuity paid through a third party is covered by section 580.

2356. *Subsection (3)* clarifies the meaning of "employer". It derives from section 612(2A) of ICTA.

Section 587: Application to marine pilots' benefit fund
2357. This section ensures that the provisions of Chapter 6 apply to a marine pilots' benefit fund. It derives from section 607 of ICTA.

2358. The purpose of the legislation is to allow self-employed marine pilots to belong to an occupational pension scheme. Such membership would normally be available only to employees.

2359. One effect of the applying the provisions of Chapter 6 to a marine pilots' benefit fund is that the Schedule D Case VI charge on unauthorised payments has been rewritten as a pension income charge. See *Change 136* in Annex 1.

Section 588: Meaning of "employee" and "ex-spouse"
2360. This section clarifies the meaning of "employee" and defines the meaning of "ex-spouse".

2361. *Subsection (1)* derives from the definition of "employee" in section 612(1) of ICTA and the definition of "ex-spouse" in section 659D of ICTA.

2362. *Subsection (2)* derives from the definition of "director" in section 612(1) of ICTA.

Section 589: Regulations
2363. This section allows the Board of Inland Revenue to make regulations for the administration of the charges identified in this Chapter. It derives from section 612(3) of ICTA.

Chapter 7: Former approved superannuation funds
Overview
2364. This Chapter identifies the payments made by former approved superannuation funds that are charged to tax as pension income.

Section 590: Annuities
2365. This section applies to annuities paid by former approved superannuation funds. It derives from section 608(4) of ICTA.

2366. "Former approved superannuation fund" means an occupational pension scheme that was approved under section 208 of ICTA 1970. These schemes lost their approval in 1980 when the code for retirement benefit schemes in Chapter 1 of Part 14

of ICTA took full effect. But section 608 of ICTA allows a scheme approved under section 208 of ICTA 1970 to remain exempt from income tax on its fund income provided two conditions are met. First, no further contributions are made into the scheme. Second, no changes are made to the scheme rules.

2367. The section uses the same language as section 580 to identify the arrangements under which the annuities are paid.

Section 591: Taxable pension income
2368. This section deals with the basis of assessment. It identifies the amount of taxable pension income, which feeds into the computation of net taxable pension income in section 567.

2369. The section derives from section 608(4) of ICTA.

2370. ICTA charges section 608(4) annuities under Schedule E. But they are not included in the list, in section 41 of FA 1989, of income that is taxed on the amount accruing in the tax year. The basis of assessment indicated in section 608(4) of ICTA is the annuity paid in the tax year. This section makes that basis of charge clear.

Section 592: Person liable for tax
2371. This section identifies the person chargeable. It is new.

2372. ICTA taxes this income under Schedule E. It does not identify the person chargeable. This section identifies the person liable for tax on annuities within section 590 as the person receiving or entitled to the income. See *Change 135* in Annex 1.

Section 593: Unauthorised payments: application of section 583
2373. This section applies to unauthorised payments from former approved superannuation funds. It derives from sections 599A(9) and 600 of ICTA.

2374. Section 600(1) of ICTA imposes a charge on:

> a payment made out of funds which are held for the purposes of a scheme which is approved for the purposes of -
>
> this Chapter; … or
>
> (c) section 208 … of the 1970 Act.

2375. Schemes can no longer be approved under section 208 of ICTA 1970. The present tense, "is approved", was introduced into the opening paragraph of section 600 of ICTA by Schedule 6 of FA 1989. It is used because subsection (1)(a) of section 600 applies to retirement benefits schemes approved under Chapter 1 of Part 14 of ICTA (dealt with by section 583 in Chapter 6 of this Part). But the charge

on unauthorised payments still applies to schemes approved under section 208 ICTA 1970. That charge is rewritten in this section so that this Chapter deals with all the charges on former approved superannuation funds.

2376. The rules in section 600 of ICTA that apply to former approved superannuation funds are the same as those that apply to approved retirement benefits schemes. Rather than repeating those rules this section applies sections 583, 584, 585 and 588.

2377. *Subsection (1)* identifies the payments to which section 593 is applied. The payment must not be authorised by the rules of the fund or be made as a consequence of paragraph 33 of Schedule 6 to FA 1989. The effect of paragraph 33 of Schedule 6 to FA 1989 is discussed in paragraph 2342.

2378. *Subsection (2)* prevents section 593 applying if the payment has been taxed by section 623 as a return of surplus funds from an additional voluntary contributions scheme. It derives from section 599A(9) of ICTA.

2379. *Subsection (3)* clarifies the meaning of payment. It derives from section 600(4) of ICTA.

Section 594: Meaning of "former approved superannuation fund"
2380. This section identifies the superannuation funds that are covered by this Chapter. It derives from section 608(1) of ICTA.

Chapter 8: Approved personal pension schemes
Overview
2381. This Chapter identifies the payments made by approved personal pension schemes or arrangements that are taxed as pension income.

Section 595: Annuities
2382. This section identifies annuities from approved personal pension schemes as pension income. It derives from section 648A of ICTA.

2383. The effect of section 648A(1)(b) of ICTA is preserved by a consequential amendment to section 18(1)(b) of ICTA. This amendment ensures that an annuity taxed in the pension income Part is not also taxed under Schedule D.

2384. Section 648A(2) of ICTA has not been rewritten as it is no longer needed. That provision is a transitional measure introduced when the basis of assessment switched from Schedule D Case III to Schedule E. It allows the Board to authorise the pension payer to continue to treat the annuity as if it were taxed Schedule D Case III. This is to give the payer time to set up a PAYE scheme. This power is no longer needed.

Section 596: Taxable pension income
2385. This section deals with the basis of assessment. It identifies the amount of taxable pension income, which feeds into the computation of net taxable pension income in section 567.

2386. The section is new. Tax is charged on the amount of the annuity received in the tax year. See *Change 137* in Annex 1.

Section 597: Person liable for tax
2387. This section identifies the person chargeable. It is new.

2388. ICTA taxes this income under Schedule E. It does not identify the person chargeable. This section identifies the person liable for tax on annuities within section 595 as the person receiving or entitled to the income. See *Change 135* in Annex 1.

Section 598: Income withdrawals
2389. This section identifies income withdrawals from approved personal pension arrangements as pension income. It derives from section 643(5) of ICTA.

Section 599: Taxable pension income
2390. This section deals with the basis of assessment. It identifies the amount of taxable pension income, which feeds into the computation of net taxable pension income in section 567.

2391. The section derives from section 643(5) of ICTA. It makes it clear that tax is charged on the total of the income withdrawals made in the tax year.

Section 600: Person liable for tax
2392. This section identifies the person chargeable. It is new.

2393. ICTA taxes this income under Schedule E. It does not identify the person chargeable. This section identifies the person liable for tax on income withdrawals within section 598 as the person receiving or entitled to the income. See *Change 135* in Annex 1.

Section 601: Unauthorised personal pension payments
2394. This section identifies unauthorised payments from personal pension schemes or arrangements as pension income. It derives from section 647 of ICTA.

2395. *Subsection (2)* defines "personal pension payment". It derives from section 647(1) of ICTA.

2396. *Subsection (4)* deals with the case in which the payment is made at a time when the scheme and the individual's arrangements are approved. It derives from

section 647(2)(a) of ICTA. A payment that is not authorised by the scheme rules is taxable.

2397. *Subsection (5)* deals with the case in which the payment is made at a time when the scheme is not approved. It derives from section 647(2)(b) of ICTA. A payment is taxable if it would not have been authorised by the rules of the scheme when the scheme was last approved.

2398. *Subsection (6)* deals with the case in which the payment is made at a time when the arrangements are not approved. It derives from section 647(2)(b) of ICTA. A payment is taxable if it would not have been authorised by the arrangements when the arrangements were last approved.

2399. *Subsection (7)* provides that "payment" includes non-cash payment. It derives from section 647(4) of ICTA.

Section 602: Taxable pension income

2400. This section deals with the basis of assessment. It identifies the amount of taxable pension income, which feeds into the computation of net taxable pension income in section 567.

2401. The section derives from section 647(3) of ICTA.

Section 603: Person liable for tax

2402. This section identifies the person chargeable. It derives from section 647(3) of ICTA.

Section 604: Meaning of "personal pension scheme" and related expressions

2403. This section cross-refers to various definitions and interpretations.

2404. It derives from section 630(1) of ICTA.

2405. The definition of "approved" in section 630(1) of ICTA is:

> (a) in relation to a scheme (other than an approved retirement benefits scheme), means approved by the Board under this Chapter; and
>
> (b) in relation to arrangements, means -
>
> (i) made in accordance with a scheme which is for the time being, and was when the arrangements were made, an approved scheme; or
>
> (ii) made in accordance with a scheme which is for the time being an approved converted scheme but which was, when the arrangements were made, an approved retirement benefits scheme
>
> but does not refer to cases in which approval has been withdrawn.

2406. The definition of "income withdrawal" in section 630(1) of ICTA is:

> a payment of income, under arrangements made in accordance with a personal pension scheme, otherwise than by way of an annuity.

2407. The definition of "personal pension arrangements" in section 630(1) of ICTA is:

> arrangements made by an individual in accordance with a personal pension scheme.

2408. The definition of "personal pension scheme" in section 630(1) of ICTA is:

> a scheme whose sole purpose is the provision of annuities, income withdrawals or lump sums under arrangements made by individuals in accordance with the scheme.

Chapter 9: Retirement annuity contracts

Overview

2409. This Chapter identifies annuities paid under a retirement annuity contract as pension income.

Section 605: Annuities

2410. This section applies to annuities paid under a retirement annuity contract. It derives in part from section 18(1)(a)(i) of ICTA and in part is new.

2411. "Retirement annuity contract" is a widely understood term although it is not defined in ICTA. It means a contract that satisfies the conditions for relief set out in Chapter 3 of Part 14 of ICTA. It has not been possible to enter into such a new contract since 1988. But premiums and annuities will be paid under existing contracts for many years to come.

2412. In ICTA there is no specific charge on annuities paid under retirement annuity contracts. The annuities are taxed by the ordinary rules of Schedule D Case III. The pension income Part creates a specific charge on annuities paid under retirement annuity contracts in the pension income Part for two reasons.

2413. First, retirement annuity contracts remain an important source of retirement income for the self-employed.

2414. Second, the specific charge will help to establish a clear boundary between those annuities that qualify for the relief given by section 656 of ICTA and those that do not. This point is particularly relevant for the purchased life annuities dealt with in Chapter 10. It is discussed in paragraphs 2425 and 2426 of the explanatory notes on that Chapter.

Section 606: Meaning of "retirement annuity contract"

2415. This section defines "retirement annuity contract". It derives from sections 620, 621 and 622(3) of ICTA.

2416. The term "retirement annuity contract" is not defined in ICTA or the Finance Acts. This section introduces a definition based on the conditions under which the premiums qualify for tax relief.

2417. *Paragraph (a)* applies to annuity contracts and trust schemes. It derives from sections 620 and 621 of ICTA. Section 620 applies to annuity contracts that have as their main object the payment of a retirement annuity to an individual. It also applies to trust schemes established to pay retirement annuities to an individual in an occupational group. Section 621 covers contracts to pay annuities to the spouse or dependant of the individual.

2418. *Paragraph (b)* applies to substituted contracts. It derives from section 622(3) of ICTA. Section 622 is concerned with the option to apply the accrued benefits arising from a maturing contract in taking out another contract. It is no longer possible to exercise this option to create a new retirement annuity contract. But annuities are still paid under substituted contracts. So a reference to substituted contracts is needed in the definition of "retirement annuity contract".

Section 607: Taxable pension income

2419. This section deals with the basis of assessment. It identifies the amount of taxable pension income, which feeds into the computation of net taxable pension income in section 567.

2420. It derives from section 64 of ICTA.

Section 608: Person liable for tax

2421. This section identifies the person chargeable. It derives from section 59(1) of ICTA.

Chapter 10: Other employment-related annuities

Overview

2422. This Chapter identifies various purchased life annuities as pension income. It applies to purchased life annuities in the nature of pension income that are not identified in other Chapters of the pension income Part.

2423. In ICTA there is no specific charge on the annuities included in this Chapter. They are taxed as annual payments under the ordinary rules of Schedule D Case III. There are two reasons for creating a specific charge on these annuities in the pension income Part.

2424. First, the pension income Part should include all the income in the nature of pension income.

2425. Second, it is the clearest way of dealing with sections 656 and 657 of ICTA.

2426. A purchased annuity includes a payment of income and an element that in economic terms is the return of capital. Section 656 of ICTA exempts the capital element of an annuity payment from income tax. But this relief is not given to the annuities listed in section 657(2) of ICTA. Those annuities are:

- annuities paid by the tax-advantaged schemes including those paid to give effect to pension sharing orders. The tax-advantaged schemes are approved retirement benefits schemes, approved personal pension schemes and retirement annuity contracts;

- annuities in the nature of pension income other than those paid by the tax-advantaged schemes; and

- annuities purchased in accordance with a direction in a will, or to provide for an annuity payable by virtue of a will or settlement out of income of property disposed of by the will or settlement.

2427. This Chapter taxes the annuities described in the second bullet in paragraph 2426. Other Chapters of the pension income Part tax the annuities described in the first bullet. This will allow section 657 of ICTA to be rewritten so it applies only to the annuities in the third bullet.

Section 609: Annuities for the benefit of dependants
2428. This section applies to annuities if their purchase qualified for relief under section 273 of ICTA. It derives in part from section 18(1)(a)(i) of ICTA and in part is new.

2429. *Subsection (1)* is new. It identifies the annuities as pension income.

2430. *Subsection (2)* derives from section 18(1)(a)(i) of ICTA. It limits the scope of the section if the annuity is a foreign annuity. Foreign annuities are taxable only if paid to persons resident in the United Kingdom.

Section 610: Annuities under sponsored superannuation schemes
2431. This section applies to an annuity purchased under a sponsored superannuation scheme. It derives in part from section 18(1)(a)(i) of ICTA and in part is new.

2432. *Subsection (1)* is new. It identifies the annuities to be taxed as pension income. To do this the section has to describe the process under which the annuities are paid. It does this using the same language that section 580 uses to identify annuities paid by approved retirement benefits schemes.

2433. *Subsection (2)* derives from section 18(1)(a)(i) of ICTA. It limits the scope of the section if the annuity is a foreign annuity. Foreign annuities are taxable only if they are paid to persons resident in the United Kingdom.

2434. *Subsection (3)* ensures there is no overlap with other sections in the pension income Part. The definition of "sponsored superannuation scheme" in section 624(1) of ICTA predates the introduction of approved retirement benefits schemes in Chapter 1 of Part 14 of ICTA. An approved retirement benefits scheme is likely to be within the definition of "sponsored superannuation scheme". In ICTA an annuity paid by an approved retirement benefits scheme is taxed under Schedule E. The annuities identified in this section are taxed under Schedule D. A Schedule E charge takes priority over a Schedule D charge. This subsection preserves that order of priority.

2435. *Subsection (4)* defines "sponsored superannuation scheme". It cross-refers to section 624(1) of ICTA. The definition of "sponsored superannuation scheme" in section 624(1) of ICTA is as follows:

> 'a sponsored superannuation scheme' means a scheme or arrangement -
>
> (a) relating to service in particular offices or employments, and
>
> (b) having for its object or one of its objects to make provision in respect of persons serving in those offices or employments against future retirement or partial retirement, against future termination of service through death or disability, or against similar matters,
>
> being a scheme or arrangement under which any part of the cost of the provision so made is or has been borne otherwise than by those persons by reason of their service (whether it is the cost or part of the cost of the benefits provided, or of paying premiums or other sums in order to provide those benefits, or of administering or instituting the scheme or arrangement).

Section 611: Annuities in recognition of another's services

2436. This section applies to an annuity purchased by any person in recognition of another's services. It derives in part from section 18(1)(a)(i) of ICTA and in part is new.

2437. *Subsection (1)* is new. It identifies the annuities to be taxed as pension income.

2438. *Subsection (2)* derives from section 18(1)(a)(i) of ICTA. It limits the scope of the section if the annuity is a foreign annuity. Foreign annuities are taxable only if they are paid to persons resident in the United Kingdom.

2439. *Subsection (3)* ensures there is no overlap with other sections in the pension income Part. An annuity paid by an approved retirement benefits scheme may be purchased in recognition of another's services. In ICTA an annuity paid by an approved retirement benefits scheme is taxed under Schedule E. The annuities identified in this section are taxed under Schedule D. A Schedule E charge takes priority over a Schedule D charge. This subsection preserves that order of priority.

2440. *Subsection (4)* gives the meaning of "office". It applies section 5 in Part 2 (Employment Income: charge to tax).

Section 612: Taxable pension income: UK annuities
2441. This section deals with the basis of assessment if the annuity arises from a source in the United Kingdom. It identifies the amount of taxable pension income, which feeds into the computation of net taxable pension income in section 567.

2442. The section derives from section 64 of ICTA.

Section 613: Taxable pension income: foreign annuities
2443. This section deals with the basis of assessment if the annuity arises from a source outside the United Kingdom. It identifies the amount of taxable pension income, which feeds into the computation of net taxable pension income in section 567.

2444. The section invokes sections 65, 68, 584 and 585 of ICTA. It is new.

2445. In ICTA the basis of assessment for a foreign pension is given by the rules of Schedule D Case V. The pension income Part does not repeat those rules but cross-refers the reader to them.

2446. *Subsection (4)* makes it clear that the 10% deduction in section 65(2) of ICTA and the relief in section 585(2) of ICTA apply to these annuities. See *Change 138* in Annex 1.

Section 614: Person liable for tax
2447. This section identifies the person chargeable for all the annuities in this Chapter. It derives from section 59(1) of ICTA.

Chapter 11: Certain overseas government pensions paid in the UK
Overview
2448. This Chapter identifies certain pensions paid in respect of government service overseas as pension income.

Section 615: Certain overseas government pensions paid in the United Kingdom
2449. This section derives from paragraph 4 of Schedule E (section 19(1) and section 133(2) of ICTA).

2450. Paragraph 4 of Schedule E imposes a charge on certain pensions paid by or on behalf of overseas governments to United Kingdom residents. It refers to a "pension or annuity". As in paragraph 2 of Schedule E "annuity" is used here in the sense of a regular income payment rather than a purchased annuity. The word "pension" has a wide meaning. An annuity taxed by paragraph 4 of Schedule E is within that meaning. It is not necessary for this Act to rewrite the reference to annuities.

2451. *Subsection (2)* identifies the categories of person to whom the pension must be paid. The effect of the Interpretation Act 1978 is that "widow" includes "widower".

The subsection incorporates this effect. The pension must be payable in respect of overseas government service.

2452. *Subsection (4)* identifies the countries covered by the section. It does this by reference to other legislation. In December 2002 the countries covered were:

(a) A country which forms part of Her Majesty's dominions. These are:

Anguilla, Bermuda, British Antarctic Territory, British Indian Ocean Territory, British Virgin Islands, Cayman Islands, Falkland Islands, Gibraltar, Montserrat, Pitcairn, Henderson, Ducie and Oeno Islands, St Helena, St Helena Dependencies (Ascension Island, Tristan da Cunha), South Georgia and South Sandwich Islands, Turks and Caicos Islands.

(b) Any other country mentioned in Schedule 3 of British Nationality Act 1981. These are:

Antigua and Barbuda, Australia, The Bahamas, Bangladesh, Barbados, Belize, Botswana, Brunei, Canada, Republic of Cyprus, Dominica, Fiji, The Gambia, Ghana, Grenada, Guyana, India, Jamaica, Kenya, Kiribati, Lesotho, Malawi, Malaysia, Maldives, Malta, Mauritius, Namibia, Nauru, New Zealand, Nigeria, Pakistan, Papua New Guinea, Saint Christopher and Nevis, Saint Lucia, Saint Vincent and the Grenadines, Seychelles, Sierra Leone, Singapore, Solomon Islands, South Africa, Sri Lanka, Swaziland, Tanzania, Tonga, Trinidad and Tobago, Tuvalu, Uganda, Vanuatu, Western Samoa, Zambia, Zimbabwe.

(c) Any territory under Her Majesty's protection. There are no such countries at present.

2453. The section does not identify the individual countries. This is because it would then be necessary to amend primary tax legislation to take account of any changes. A recent example is Hong Kong's change of status. The section follows the pragmatic approach of ICTA.

2454. *Subsection (5)* prevents the section applying to payments made by the United Kingdom government. The phrase "public revenue of the United Kingdom" is retained because it has a settled technical meaning. It means a payment out of the United Kingdom Consolidated Fund. The reference to Northern Ireland is needed because there is also a Northern Ireland Consolidated Fund.

2455. *Subsection (6)* defines "overseas government service". It derives from the definition of "relevant service" in paragraph 4 of Schedule E (section 19(1) of ICTA).

2456. *Subsection (7)* derives from section 133(2) of ICTA. That section extends the charge on pensions taxed under Schedule E to voluntary pensions. Section 133(2) applies to these overseas government pensions if any are paid on a voluntary basis.

Section 616: Taxable pension income
2457. This section deals with the basis of assessment. It identifies the amount of taxable pension income, which feeds into the computation of net taxable pension income in section 567.

2458. It derives from section 41 of FA 1989. Section 41 charges pensions on the amount accruing in the tax year. This means that the charge is calculated on the amount accruing from day to day without regard to when the income is actually paid.

Section 617 Deduction allowed from taxable pension income
2459. This section allows a deduction of 10% from the amount chargeable. It derives from section 196 of ICTA. The deduction feeds into the calculation of net taxable pension income in section 567(3).

Section 618: Person liable for tax
2460. This section identifies the person chargeable. It is new.

2461. In ICTA this income is taxed under Schedule E. ICTA does not identify the person chargeable. This section identifies the person liable for tax on pensions within section 615 as the person receiving or entitled to the income. See *Change 135* in Annex 1.

Chapter 12: House of Commons Members' Fund
Overview
2462. This Chapter identifies periodical payments granted out of the House of Commons Members' Fund as pension income.

Section 619: The House of Commons Members' Fund
2463. This section derives from section 613(3) of ICTA.

2464. The section will apply to a very small number of taxpayers, possibly no more than 100. The House of Commons Members' Fund was established in 1939. It was superseded by the Parliamentary Contributory Pension Fund in 1964. The 1939 fund continues to make grants to former Members and their dependants. These grants are described as "periodical payments".

2465. *Paragraph (a)* applies to grants made to former Members and their dependants who qualify for grants under the House of Commons Members' Fund Act 1939.

2466. *Paragraphs (b) and (c)* apply to grants made to former Members and their dependants who receive grants under section 4 of the House of Commons Members Fund Act 1948 because they do not qualify under the 1939 Act. These payments are made from sums appropriated from the fund and the income earned on those appropriated amounts.

2467. Section 613(1) and (2) of ICTA deal with Members' contributions to the fund. Because Members no longer pay these contributions it is not necessary for this Act to rewrite section 613(1) and (2).

Section 621: Taxable pension income
2468. This section deals with the basis of assessment. It identifies the amount of taxable pension income, which feeds into the computation of net taxable pension income in section 567.

2469. The section derives from section 613(3) of ICTA and makes it clear that tax is charged on the full amount paid in the tax year.

Section 622: Person liable for tax
2470. This section identifies the person chargeable. It is new.

2471. In ICTA this income is taxed under Schedule E. ICTA does not identify the person chargeable. This section identifies the person liable for tax on payments within section 619 as the person receiving or entitled to the income. See *Change 135* in Annex 1.

Chapter 13: Return of surplus employee additional voluntary contributions
Overview
2472. Members of retirement benefits schemes can boost the pensions they will receive by making additional voluntary contributions (AVCs). They may make AVCs to their employer's scheme or to a separate "free-standing" AVCs scheme. If these schemes are "approved" by the Inland Revenue the member is entitled to tax relief on the payments and the investment income of the scheme is exempt. If a scheme does particularly well it is possible for the total benefits available to a member to exceed the maximum benefits permitted under the approval rules. The scheme administrator then has to return surplus AVCs to the member. In paying back the surplus the administrator has to deduct a special tax charge (see section 599A(2) of ICTA) designed to recover the tax relief in respect of both the AVCs and the investment income.

2473. This Chapter is concerned with the treatment of the scheme member. If the scheme administrator has to return surplus AVCs the member is treated by section 595A(5) as having received the payment net of basic rate tax. This Chapter rewrites this charge as pension income. See *Change 139* in Annex 1.

Section 623: Return of surplus employee additional voluntary contributions
2474. This section identifies a return of surplus funds to a member of an exempt approved retirement benefits scheme or a relevant statutory scheme as pension income. It derives from sections 599A(1), (5), (9) and (10) of ICTA.

2475. *Subsection (4)* requires the payment to be to or for the benefit of an employee. The meaning of "employee" is extended by section 612(1) of ICTA to include future and former employees. This is made clear in section 628(1).

2476. Section 599A(1) of ICTA applies to payments made to or for the benefit of employees or their personal representatives. But section 599A(5) of ICTA applies only to payments made to or for the benefit of employees. For this reason the section makes no mention of personal representatives.

2477. *Subsection (5)* prevents the payments also being taxed as a repayment of the employee's contributions or as a commutation of the pension. It derives from section 599A(9) of ICTA. The section uses the same language as section 583(6). The regulations referred to in subsection (3)(b) apply to superannuation funds approved before 6 April 1980. These regulations are not yet obsolete.

2478. Section 599A(9) of ICTA gives this section priority over any charge under section 600 of ICTA. That rule has been included in the rewrite of section 600 as section 583(2).

Section 624: Taxable pension income
2479. This section sets out the basis of assessment. It identifies the amount of taxable pension income, which feeds into the computation of net taxable pension income in section 567.

2480. It derives from section 599A(5). Tax is charged on the grossed up amount of the payments made in the tax year.

Section 625: Person liable for tax
2481. This section identifies the person chargeable. It derives from section 599A(5) and (8) of ICTA.

Section 627: Meaning of "grossing up"
2482. This section explains what is meant by "grossing up". It is new. Although the concept of grossing up is familiar it is not explained in ICTA.

Section 628: Interpretation
2483. This section cross-refers to various definitions in ICTA. It derives from the interpretations given in Chapter 1 of Part 14 of ICTA.

2484. Subsection (1) clarifies the meaning of "employee". It gives the meaning of "exempt approved scheme" and "relevant statutory scheme" by cross-reference.

2485. "Exempt approved scheme" is defined in section 592(1) of ICTA as follows:

> This section has effect as respects -
>
> (a) any approved scheme which is shown to the satisfaction of the Board to be established under irrevocable trusts; or
>
> (b) any other approved scheme as respects which the Board, having regard to any special circumstances, direct that this section shall apply;
>
> and any scheme which is for the time being within paragraph (a) or (b) above is in this Chapter referred to as an 'exempt approved scheme'.

2486. "Relevant statutory scheme" is defined in section 611A(1) of ICTA as follows:

> In this Chapter any reference to a relevant statutory scheme is to -
>
> (a) a statutory scheme established before 14th March 1989, or
>
> (b) a statutory scheme established on or after that date and entered in the register maintained by the Board for the purposes of this section, or
>
> (c) a parliamentary pension scheme.

2487. *Subsection (2)* derives from the definition of "director" in section 612(1) of ICTA.

2488. *Subsection (3)* derives from section 599A(10) of ICTA and the definition of employee in section 612(1) of ICTA.

2489. *Subsection (4)* applies the definition of "office" in section 5(3) in Part 2 (Employment Income: charge to tax).

Chapter 14: Pre-1973 pensions paid under the Overseas Pensions Act 1973

Overview

2490. This Chapter identifies certain pensions paid since 6 April 1973 under the Overseas Pensions Act 1973 as pension income.

Section 629: Pre-1973 pensions paid under the Overseas Pensions Act 1973

2491. This section derives from section 616(3) of ICTA.

2492. Section 616(3) of ICTA was introduced to deal with a consequence of the Overseas Pensions Act 1973. Under the Overseas Pensions Act 1973 the United Kingdom government took responsibility for paying certain pensions previously paid by Commonwealth governments. This converted the pensions from foreign pensions taxed under Schedule D Case V to United Kingdom pensions taxed under Schedule E. This might have been to the taxpayer's disadvantage because the income could no longer be taxed on the remittance basis.

2493. The effect of section 616(3) of ICTA is to treat the pensions as if they are still paid by the overseas government. To qualify the pension must have been paid since 6 April 1973 to the original pensioner, or to the original pensioner's widow or widower.

2494. *Subsection (1)(b)* introduces the term "pre-1973 pension". That term is defined in section 630.

2495. *Subsection (2)* prevents the section applying to any part of the pension that is paid under the Pensions (Increase) Act 1971. These increases to the pension have always been paid by the United Kingdom government and have always been taxed as United Kingdom pensions.

Section 630: Interpretation

2496. This section defines various terms used in the Chapter. It derives from section 616(3) and (4) of ICTA.

2497. *Subsection (1)* defines "original pensioner". It derives from section 616(4) of ICTA. The pensioner must be the person whose service earned the pension and he or she must have retired before 6 April 1973.

2498. *Subsection (2)* defines "pre-1973 pension". The pension must have been paid since 6 April 1973 to the original pensioner or to the pensioner's widow or widower. The recipient must be resident in the United Kingdom.

Section 631: Taxable pension income

2499. This section deals with the basis of assessment. It identifies the amount of taxable pension income, which feeds into the computation of net taxable pension income in section 567.

2500. It derives from section 616(3) of ICTA and invokes sections 65 and 68 of ICTA.

2501. Section 616(3) of ICTA treats the pension as if the original overseas government or body paid it. This section adopts a different approach. The practical effect of section 616(3) is to tax the pension as a foreign pension. The section legislates the practical effect.

2502. In ICTA the basis of assessment for a foreign pension is given by the rules of Schedule D Case V. The pension income Part does not repeat those rules but cross-refers the reader to them. There is no cross-reference to sections 584 and 585 of ICTA. These sections will not apply if the United Kingdom government pays the pensions.

Section 632: Person liable for tax
2503. This section identifies the person chargeable. It derives from section 59(1) of ICTA.

Chapter 15: Voluntary annual payments
Overview
2504. This Chapter identifies voluntary annual payments as pension income.

Section 633: Voluntary annual payments
2505. This section derives from sections 58(2) and 133(1) of ICTA.

2506. Section 58 of ICTA imposes a charge on voluntary pensions and voluntary annual payments paid by or on behalf of a person outside the United Kingdom. Section 133 of ICTA imposes a charge on voluntary pensions and voluntary annual payments paid by or on behalf of a person in the United Kingdom. The charges on voluntary pensions have been rewritten in Chapters 3 and 4. These are the Chapters that deal with United Kingdom and foreign pensions generally. As voluntary annual payments are not pensions it is not appropriate to include them in Chapters that deal with pensions. So the charges on voluntary annual payments have been rewritten in a separate Chapter.

2507. The conditions for the section to apply are very similar to those that apply to foreign voluntary pensions. Those conditions have been rewritten in section 574 and are repeated in this section. The only difference is in subsection (4), which deals specifically with foreign voluntary annual payments. Subsection (4) restricts the charge to payments made to persons resident in the United Kingdom. This restriction is not needed in section 574 because the same effect is achieved by section 573.

Section 634: Taxable pension income: UK voluntary annual payments
2508. This section is concerned with the basis of assessment if the annual payment is paid by or on behalf of a person who is in the United Kingdom. It identifies the amount of taxable pension income, which feeds into the computation of net taxable pension income in section 567.

2509. The section derives from section 41 of FA 1989. That section provides that income taxed by section 133 of ICTA is charged on the amount accruing in the tax year. This means that the charge is calculated on the amount accruing from day to day without regard to when the income is actually paid.

Section 635: Taxable pension income: foreign voluntary annual payments
2510. This section deals with the basis of assessment if the annual payment is paid by or on behalf of a person who is outside the United Kingdom. It identifies the amount of taxable pension income, which feeds into the computation of net taxable pension income in section 567.

2511. It invokes sections 65, 68, 584 and 585 of ICTA. It is new.

2512. In ICTA the basis of assessment for a foreign pension is given by the rules of Schedule D Case V. The pension income Part does not repeat those rules but cross-refers the reader to them.

Section 636: Person liable for tax

2513. This section identifies the person chargeable for both United Kingdom and foreign source payments.

2514. For a payment made by or on behalf of a person who is in the United Kingdom the section is new. ICTA taxes this income under Schedule E. It does not identify the person chargeable. The section identifies the person liable for tax on annual payments within section 633 as the person receiving or entitled to the income. See *Change 135* in Annex 1.

2515. For a payment made by or on behalf of a person who is outside the United Kingdom the section is derived from section 59(1) of ICTA.

Chapter 16: Exemption for certain lump sums

Overview

2516. This Chapter is concerned with lump sums paid under tax-advantaged pension schemes.

Section 637: Exemption for lump sums provided under certain pension schemes etc.

2517. This section exempts lump sums paid under tax-advantaged pension schemes from income tax. It derives from section 189 of ICTA.

2518. A lump sum is not a pension. The exemption is included in the pension income Part because the payment of lump sums is a feature of many pension schemes.

2519. *Subsection (1)* provides the exemption. Section 620(3) of ICTA allows the Board of Inland Revenue to approve a retirement annuity contract that pays a lump sum in specified circumstances. These lump sums have always been considered to be tax-free. The section makes this clear by including these payments in the exemption. See *Change 140* in Annex 1.

2520. *Subsection (2)* limits the scope of the exemption. The exemption applies only if:

- the payment has been earned; or
- the taxpayer has lost his or her job or has suffered a loss of earnings and either event is due to ill health.

2521. This limitation is intended to prevent "golden handshakes" being paid as exempt lump sums.

2522. *Subsection (4)* limits the exemption given to lump sum payments made under retirement annuity contracts to payments that satisfy the conditions for approval in section 620(3) of ICTA.

2523. *Subsection (5)* defines and clarifies various terms used in the section. In part it is new and in part it derives from Part XIV of ICTA.

2524. "Approved personal pension arrangements" derives from section 630(1) of ICTA.

2525. "Personal pension arrangements" is defined in section 630(1) of ICTA as follows:

> arrangements made by an individual in accordance with a personal pension scheme.

2526. "Approved" in relation to personal pension arrangements is defined in section 630(1) of ICTA as follows:

> (i) [arrangements] made in accordance with a scheme which is for the time being, and was when the arrangements were made, an approved scheme; or
>
> (ii) made in accordance with a scheme which is for the time being an approved converted scheme but which was, when the arrangements were made, an approved retirement benefits scheme;
>
> but does not refer to cases in which approval has been withdrawn.

2527. The definition of "office" applies section 5 in Part 2 (Employment income: charge to tax).

2528. *Subsection (6)* defines "tax-exempt pension scheme". A scheme described in section 221(1) and (2) of ICTA 1970 is a former approved superannuation scheme. These schemes lost their approval in April 1980. But it is still possible for such a scheme to pay a lump sum and so the reference to these schemes is not obsolete.

2529. *Subsection (7)* defines "relevant statutory scheme", "retirement benefits scheme" and, in relation to retirement benefits schemes, "approved".

2530. Section 611A(1) of ICTA gives the meaning of "relevant statutory scheme" as follows:

> (a) a statutory scheme established before 14th March 1989, or
>
> (b) a statutory scheme established on or after that date and entered in the register maintained by the Board for the purposes of this section, or
>
> (c) a parliamentary pension scheme.

2531. Section 611(1) of ICTA gives the meaning of "retirement benefits scheme" as follows:

> 'retirement benefits scheme' means, subject to the provisions of this section, a scheme for the provision of benefits consisting of or including relevant benefits, but does not include -
>
> (a) any national scheme providing such benefits; or
>
> (b) any scheme providing such benefits which is an approved personal pension scheme under Chapter IV of this Part.

Chapter 17: Exemptions: any taxpayer

Overview

2532. This Chapter exempts various pensions from any charge to income tax. The exemption applies whether or not the taxpayer is resident in the United Kingdom.

2533. Four of the provisions rewritten in this Chapter, sections 315, 318, 330 and 617 of ICTA, provide that the "income shall not be treated as income for any income tax purpose". Either they use that phrase or a very similar form of words. Section 317 of ICTA, rewritten as section 638, provides that the income "shall be disregarded for all the purposes of the Income Tax Acts".

2534. In order to make the exemptions simple and consistent the phrase "no liability to income tax arises" is used throughout this Act to express exemption from tax. See *Note 28* in Annex 2.

Section 638: Awards for bravery

2535. This section exempts pensions and annuities paid to holders of various awards for bravery. It derives from section 317 of ICTA.

Section 639: Pensions in respect of death due to military or war service

2536. This section exempts pensions and allowances paid on death due to service in the armed forces, wartime service in the merchant navy or war injuries. It derives from section 318 of ICTA.

2537. *Paragraph (a)* applies to pensions and allowances paid in respect of both civilians and members of the armed forces. It derives from section 318(2)(a) of ICTA. Section 318(2) identifies the exempted pensions in general terms. This avoids the need to identify the specific schemes under which the pensions are paid. The section follows the pragmatic approach of section 318(2). This is because the pensions are paid under a range of schemes. It avoids the need to amend primary tax legislation every time a new scheme is introduced.

2538. *Paragraph (b)* applies to pensions and allowances paid in respect of members of the armed forces who died in peacetime service before the 1939–1945 war. It derives from section 318(2)(b) of ICTA.

2539. *Paragraph (c)* applies to pensions and allowances paid by countries outside the United Kingdom. It derives from section 318(2)(c) of ICTA.

Section 640: Exemption under section 639 where income withheld
2540. This section extends the exemption identified in section 639 if the pension or allowance is reduced because another pension or allowance is also payable. It derives from section 318(3) of ICTA.

Section 641: Wounds and disability pensions
2541. This section applies to wounds and disability pensions paid to members of the armed forces and civilians. It exempts the pensions from any charge to income tax. It derives from section 315 of ICTA.

2542. *Paragraphs (a) to (d) of subsection (1)* identify pensions paid to members of the armed forces. They are derived from section 315(2)(a) to (d) of ICTA. Section 315(2)(a) to (d) identifies the pensions in general terms. This avoids the need to identify each of the various schemes under which the pensions are paid. The section follows the pragmatic approach of section 315(2).

2543. The section uses the term "the armed forces of the Crown" rather than "the naval, military or air forces of the Crown". The two terms have the same meaning. They cover all United Kingdom service personnel, including members of the regular forces, the reserve forces and the women's services. The term has also been used in the rewrite of sections 197 and 316 of ICTA (sections 296 and 297).

2544. *Paragraphs (e) and (f) of subsection (1)* apply to pensions paid to civilians and members of the merchant navy who have been disabled as a result of war service. They are derived from section 315(2)(e) of ICTA. This Act does not rewrite the reference to the Injuries in War (Compensation) Act 1915 as there are no surviving beneficiaries of these schemes.

2545. *Paragraph (g) of subsection (1)* also applies to pensions paid to civilians and members of the merchant navy. This is new. It gives statutory effect to the practice of extending the exemption to pensions granted by schemes established under sections 3 to 5 of the Pensions (Navy, Army, Air Force and Mercantile Marine) Act 1939. See *Change 141* in Annex 1.

2546. *Subsection (2)* prevents the exemption applying to any amount not attributable to disablement or disability. It derives from section 315(3) of ICTA.

Section 642: Compensation for National-Socialist persecution
2547. This section exempts annuities and pensions paid by the German and Austrian Governments to victims of National-Socialist persecution. It derives from section 330 of ICTA.

2548. Paragraph 46 of Schedule 6 to this Act repeals the reference to section 330 of ICTA in section 65(2) of ICTA. The exemption means the reference is unnecessary.

Section 643: Malawi, Trinidad and Tobago and Zambia government pensions
2549. This section exempts certain pensions paid since 6 April 1973 in respect of government service in Malawi, Trinidad and Tobago and Zambia. It derives from sections 616(1) and (2) of ICTA.

2550. Sections 616(1) and (2) of ICTA were introduced in 1973 to deal with a consequence of the Overseas Pensions Act 1973. Under the Overseas Pensions Act 1973 the United Kingdom government took over responsibility for paying certain pensions previously paid by Commonwealth governments. In 1973 the United Kingdom had double taxation agreements in force with three countries under which government service pensions paid by those countries were exempt from United Kingdom tax.

2551. The effect of the Overseas Pensions Act 1973 was to make these pensions United Kingdom pensions. The benefit of the exemptions given by the double taxation agreements would have been lost if they had not been preserved in some way. Section 616(1) and (2) of ICTA preserved the exemptions by treating the pensions as if they were still paid by the original government. The practical effect is that the pensions are exempt as long as the relevant provisions of the double taxation agreement are unchanged. The section legislates the practical effect.

2552. *Subsection (5)* prevents the exemption applying to any part of the pension that is paid under the Pension (Increase) Act 1971. These increases have always been paid by the United Kingdom government and have always been taxed under Schedule E as United Kingdom pensions.

Section 644: Pensions payable where employment ceased due to disablement
2553. This section exempts disablement pensions paid solely as a consequence of work-related illness or accident or war injuries. It gives statutory effect to ESC A62. See *Change 142* in Annex 1.

2554. *Subsection (1)* applies the section to qualifying disablement pensions.

2555. *Subsection (2)* defines "disablement pension". It is a pension paid to a person who has left an employment because of disablement. The section does not apply to pensions paid by tax-approved pension schemes. These are approved retirement benefits schemes and former approved superannuation funds.

2556. *Subsection (4)* gives the meaning of "office". It applies section 5 in Part 2 (Employment income: charge to tax).

Section 645: Social security pensions: increases in respect of children
2557. This section applies to a social security benefit, taxed as pension income, if the benefit is increased because the recipient is responsible for a child. It derives from section 617(1)(b) of ICTA and ESC A24.

2558. *Subsection (2)* defines "social security pension". *Paragraph (a)* derives from section 617(1)(b) of ICTA. *Paragraph (b)* derives from ESC A24.

Section 646: Former miners etc: coal and allowances in lieu of coal
2559. This section applies to free coal and payments in lieu of free coal given to retired miners and their widow or widower. It gives statutory effect to an extension to ESC A6 published in paragraph SE 66695 of the Inland Revenue's Schedule E manual. See *Change 69* in Annex 1.

2560. *Subsection (2)* limits the scope of the exemption to the provision of free coal, or the payment of cash in lieu, of an amount that represents a reasonable level of personal consumption. But *subsection (3)* assumes that this condition is met unless the Inland Revenue can show that it is not. The purpose of these two subsections is to reproduce the restriction that applies to all ESCs - a concession will not be given where an attempt is made to use it to avoid tax.

2561. *Subsection (4)* gives the definition of "former colliery worker". The definition is the same as that in section 306.

Chapter 18: Exemptions: Non-UK resident taxpayers
Overview
2562. This Chapter exempts certain pensions paid to non-residents in respect of government service overseas.

Section 647: Introduction and meaning of "foreign residence condition" etc.
2563. This section describes the foreign residence condition that must be satisfied if the exemptions identified later in the Chapter are to apply. It also expands the meaning of pension. It derives from section 615 of ICTA.

2564. *Subsections (2) and (3)* deal with the foreign residence condition. The taxpayer must make a claim to the Board to be non-resident.

2565. *Subsection (4)* identifies various payments that are also treated as pension income for the purposes of this Chapter. It derives from the definition of pension in section 615(7) of ICTA.

Section 648: The Central African Pension Fund
2566. This section exempts pensions paid from the Central African Pension Fund. It derives from section 615(2)(f) of ICTA.

Section 649: Commonwealth government pensions
2567. This section exempts pensions paid by various Commonwealth governments from funds established in the United Kingdom. It derives from section 615(2)(b) of ICTA.

2568. *Subsection (2)* defines "Commonwealth government". The exemption does not apply to all the countries that are current members of the Commonwealth. But the term is not inaccurate because the section applies only to countries that have a former colonial connection to the United Kingdom.

2569. *Subsections (3), (4) and (5)* set out a number of other definitions used to establish the meaning of "Commonwealth government". The reference to "colony" in section 615(2)(b) of ICTA has been rewritten as "British overseas territory". This incorporates the change introduced into Schedule 1 to the Interpretation Act 1978 by section 1(3) of the British Overseas Territories Act 2002. Any reference to "colony" is now interchangeable with "British overseas territory".

Section 650: Oversea Superannuation Scheme
2570. This section exempts pensions paid under the Oversea Superannuation Scheme. It derives from section 615(2)(c) of ICTA, and corrects a small error in ICTA, which refers to this scheme as the "Overseas Superannuation Scheme".

2571. *Subsection (2)* cross-refers to the legislation under which the pensions must be paid. The schemes are now operated under the Overseas Pensions Act 1973.

Section 651: Overseas Pensions Act 1973
2572. This section exempts pensions paid under section 1 of the Overseas Pension Act 1973. It derives from section 615(2)(d) of ICTA.

2573. *Subsection (2)* prevents the exemption applying to any part of the pension paid under the Pensions (Increase) Acts. It derives from section 615(4) of ICTA. These increases have always been paid by the United Kingdom government and have always been taxed under Schedule E as United Kingdom pensions.

Section 652: Overseas Service Act 1958
2574. This section exempts pensions paid under the Overseas Service Act 1958. It derives from sections 615(2)(e) of ICTA.

2575. *Subsection (4)* cross-refers to the legislation under which the pensions must be paid. These schemes are now to be operated under the Overseas Pensions Act 1973.

2576. *Subsection (5)* requires the pensions to be paid in accordance with schemes made under the Overseas Pensions Act 1973. These are schemes that the Secretary of State certifies as corresponding to the 1958 Act. This subsection derives from section 615(8)(c) of ICTA.

2577. *Subsections (6) and (7)* give the conditions that must be satisfied for a person to be treated as employed in the service of an overseas territory. They are derived from section 615(9) and (10) of ICTA.

Section 653: Overseas Service Pensions Fund
2578. This section exempts pensions paid out of the Overseas Service Pensions Fund. It derives from section 615(2)(g) of ICTA.

2579. *Subsection (3)* extends the meaning of "pension" to include any gratuity or other sum payable in respect of ill health. It derives from the definition of "pension" in section 615(7) of ICTA.

Section 654: The Pensions (India, Pakistan and Burma) Act 1955
2580. This section exempts pensions paid under the Pensions (India, Pakistan and Burma) Act 1955. It derives from section 615(2)(a) of ICTA.

2581. In *subsection (2)(b)(ii)* "correspond to the provision made under the 1955 Act" is a reference to the provision for pensions to be paid.

2582. *Subsection (3)* prevents the exemption applying to any part of the pension that is paid under the Pension (Increase) Act 1971. These increases have always been paid by the United Kingdom government and have always been taxed under Schedule E as United Kingdom pensions.

Part 10: Social security income
Overview
2583. This Part identifies the income that is taxed as social security income. It derives mainly from section 617 of ICTA. It also derives from other provisions of the Income Tax Acts that deal with the taxation of social security income.

2584. Section 617 of ICTA contains the main rules and charges United Kingdom social security benefits to tax under Schedule E. It sets out in narrative form the various social security benefits that are charged to tax. It also identifies the benefits that are not charged to tax. And it provides that some of those benefits are not to be treated as income for any income tax purpose.

2585. Subsections (3) and (4) of section 617 of ICTA deal with whether social security contributions may be deducted for tax purposes. The sections in this Part deal only with the charging of benefits. So the rules about deductions are not rewritten here.

2586. The aim of the social security income Part is to set out all the rules charging or exempting benefits payable under the social security Acts. The approach is to list the benefits in two tables. One table lists the taxable benefits and the other lists the non-taxable benefits.

2587. The Part also sets out the charging and exemption rules that apply to foreign benefits.

Chapter 1: Introduction
Overview
2588. This Chapter sets out the structure of the social security income Part.

Section 655: Structure of Part 10
2589. This is the only section in the Chapter. It is new.

2590. *Subsection (1)* lists the other Chapters in the Part. It identifies the different Chapters that deal with United Kingdom and foreign social security benefits. In each case, different Chapters deal with the benefits that are charged to tax and those that are exempt.

2591. *Subsection (2)* is a signpost to three rules that apply to government payments but which are not dealt with in this Part. The rules are not rewritten in this Part because they may apply more widely than to social security income alone. For instance, a Treasury order under section 151 of FA 1996 may require that a benefit is taxed as a business receipt.

Chapter 2: Tax on social security income
Overview
2592. This Chapter imposes the charge on "net taxable social security income" and explains how to calculate "net taxable social security income". There are four steps in the process:

- **Step one** - identify the income as social security income;
- **Step two -** exclude any exempt income;
- **Step three -** calculate the amount of "taxable social security income"; and
- **Step four -** calculate "net taxable social security income" by allowing any payroll giving deductions from "taxable social security income".

2593. These steps are carried out separately for each United Kingdom and foreign social security benefit.

2594. The Chapter includes a signpost to the provisions that identify the person liable to pay any tax charged on United Kingdom and foreign social security benefits.

Section 656: Nature of charge to tax on social security income
2595. This section explains that the charge on social security income does not extend to income that is exempt from tax. It is new.

2596. Exempt income is included in the definition of social security income but is not taxed. The definition of "exempt income" applies for the purposes of the social security income Part. In particular, the expression is used in section 681(1) (taxable and other foreign benefits: exemptions).

Section 657: Meaning of "social security income", "taxable benefits" etc.
2597. This section introduces the terms which are used to identify the benefits that are taxable and to arrive at the amount of income that is charged to tax. It is new.

2598. *Subsection (2)* makes it clear that the expression "social security income" (used in section 656) includes both taxable benefits and those that are exempt.

2599. *Subsection (4)* ensures that the four statutory payments listed in section 660(2) are not included in social security income if they are charged to tax as employment income.

Section 658: Amount charged to tax
2600. This section imposes the charge to tax. It is new.

2601. The section explains how relief for payroll giving is allowed against social security income. The rules for the relief are in Part 12. Those rules depend on a definition of "taxable social security income" from which the payroll giving deduction ("PGD") is subtracted to arrive at the "net taxable social security income". That lower amount is the amount on which tax is charged.

2602. Each taxable benefit is treated separately in the calculation of net taxable social security income.

Section 659: Person liable for tax
2603. This section is a signpost to the sections later in the Part where the person liable for the tax is identified for United Kingdom and foreign benefits. It is new.

Chapter 3: Taxable UK social security benefits
Overview
2604. This Chapter sets out the rules for taxing United Kingdom social security benefits.

2605. The charge on United Kingdom social security benefits in ICTA is under Schedule E. The charge is under paragraph 5 of Schedule E (section 19(1) of ICTA):

> … any other provision of the Tax Acts directing tax to be charged under this Schedule …

2606. Section 150(a) of ICTA charges allowances under Job Release schemes. The last Order under the Job Release Act 1977 extended the effect of the Act to 29 September 1988. So this Act does not rewrite paragraph (a) of the section (or section 191 of ICTA). The other paragraphs, which charge statutory adoption pay,

statutory maternity pay, statutory paternity pay and statutory sick pay, are rewritten in this Act - see paragraph 2608.

2607. The Chapter sets out the income chargeable. It also identifies the basis of assessment and the person chargeable.

Section 660: Taxable benefits: UK benefits – Table A

2608. This section sets out the United Kingdom benefits that are taxable. It derives from section 617(1) of ICTA. That subsection deals with most United Kingdom benefits (some of which are taxed in Part 9 as pensions). The table in this section also lists other benefits that are not within section 617:

- statutory adoption pay, statutory maternity pay, statutory paternity pay and statutory sick pay, from section 150 of ICTA;
- income support, from section 151 of ICTA;
- jobseeker's allowance, from section 151A of ICTA; and
- incapacity benefit, from section 139 of FA 1994.

2609. *Subsection (1)* is the first of the tables ("Table A"). This table lists the taxable UK benefits. The second table ("Table B") is in section 677 – see paragraph 2682.

2610. The table identifies each benefit by the section of the social security Act under which it is paid. The table also identifies the corresponding Northern Ireland provision if it has been enacted. The suspension of the Northern Ireland Assembly has prevented the enactment of some proposed Northern Ireland provisions. Those provisions are described rather than identified in the table.

2611. The table arranges the benefits in alphabetical order. This means that a particular benefit should be easy to find. And it should be easy to maintain the clarity of the table because it will be easy to insert any new benefit into the table in the right place.

2612. Incapacity benefit is included in the table of taxable benefits. See *Change 143* in Annex 1.

2613. *Subsection (2)* is a special rule for statutory adoption pay, statutory maternity pay, statutory paternity pay and statutory sick pay. It derives from the opening words "if they would not otherwise be (chargeable)" in section 150 of ICTA.

2614. In most cases these payments are earnings from an employment and charged to tax under the employment income Parts of this Act. This subsection ensures that a charge under the employment income Parts takes precedence over a charge under the social security income Part.

2615. In other cases the payments are made by the government. Then there is no charge to tax on them as earnings and they are charged as social security income.

Section 661: Taxable social security income

2616. This section sets out the basis of assessment for some United Kingdom social security benefits. It derives from section 41(2) of FA 1989, which applies only to the benefits (and pensions) mentioned in section 41(1) of FA 1989.

2617. Incapacity benefit is explicitly brought within the rule in section 41 of FA 1989 by section 139(3) of FA 1994.

2618. Five benefits in Table A are not covered by the rule in section 41 of FA 1989. They are statutory adoption pay, statutory maternity pay, statutory paternity pay statutory sick pay (all charged to tax by section 150 of ICTA) and jobseeker's allowance (charged to tax by section 151A of ICTA). There is no statutory basis of assessment for these benefits in ICTA.

2619. So the section applies only to the first four benefits listed in Table A.

Section 662: Person liable for tax

2620. This section identifies the person chargeable. It is new.

2621. The rule in this section applies only to United Kingdom social security income. But an identical rule applies to foreign social security income – see section 680.

2622. The social security income Part includes income that ICTA taxes under Schedule E and income that ICTA taxes under Schedule D. For income taxed under Schedule D section 59(1) of ICTA identifies the person chargeable as the person "receiving or entitled" to the income.

2623. There is no equivalent of section 59(1) of ICTA for social security benefits that ICTA taxes under Schedule E. It would be inconsistent to identify a person chargeable for some but not all social security income. The social security income Part avoids this inconsistency. It makes the person liable for tax on social security income the person receiving or entitled to the income in all cases where ICTA does not specify the person chargeable. See *Change 135* in Annex 1.

Chapter 4 Taxable UK social security benefits: exemptions

Overview

2624. This Chapter sets out the partial exemptions that apply to the taxable benefits listed in Table A. It derives from sections 151, 151A and 617 of ICTA and section 139 of FA 1994.

2625. One exemption applies generally. That is the exemption for any part of a benefit that is in respect of a child. The other exemptions relate to part of the following benefits:

- incapacity benefit;
- income support; and
- jobseeker's allowance.

2626. This Chapter deals with the benefits that are sometimes taxable. Chapter 5 deals with the benefits that are never taxable.

2627. Section 617(2) of ICTA provides that payments within the subsection "shall not be treated as income for any purpose of the Income Tax Acts". In order to make the exemptions simple and consistent the phrase "no liability to income tax arises" is used throughout this Act to express exemption from tax. See *Note 28* in Annex 2.

Section 663: Long-term incapacity benefit: previous entitlement to invalidity benefit

2628. Long-term incapacity benefit is usually taxable. But this section exempts long-term incapacity benefit from tax in some circumstances. The section derives from section 139(2) and (5) of FA 1994.

2629. *Subsection (1)* exempts long-term incapacity benefit from tax if it relates to a period of incapacity for work that started before 13 April 1995. On 13 April 1995 incapacity benefit replaced sickness benefit and invalidity benefit.

2630. This provision has a limited life because no new claimants will be entitled to the exemption. But a significant number of claimants remain entitled to the exemption.

2631. *Subsection (2)* contains the definition of invalidity benefit. This was the expression used to describe invalidity pension and invalidity allowance. Neither sickness benefit nor invalidity benefit was taxable.

Section 664: Short-term incapacity benefit not payable at the higher rate

2632. This section limits the charge to tax on short-term incapacity benefit. It relies on definitions in the social security legislation. It derives from section 139(1)(a) of FA 1994.

2633. The charge on incapacity benefit in section 139 of FA 1994 excludes "benefit payable for an initial period of incapacity". That period is defined as a period for which short-term benefit is payable other than at the "higher rate".

2634. *Subsection (1)* restricts the charge to tax on short-term incapacity benefit so that it is taxable only if it is payable at the "higher rate".

2635. *Subsection (2)* cross-refers to the definition of "higher rate" in the social security legislation. The phrase is construed in accordance with section 30B(5) of the Social Security Contributions and Benefits Act 1992. That section refers to the rates of benefit set out in Schedule 4 to the Act. The benefit is payable at the "higher rate" after the first 196 days of a period of incapacity for work.

2636. As noted in paragraph 2608, incapacity benefit is charged to tax by section 139 of FA 1994. So it is logical for the benefit to be excluded from the charge in section 617 of ICTA. A free-standing charge was set up by section 139 of FA 1994 in case section 617(1) was not effective in taxing a new benefit – an explicit charge was thought to be safer.

2637. When incapacity benefit replaced sickness benefit and invalidity benefit in 1995, the references to the older benefits were not removed from section 617(1) of ICTA (some publishers have updated the text to help the reader). Instead, section 13(2) of the Social Security (Incapacity for Work) Act 1994 treats the references to sickness benefit and invalidity benefit in section 617(1)(a) as references to incapacity benefit. So incapacity benefit appears to be excluded from the charge in section 617 by subsection (1)(a).

2638. A consequence of exclusion from the section 617(1) charge would be that the benefit is not regarded as income for income tax purposes because of section 617(2)(c). This was overlooked when section 139 of FA 1994 set up the free-standing charge. So the benefit is apparently disregarded by section 617 of ICTA but clearly taxed by section 139 of FA 1994.

2639. This Act clarifies the law, to bring it into line with the clear, undisputed, policy objective (to tax incapacity benefit) and generally accepted practice. See *Change 143* in Annex 1.

Income support

Section 665: Exempt unless payable to member of couple involved in trade dispute

2640. This section derives from section 151(1)(b) of ICTA.

2641. It contains the basic rule that income support is taxable only if it is payable to a member of a couple and the claimant but not the claimant's partner is on strike. (Section 151 of ICTA refers to Part 5 of the Social Security Act 1986. In accordance with the Social Security (Consequential Amendments) Act 1992 that reference is to be read as being to section 126 of the Social Security Contributions and Benefits Act 1992. Some publishers have updated the text to help the reader). If both are on strike, there is no benefit "in respect of the relevant couple" (see paragraph 2651 and

section 668) and nothing is taxable. There is a similar rule for jobseeker's allowance in section 673 (see paragraph 2671).

2642. Sections 666 to 668 (see paragraphs 2645 to 2656) contain other limitations to the charge on income support.

2643. The section includes no reference to the rule in section 151(1)(a) of ICTA because, in the circumstances described in that paragraph (the application of the "available for work" test), income support is no longer payable. The claimant would now be entitled to jobseeker's allowance instead.

2644. So this Act does not rewrite the rule in section 151(1)(a) of ICTA which is no longer needed.

Section 666: Child maintenance bonus
2645. This section sets out the first restriction to the charge on income support. It derives from section 617(2)(ad) of ICTA.

2646. It deals with the exemption from tax for a child maintenance bonus paid under the Child Support Act 1995. That Act provides that the bonus is to be treated as income support (or jobseeker's allowance). So the exemption appears in this section. The corresponding exemption for a bonus treated as jobseeker's allowance is in section 670 – see paragraph 2659.

Section 667: Amounts in excess of taxable maximum
2647. This section deals with the second restriction to the charge on income support. It derives from section 151(3) of ICTA.

2648. *Subsection (1)* sets out the restriction. No more than the "taxable maximum" of the benefit is taxable. This term is used in section 151(3) of ICTA. The section retains it as a useful and clear label for the amount that has to be calculated by applying the rules in section 668.

Section 668: Taxable maximum
2649. This section sets out how to calculate the "taxable maximum", which is used in applying the restriction in section 667(1). The section derives from section 151(5) and (7) of ICTA. Those subsections tax only the part of the benefit that is attributable to the person involved in the strike.

2650. The rules are complicated because they have to deal with:

- amounts of income support that are attributable to persons other than the person involved in the strike; and

- benefit payable for a period of less than a week.

2651. *Subsections (1) and (2)* set out how to calculate the "taxable maximum" for a week. Subsection (1) is the rule for the simple case where the amount of income support derives from the circumstances of the couple alone. Subsection (2) is the rule for the case where the benefit includes amounts for other people, such as children or adult dependants.

2652. In either case the section restricts the tax charge to one half of the amount of the benefit attributable to the couple.

2653. The charge on income support is in section 151 of ICTA rather than section 617 of ICTA. So the general exemption for an increase in benefit for a child in section 617(1)(b) does not apply. But the definition of "taxable maximum" in section 151 ensures that any such increase is never taxed.

2654. Income support is included in the table of taxable United Kingdom benefits (section 660). So the general exemption for any increase in the benefit for a child applies (section 676). The sections exempt this increase twice: once in subsection (2) of this section in calculating the "taxable maximum" for income support, and again (generally) in section 676. This double exemption does not present any difficulties.

2655. *Subsection (3)* gives the method for calculating the "taxable maximum" if the benefit is payable for a period of less than a week. The section uses a method statement and a formula to make the rule easier to understand.

2656. It is not clear why a fraction of one-sixth is used in section 151(5) of ICTA. It was probably carried forward from the days of supplementary and unemployment benefit. The section uses one-seventh as the fraction. This brings the section into line with both the relevant social security regulations: regulation 73 of SI 1987 No 1967 (income support) and regulation 150 of SI 1996 No 207 (jobseeker's allowance). See *Change 144* in Annex 1

Section 669: Interpretation

2657. This section contains the meanings of the expressions used in sections 667 and 668. It is new.

- "Married couple" means a man and woman who are married to each other and are members of the same household.

- "Unmarried couple" means a man and woman who are not married to each other but are living together as husband and wife.

Jobseeker's allowance

Section 670: Child maintenance bonus

2658. This section sets out the first restriction to the charge to tax on jobseeker's allowance. It derives from section 617(2)(ad) of ICTA.

2659. The section deals with the exemption from tax for a child maintenance bonus paid under the Child Support Act 1995. That Act provides that the bonus is to be treated as jobseeker's allowance (or income support). So the exemption appears in this section. The corresponding exemption for a bonus treated as income support is in section 666 – see paragraph 2646.

Section 671: Amounts in excess of taxable maximum
2660. This section deals with the second restriction to the charge to tax on jobseeker's allowance. It derives from section 151A of ICTA.

2661. *Subsection (1)* sets out the restriction. No more than the "taxable maximum" of the benefit is taxable. This term is used in section 151A(2) of ICTA. The section retains it as a useful and clear label for an amount that has to be calculated by applying the rules in sections 672 to 674.

2662. There are two types of jobseeker's allowance: income-based and contribution-based. The amount of a contribution-based allowance is determined simply by the claimant's age. But a couple may also qualify for an income-based addition to a contribution-based allowance, to bring the allowance up to the amount of income support.

2663. In the case of a couple, the taxable maximum is based on what would have been payable to the couple as an income-based allowance.

2664. The rules are complicated because they have to deal with:

- the difference between an income-based allowance and a contribution-based allowance;
- amounts of jobseeker's allowance that are attributable to persons other than the claimant;
- a person involved in a strike being prevented from claiming the allowance; and
- an allowance payable for a period of less than a week.

Section 672: Taxable maximum: general
2665. This section sets out how to calculate the "taxable maximum", for use in section 671. It derives from section 151A(3) of ICTA.

Section 673: Taxable maximum: income-based jobseeker's allowance
2666. This section sets out how to calculate the "taxable maximum" for a week in the case of an income-based allowance. It derives from section 151A(4), (6) and (8) of ICTA.

2667. *Subsection (2)* sets out the rule for a single person. The taxable maximum is based on the amount of the contribution-based allowance which would have been payable to the person, excluding any amount of the allowance that is for other people such as children or adult dependants.

2668. *Subsection (3)* sets out the general rule for a member of a couple. The taxable maximum is the "applicable amount", excluding any amount of the allowance that is for other people such as children or adult dependants.

2669. The charge on an income-based jobseeker's allowance is in section 151A of ICTA rather than section 617 of ICTA. So the general exemption for an increase in benefit for a child in section 617(1)(b) does not apply. But the definition of "taxable maximum" in section 151A ensures that any such increase is never taxed.

2670. Jobseeker's allowance is included in the table of taxable United Kingdom benefits (section 660). So the general exemption for any increase in the benefit for a child applies (section 676). The sections exempt this increase twice: once in subsection (3) of this section in calculating the "taxable maximum" for jobseeker's allowance, and again (generally) in section 676. This double exemption does not present any difficulties.

2671. *Subsection (4)* sets out the special rule that applies if one member of a couple is involved in a strike. There is a similar rule for income support (see section 665).

Section 674: Taxable maximum: contribution-based jobseeker's allowance

2672. This section sets out how to calculate the "taxable maximum" for a week in the case of a contribution-based allowance. It derives from section 151A(5) and (7) of ICTA.

2673. *Subsection (2)* sets out the rule for a single person. The taxable maximum is based on the amount of the "age-related amount" applicable to the person, excluding any amount of the allowance that relates to other people such as children or adult dependants.

2674. *Subsection (3)* sets out the general rule for a member of a couple. The taxable maximum is based on the amount of the income-based allowance which would have been payable to the person, excluding any amount of the allowance that relates to other people such as children or adult dependants.

2675. The charge on a contribution-based jobseeker's allowance is in section 151A of ICTA rather than in section 617 of ICTA. So the general exemption for an increase in benefit for a child in section 617(1)(b) does not apply. But the definition of "taxable maximum" in section 151A ensures that any such increase is never taxed.

2676. Jobseeker's allowance is included in the table of taxable United Kingdom benefits (section 660). So the general exemption for any increase in the benefit for a

child applies (section 676). The sections exempt this increase twice: once in subsection (3) of this section in calculating the "taxable maximum" for jobseeker's allowance, and again (generally) in section 676. This double exemption does not present any difficulties.

Section 675: Interpretation
2677. This section contains the meanings of the expressions used in the rules in sections 671 to 674.

- The "applicable amount" is the "age-related amount", less some earnings and pension receipts. It is usually the level to which income is made up by income support.

- A "contribution-based jobseeker's allowance" is one based on the claimant's Class 1 contributions in the two years before the year of claim.

- An "income-based jobseeker's allowance" is one based on the claimant's income.

- "Married couple" means a man and woman who are married to each other and are members of the same household.

- "Unmarried couple" means a man and woman who are not married to each other but are living together as husband and wife.

Section 676: Increases in respect of children
2678. This section exempts the part of a benefit that is for a child. It derives from section 617(1)(b) of ICTA.

Chapter 5: UK social security benefits wholly exempt from income tax
Overview
2679. This Chapter sets out the United Kingdom benefits that are not charged to tax.

2680. This Chapter deals with the benefits that are never taxable. Chapter 4 deals with the benefits that are sometimes taxable.

Section 677: UK social security benefits wholly exempt from tax: Table B
2681. This section introduces and sets out the table ("Table B") of exempt benefits. It derives from section 617(1)(a) and (2) of ICTA.

2682. *Subsection (1)* introduces the second of the tables ("Table B"). This table lists the exempt United Kingdom benefits. The first table ("Table A") is in section 660 – see paragraph 2609.

2683. In order to make the exemptions simple and consistent the phrase "no liability to income tax arises" is used throughout this Act to express exemption from tax. See *Note 28* in Annex 2.

2684. Part 1 of the table identifies each benefit by the section of the social security Act under which it is paid. Part 2 of the table identifies the benefits that are paid under regulations. The table also identifies the corresponding Northern Ireland provisions.

2685. The table arranges the benefits in alphabetical order. This means that a particular benefit should be easy to find. And it should be easy to maintain the clarity of the table because it will be easy to insert any new benefit into the table in the right place.

2686. Disabled person's tax credit and working families' tax credit are abolished by section 1(3) of the Tax Credits Act 2002. They are not taxable. The exemption is preserved by paragraph 88 of Schedule 7 to this Act.

2687. *Subsection (2)* is a signpost to the special treatment of industrial death benefit. This benefit is part of industrial injuries benefit, which appears in Table B and is not generally taxable. But industrial death benefit is a pension and is charged to tax in the pension income Part.

Chapter 6: Taxable foreign benefits

Overview

2688. This Chapter sets out the rules for taxing foreign social security benefits.

2689. There is no explicit charge on foreign social security benefits in ICTA. But the benefits arise from rights under foreign social security law and those rights are "possessions out of the United Kingdom" (section 18(3) of ICTA). So the income is assessable under Schedule D Case V.

2690. This Act includes an explicit charge to tax on foreign social security benefits. See *Change 145* in Annex 1.

Section 678: Taxable benefits: foreign benefits

2691. This section identifies the foreign benefits that are taxable. The section is new. The taxable foreign benefits are part of "taxable benefits" (section 657(3)).

2692. *Subsection (1)(a)* uses words similar to those used in section 318(2)(c) of ICTA (war pensions) to identify the foreign benefits that are taxable. *Subsection (1)(b)* reproduces the territorial restriction in paragraph (a)(i) of Schedule D (section 18(1) of ICTA). A foreign social security benefit is charged to tax only if it is payable to a United Kingdom resident.

2693. *Subsection (2)* is a boundary rule. It provides that a foreign social security benefit that is also a pension is taxed only once, in the pension income Part. United

Kingdom benefits that are pensions are identified in the pension income Part and do not appear in Table A. So there is no overlap. But it is theoretically possible for a foreign benefit within this section to take the form of a pension. In that case, the boundary rule ensures that the benefit is charged as a pension and qualifies for the one-tenth deduction in section 65(2) of ICTA.

Section 679: Taxable social security income
2694. This section deals with the basis of assessment. It identifies the amount of taxable social security income, which feeds into the computation of net taxable social security income in section 658. The section invokes sections 65, 68, 584 and 585 of ICTA.

2695. In ICTA the basis of assessment for a foreign social security benefit is given by the rules of Schedule D Case V. The social security income Part does not repeat those rules but cross-refers the reader to them. The rules are in section 65 of ICTA and include the remittance basis. Section 65 is modified by the rules for Irish income in section 68 of ICTA. Sections 584 and 585 of ICTA are also relevant. Section 584 gives relief for income taxed on an arising basis if that income cannot be remitted to the United Kingdom. Section 585 gives relief for income taxed on a remittance basis if the remittances are delayed.

Section 680: Person liable for tax
2696. This section provides that the person chargeable is the person receiving or entitled to the income. It derives from section 59(1) of ICTA.

2697. Paragraph 2689 explains that the charge on foreign social security benefits in ICTA is under Schedule D. So section 59(1) of ICTA applies to charge the person receiving or entitled to the income.

Chapter 7: Taxable and other foreign benefits: exemptions
Overview
2698. This Chapter sets out the foreign benefits that are not charged to tax. It is new.

Section 681: Taxable and other foreign benefits: exemptions
2699. The section derives from ESC A24. This Act legislates the ESC that exempts certain foreign benefits from tax. In practice the ESC is applied not only to the benefits set out in the ESC but to all foreign benefits that correspond to exempt United Kingdom benefits. The section reflects this. See *Change 146* in Annex 1.

2700. In order to make the exemptions simple and consistent the phrase "no liability to income tax arises" is used throughout this Act to express exemption from tax. See *Note 28* in Annex 2.

2701. *Subsection (1)* deals with foreign benefits that correspond to the taxable UK benefits listed in Table A. It exempts the foreign benefits to the same extent that the

United Kingdom benefits are exempt income because of one of the rules in Chapter 4. The definition of "exempt income" is in section 656(2).

2702. *Subsection (2)* deals with the foreign benefits that correspond to the exempt UK social security benefits listed in Table B (in Chapter 5). These foreign benefits are not substantially similar to the taxable UK benefits listed in Table A. So they are not covered by subsection (1). But they are wholly exempt from tax. The phrase "no liability to tax" removes not only a charge under this Part but any charge to income tax.

Part 11: Pay As You Earn

Overview

2703. Part 11 provides for the Pay As You Earn system (generally known as "PAYE"). Under PAYE tax is deducted at source from payments made by employers and others. PAYE is the primary means of collecting income tax on PAYE income (broadly employment income, most pension income and social security income). The details are left for regulations made by the Board of Inland Revenue. This Part of the Act:

- provides the powers to make PAYE regulations and issue tax tables;
- extends PAYE to some persons and payments not otherwise covered; and
- allows alternatives to PAYE in some circumstances.

2704. *Chapter 1* introduces the Part and gives the meaning of "PAYE income".

2705. *Chapter 2* requires the Board of Inland Revenue to make regulations for the assessment and collection of income tax on PAYE income. These "PAYE regulations" may (among other things) require employers and others to deduct tax from payments of PAYE income.

2706. *Chapter 3* is the first of two Chapters dealing with special provisions. It covers sections which deal with special types of payer or payee.

2707. *Chapter 4* is the second Chapter dealing with special provisions. It deals with PAYE on the provision to employees of vouchers or of assets readily convertible into money, and the proceeds arising from share schemes.

2708. *Chapter 5* allows the PAYE regulations to provide for "PAYE settlement agreements" (PSAs) between employers and the Inland Revenue. Under these, employers can agree to meet the income tax liabilities of their employees on some expenses and benefits in kind. The agreement replaces the normal processes of PAYE and assessment.

2709. *Chapter 6* contains miscellaneous and supplemental material.

Approach taken in Part 11
2710. The legislation for PAYE spans over 50 years (see the history below). It is (and always has been) divided between primary legislation and regulations made by the Board. Part 11 does not change this broad division. It mainly:

- brings the legislation into consistent, more modern language;
- breaks up some long, complex sections in ICTA to help readers see what is done where;
- rearranges provisions to bring together at the start the main powers for the Board to make regulations and to reveal better the result of changes since the consolidation in 1988;
- brings into the primary legislation some provisions from regulations in order to give readers a more complete set of provisions in this Part; and
- omits material which is now redundant.

Added material
2711. Section 692 is new. It deals with organised arrangements for sharing tips which are not dealt with in ICTA but only in the PAYE regulations (see regulation 5 of SI 1993 No 744).

2712. But the main additions to the sections are from the regulations for notional payments (the Income Tax (Employments) (Notional Payments) Regulations 1994, SI 1994 No 1212). Much of those regulations is incorporated in sections 693 to 695, 697, 701, 702 and 710. The balance will be incorporated in the PAYE regulations. This changes neither the law nor practice as this Act reproduces the regulations currently in force. The only effect is that the primary legislation, unlike the regulations, will not be capable of amendment by regulations made by the Board; and that readers have all the PAYE legislation in just two chunks - this Part and the PAYE regulations.

Omitted material
2713. This Part also omits some bits of legislation which, on close examination, are now not necessary. The commentary on each section gives details of minor omissions. But there are two other bits of legislation which are omitted altogether.

Section 139(4) of FA 1994
2714. The first is section 139(4) of FA 1994 which is unnecessary. See *Note 56* in Annex 2.

Section 205(1) to (3) and (5) of ICTA
2715. The second is section 205(1) to (3) and (5) of ICTA. Section 205(1) to (3) of ICTA provides that an assessment of income need not be made in certain cases. The

introduction of self assessment for income tax made that redundant. See *Note 62* in Annex 2.

Background

2716. PAYE is the biggest part of the income tax system; and for many people their only contact with income tax. There are 1.5 million PAYE schemes operated by employers, pension providers and others. They deal with around 35 million employments, offices, pensions and so on. (In the rest of the commentary on Part 11, as in the PAYE regulations, "employee" is generally used to mean anyone getting income within the scope of PAYE. "Employer" and "employment" should generally be read accordingly.) Most of the £160 billion income tax and national insurance contributions collected by the Inland Revenue comes through PAYE.

2717. The core of PAYE is deduction at source. This means that employers deduct tax when they make payments to employees. The amount they deduct depends on:

- PAYE tables issued by the Inland Revenue for employers and employees generally;
- a PAYE code issued by the Inland Revenue for each individual employee and employment; and
- the amount the employer pays and (usually) the cumulative total of previous payments in the tax year.

2718. The PAYE code:

- gives each employee the allowances and reliefs to which they are likely to be entitled for the tax year;
- subtracts any allowances needed to cover other employment income – eg benefits in kind such as company cars; and
- can also collect underpayments of tax from earlier years.

2719. As a result the majority of employees never have to make a lump sum payment to the Inland Revenue. Employees remain liable for income tax on the basis of their income for the tax year. But PAYE deductions from their income are in effect "payments on account" of that tax bill. So more often than not employees end the year having paid the right amount of tax or near enough the right amount for the difference to be dealt with by collecting an underpayment through PAYE in a later year (or by repaying employees if it turns out too much has been deducted).

2720. The PAYE tables give employees an equal share of their allowances and reliefs each week or month. Combined with the way PAYE deductions are usually

worked out using the total payments to date (the "cumulative basis") this means that employees:

- pay tax evenly over the year; and
- are far more likely to pay the right amount of tax by the end of the year.

2721. These were objectives of PAYE from the outset.

History

2722. Deductions from pay by employers have been part of the income tax system for a very long time. For example in 1803 tax on emoluments from public offices and employments of profit was actually assessed on the employer. The employer was, however, entitled to deduct it from the salary. But the real history of PAYE as such starts in the Second World War.

2723. At the start of the war, manual workers and many other employees paid tax direct to the collector at half-yearly intervals. Manual workers were permitted to spread the payments over 13 weeks by buying "income tax stamps". But employers were not involved in this system.

2724. The war saw a big increase in both the number of employees paying tax and in the rates of tax. Many found this hard. This led to the introduction in F(No. 2)A 1940 of arrangements for employers to deduct Schedule E tax from pay. These arrangements were widened in 1942 to any weekly wage-earners. But they were nothing like PAYE. The tax was still assessed every six months by the Inland Revenue. The Inland Revenue then told employers how much to deduct.

2725. This left a lot of problems. Payment lagged on average some ten months behind earnings. So tax due on high earnings (for example when doing a lot of overtime) could end up being deducted when earnings were low. Changes of job (from higher to lower earnings) were another obvious source of difficulties. All this led to a search for a system of deductions from "current earnings". And one which did not deduct too much – leaving perhaps millions of people to have less to live on while they waited for a repayment after the end of the year.

2726. These problems were discussed in a White Paper in 1942 (Cmd. 6348). That favoured sticking with pretty much the system of deductions in arrears despite its problems. But the reactions to that White Paper (and the fact that both the USA and Canada had come up with systems of deduction based on current earnings) led to a change of views. Another White Paper in 1943 (Cmd. 6469) proposed what is recognisably the current PAYE system. Crucially it involved deductions based on the *cumulative* pay and tax deducted in the year. (This is still the feature which distinguishes PAYE in the United Kingdom from most other countries' PAYE system. All major developed countries other than France have some system of deduction of tax by employers from wages and salaries. That in the United Kingdom

is at the far end of the spectrum in *requiring* cumulative calculations and in the sophistication of its codes and procedures for trying to keep codes up to date.)

2727. The system was proposed only for weekly-wage earners and pensions paid by their former employers. But the legislation introduced in 1943 was extended, in response to representations, during the passage of the Bill to others earning less than £600 a year. It was enacted as the Income Tax (Employments) Act 1943 (6&7 Geo. 6. (1942-43) c.45). The core provisions of the 1943 Act are recognisably the source of the current PAYE *vires* in section 203 of ICTA:

Income Tax (Employments) Act 1943 (6&7 Geo. 6. (1942-43) c.45)

Basis of charge and method of collection of income tax on certain emoluments

1.–(1) Income tax for the year 1944-45 or any subsequent year of assessment shall be assessed and charged in respect of the emoluments specified in subsection (2) of this section on the amount of those emoluments for the year; and, on the making of any payment of, or on account of, any such emoluments made during the year 1944-45 or any subsequent year of assessment, income tax shall, subject to and in accordance with the regulations made by the Commissioners of Inland Revenue under section two of this Act, be deducted and repaid by the person making the payment, notwithstanding that when the payment is made no assessment has been made in respect of the emoluments.

…

Regulations of Commissioners of Inland Revenue

2–(1) The Commissioners of Inland Revenue shall make regulations with respect to the assessment, charge, collection and recovery of income tax in respect of emoluments to which this Act applies, being tax for the year 1944-45 or any subsequent year, and those regulations may, in particular, include provision—

(a) for requiring any person making any payment of, or on account of, any such emoluments, when he makes the payment, to make a deduction or repayment of income tax calculated by reference to tax tables prepared by the Commissioners of Inland Revenue, and for rendering persons who are required to make any such deduction or repayment accountable to, or, as the case may be, entitled to repayment from, those Commissioners;

(b) for the production to and inspection by persons authorised by those Commissioners of wages sheets and other documents and records for the purpose of satisfying themselves that income tax has been and is being deducted, repaid and accounted for in accordance with the regulations;

(c) for the collection and recovery, whether by deduction from emoluments paid in any later year or otherwise, of income tax in respect of emoluments to which this Act applies which has not been deducted or otherwise recovered during the year;

(d) for the assessment and charge of tax by the surveyor in respect of emoluments to which this Act applies; and

(e) for appeals with respect to matters arising under the regulations which would otherwise not be the subject of an appeal,

and any such regulations shall have effect notwithstanding anything in the Income Tax Acts:

Provided that the said regulations shall not affect any right of appeal to the General or other Commissioners which a person would have apart from the regulations.

(2) The said tax tables shall be constructed with a view to securing that, so far as possible—

(a) the total tax payable in respect of any emoluments assessable under Schedule E for any year of assessment is deducted from the emoluments paid during that year; and

(b) the tax deductible or repayable on the occasion of any payment of, or on account of, emoluments is such that the total net tax deducted since the beginning of the year of assessment bears to the total tax payable for the year the same proportion that the part of the year which ends with the date of the payment bears to the whole year.

In this subsection the references to the total tax payable for the year shall be construed as references to the total tax, other than surtax, estimated to be payable for the year in respect of the emoluments, subject to a provisional deduction for allowances and reliefs, and subject also, if necessary, to an adjustment for amounts overpaid or remaining unpaid on account of income tax in respect of emoluments to which this Act applies for any previous year (including any year previous to the year 1944-45).

For the purpose of estimating the total tax payable as aforesaid, it may be assumed in relation to any payment of, or on account of, emoluments, that the emoluments paid in the part of the year of assessment which ends with the making of the payment will bear to the emoluments for the whole of that year the same proportion as that part of the year bears to the whole year.

…

2728. The scope of PAYE was then further extended, before the system had come into operation, by the Income Tax (Offices and Employments) Act 1944 (7&8 Geo. 6. (1943-44) c.12) to all emoluments assessable under Schedule E (other than those payable for the armed forces)

The Income Tax (Offices and Employments) Act 1944 (7&8 Geo. 6. (1943-44) c.12)

Extension of principal Act (subject to exceptions) to all emoluments taxable under Schedule E

1–(1) Subject to the provisions of this Act, the Income Tax (Employments) Act, 1943 (hereafter in this Act referred to as "the principal Act") shall extend to all emoluments assessable to income tax under Schedule E, other than pay, pension or other emoluments payable in respect of any service in or with the armed forces of the Crown, and accordingly that Act shall have effect as if for subsections (2) to (4) of section one thereof there were substituted the following subsection –

"(2) The said emoluments (hereafter in this Act referred to as "emoluments to which this Act applies") are all emoluments assessable to income tax under Schedule E, other than pay, pension or other emoluments payable in respect of any service in or with the armed forces of the Crown".

2729. Both the 1943 and 1944 Acts were short and contained mainly transitional provisions. The details of PAYE were then, as now, left for regulations made under section 2 of the 1943 Act.

The scope of PAYE

2730. The scope of PAYE was extended by subsequent Acts to all income assessable under Schedule E; and the scope of Schedule E was itself also extended. Highlights were:

- section 27 of FA 1946 and section 24 of FA 1949 taxed as emoluments chargeable under Schedule E various National Insurance benefits;

- section 30(3) of FA 1946 extended PAYE to the armed forces for 1947-8 and subsequent years;

- section 38 of FA 1948 treated certain payments of expenses and benefits in kind as emoluments assessable under Schedule E and so brought them within the scope of PAYE;

- section 10 of FA 1956 moved foreign employments from Case V of Schedule D to Schedule E;

- sections 37 and 38 of and Schedule 4 to FA 1960 charged under Schedule E (and so brought within PAYE) some termination payments – the pre-cursor of section 148 of ICTA;

- Schedule 4 to the Income Tax Management Act 1964 amended sections 157 and 158 of ITA 1952 (as the PAYE provisions had become on consolidation) to include in the meaning of emoluments all income assessable to tax under Schedule E. This brought non-approved retirement benefits within PAYE and removed doubts about the treatment of certain pensions;

- section 25 of FA 1966 charged under Schedule E any gain on the exercise of a share option obtained as an employee when the option is exercised (see now section 135 of ICTA);

- further charges were introduced in sections 79 to 89 of FA 1972 on shares acquired as a result of rights employees get by reason of their employment (some of which were then removed or replaced by sections 77–80 of FA 1988);

- section 38 of F(No. 2)A 1975 brought agency workers within Schedule E in 1975 – mainly so as to apply PAYE to their pay;

- section 30 of FA 1981 (see now section 149 of ICTA) made taxable under Schedule E any sick pay paid by reason of the employment as a result of arrangements entered into by the employer if it would not already be taxable;

- other reliefs and exemptions from time to time to encourage share ownership and/or employee participation also give rise to charges and may require the

trustees of the scheme to operate PAYE: see for example Schedule 8 to FA 2000;

- section 27 of FA 1981 made unemployment benefit taxable as Schedule E income;

- section 29 of and Schedule 3 to FA 1987 (see now section 151 of ICTA) taxed some payments of income support as Schedule E income;

- section 139(1) and (3) of FA 1994 made incapacity benefit taxable under Schedule E (with important exceptions); and

- the Jobseekers Act 1995 inserted section 151A of ICTA which made jobseeker's allowance (broadly the successor to unemployment benefit) Schedule E income.

2731. The point of this selective list is two-fold:

- PAYE extends to much more than "ordinary" wages and salaries; but

- PAYE copes with all this (and more) because something either is or is not income assessable under Schedule E; and either is or is not a payment of such income.

What is and is not a payment for PAYE

2732. The distinction between what is and is not a *payment* of Schedule E income matters because:

- a person making a payment of Schedule E income must, subject to the PAYE regulations, deduct tax in accordance with the regulations;

- a person providing income without making a payment does not have to deduct tax (but may still have to comply with requirements in the regulations to report it – for example the report of benefits in kind and expenses on form P11D).

2733. The boundary between what is and is not a payment was used to avoid PAYE (often as part of attempts also to avoid National Insurance Contributions). This led to legislation to treat income as paid – mainly in:

- section 127 of FA 1994 which inserted section 203F to 203L of ICTA. These, broadly speaking, treated as payments any income provided in the form of tradeable assets; and

- section 65 of FA 1998 which amended and extended the 1994 legislation to cover a wider range of things which could readily be converted into money.

Machinery of PAYE

2734. There have also been a few changes to the machinery of PAYE – but remarkably few given the nearly 60 years since the 1943 Act:

- section 30 of FA 1948 (see now section 205 of ICTA) removed the need for assessments in some cases;

- section 28 of FA 1961 (see now section 206 of ICTA) dealt with an unintended effect of the legislation in 1948. See the commentary on section 709;

- section 92 of F(No.2)A 1987 provided powers to charge interest on amounts outstanding from employers after the end of the tax year. Section 128 of FA 1988 extended this to provide for interest to be paid by the Inland Revenue to employers who have overpaid. See section 684;

- section 45 of FA 1989 inserted section 203A of ICTA which defines when a payment is made for PAYE purposes (in step with the changes made in 1989 to tax earnings on the basis of when they are received). See the commentary on section 686;

- FA 1995 made minor amendments to the legislation for the introduction of self assessment for income tax – see for example *Note 62* in Annex 2; and

- section 110 of FA 1996 made provision for "PAYE settlement agreements" (PSAs) in place of long-standing informal arrangements for employers to meet employees' tax: see paragraph 2849.

Chapter 1: Introduction

Overview

2735. *Section 682* introduces the Part.

2736. *Section 683* defines PAYE income.

Section 682: Scope of this Part

2737. This section is purely introductory. It gives readers an indication of what they will find in the Part.

Section 683: PAYE Income

2738. This section defines "PAYE income". It is new.

2739. The term "PAYE income" takes the place of "income assessable under Schedule E" which is used in section 203 of ICTA. The meaning of "PAYE income" might be thought to be different from "income assessable under Schedule E". But on close examination it has the same meaning. See *Note 55* in Annex 2.

2740. *Subsection (1)* defines PAYE income as the sum of the three amounts defined in this section.

2741. *Subsection (2)* defines PAYE employment income using the terms introduced in Chapter 3 of Part 2 (see the commentary on page 12).

2742. *Subsections (3)* and *(4)* define PAYE pension income for the year. This is taxable pension income (as defined in Part 9) which:

- is taxable pension income for the year; and
- would be charged under Schedule E in ICTA.

2743. *Subsection (5)* similarly defines PAYE social security income as the total of any social security income (as defined in Part 10) which:

- is taxable social security income for the year and
- would be charged under Schedule E in ICTA.

2744. Finally, the label "PAYE income" may not be ideal in all respects. This is because:

- it is accurately labelling all the income which is subject to PAYE in the sense that PAYE must try to collect the tax on it; but
- not all PAYE income will be subject to PAYE in the sense of deductions: only *payments* of PAYE income will be subject to those.

2745. But this is no different from the present position with income assessable under Schedule E. In the course of consultation users welcomed the label "PAYE income" as plain language; and felt the subsequent sections (and the PAYE regulations) would make clear the distinction between PAYE income and payments of PAYE income.

Chapter 2: PAYE: general

Overview

2746. *Section 684* requires the Board to make regulations to collect income tax on PAYE income. These regulations include in particular requirements for those making payments of PAYE income to deduct tax by reference to tax tables.

2747. *Section 685* requires the tax tables to try to collect the right amount of tax on the PAYE income by the end of each tax year and to try to do so evenly.

2748. *Section 686* defines when a payment of PAYE income is made for PAYE purposes (in the same way as section 18 defines when earnings are received for the purposes of Part 2).

Section 684: PAYE regulations

2749. This section provides powers for the Board of Inland Revenue to make PAYE regulations. It derives mainly from part of section 203 of ICTA.

2750. Item 5 derives from section 203(10). It allows PAYE regulations to provide for the way in which any matters dealt with in the regulations are to be proved – for example in proceedings to recover tax. Section 203(10) also includes provision for proving the contents or transmission of anything that, by virtue of the regulations, takes an electronic form or is transmitted to any person by electronic means. This Part of the provision was enacted to deal with electronic filing, a predecessor of filing by internet. It is due to be repealed by section 139 of and Part VII of Schedule 20 to FA 1999 from a date laid down by Order, and is therefore omitted. Paragraph 89 of Schedule 7 to this Act preserves the omitted words in the meantime.

2751. Items 10 and 11 derive from sections 203L(4) and 206A(6) of ICTA but are applied more widely in this Act. See *Change 147* in Annex 1.

2752. *Subsection (8)* defines the term "PAYE regulations" for the purposes of this Act and of other legislation. This allows other legislation to refer more briefly and naturally to "PAYE regulations" rather than to "regulations made under section 684 of the Income Tax (Earnings and Pensions) Act 2003".

2753. This section omits as unnecessary the provision in section 203(1) that deductions are to be made from payments "notwithstanding that when payment is made no assessment has been made in respect of the income". See *Note 57* in Annex 2.

2754. Section 203(3A) is also omitted from this section as unnecessary. Section 203(3A) is a transitional rule from the introduction of independent taxation in FA 1988. It cannot affect any tax year to which this Act applies.

Section 685: Tax tables

2755. This section requires the Board to produce tax tables for PAYE which aim to collect the right tax for the tax year. It derives from section 203(6), (7) and (8) of ICTA.

2756. *Subsection (1)* requires the Board to produce tax tables which, where possible, result in:

- tax on PAYE income for a year being deducted from PAYE income paid during that year; and

- even deductions of tax through the year so, for example, a twelfth of the total tax estimated to be due for the year is collected after one month, a sixth of the (possibly revised) total tax is collected after two months, and so on.

2757. The main practical effect of *subsection (2)* is to collect underpayments through PAYE rather than by the taxpayer making a lump sum payment.

2758. *Subsection (3)* provides that, in trying to collect tax evenly, it can be assumed that the rate of past payments in the tax year is a guide to the rate of future payments.

Section 686: Meaning of "payment"

2759. This section deals with the meaning of "payment" in this Part. It derives from section 203A and part of section 202B of ICTA.

2760. Section 203A was introduced in 1989 as part of the package of changes dealing with the switch to a receipts basis of assessment. Prior to 1989 income under Cases I and II of Schedule E was assessed on an arising basis, whereas PAYE deductions were made when the emoluments were paid. The 1989 reforms made the emoluments assessable at the same time that they were paid for PAYE purposes. They provided :

- a definition of receipt in section 202B of ICTA to determine the time that emoluments were assessable, and

- a definition of payment in section 203A of ICTA.

2761. These definitions are essentially the same. This section therefore matches section 18, which derives from section 202B.

2762. In consultation leading up to this Act some users said that the heading of the section was inappropriate because it deals only with the timing of a payment. The section reproduces the heading from section 203A. It is on close examination appropriate. Section 203A and this section are not only giving the time of a payment. They also make some things which would not be payments into payments for PAYE purposes. A simple example is where an employee is entitled to collect a bonus of £1,000 on Monday. That is a payment for PAYE purposes on Monday even if the employee does not get around to collecting the money until later.

2763. *Subsection (1)* provides that for the purposes of the PAYE regulations, any payment of (or on account of) PAYE income is a payment for PAYE purposes at the earliest time given by any of the dates derived from the rules given.

2764. Rule 3 derives from section 203A(2), and Rule 3(a) from section 203A(4).

2765. *Subsection (2)* provides that a person is treated as a director for the purposes of rule 3 in subsection (1) if he or she is a director at any time during the tax year.

2766. *Subsections (3)* and *(4)* derive from section 203A(5), and from section 202B(5) and (6). In section 203A(5) reference is made to the definition of director in section 202B(5) and (6). It is more helpful to readers to repeat the definition here.

Chapter 3 PAYE: special types of payer or payee

Overview

2767. This Chapter deals with PAYE obligations where there are special types of payer or payee. The majority of these provisions were introduced to counter avoidance of PAYE – see paragraph 2733.

2768. *Section 687* treats certain payments of PAYE income actually made by an intermediary of an employer as made by the employer.

2769. *Section 688* treats agency workers who are treated as having earnings by section 44 as employees of the agency for the purposes of most of the provisions for special types of payer, payee and types of income in this Chapter and Chapter 4. It also treats the client rather than the agency as the employer for the purposes of those provisions in relation to some payments.

2770. *Section 689* deals with employees who work in the United Kingdom but whose employer is not subject to PAYE regulations, typically where the employer has no UK presence. It treats the person for whom an employee works in the United Kingdom as if that person had made certain payments which are actually made by the employer or an intermediary of the employer.

2771. *Section 690* applies only to employees who are not resident (or not ordinarily resident) in the United Kingdom and who work partly in the United Kingdom and partly not. It treats payments of income of the employee as payments of PAYE income. It also provides for the Inland Revenue to direct that only a proportion of such payments be treated as PAYE income.

2772. *Section 691* deals with workers provided by contractors. It provides for the Board to direct that PAYE must be operated by the person employees actually work for rather than their employer if that person pays for their work and the employer is not likely to operate PAYE properly.

2773. *Section 692* provides for regulations to require PAYE to be operated on tips which are collected and shared among a group of employees by the person who runs that arrangement. It also provides for the employer to operate PAYE in some circumstances if the person who shares out the tips fails to do so properly.

Section 687: Payments by intermediary

2774. This section deals with payments made by intermediaries. It derives from section 203B of ICTA.

2775. Section 203B was introduced as part of a package of PAYE provisions in FA 1994. It prevents avoidance of PAYE by using an intermediary not subject to PAYE regulations to make payments. An example is an intermediary outside the UK tax net.

2776. *Subsection (1)* states the basic proposition that a payment of income by an intermediary is treated as a payment by the employer. This section (like others in this and later Chapters) refers explicitly to "employer" and "employee". These terms take their meanings from section 712. The commentary on them uses the words in the same sense.

2777. *Subsection (2)* disapplies subsection (1) if the intermediary complies with the PAYE regulations. The wording in this Act makes it clearer that the intermediary must *both* deduct *and* account for tax in accordance with the PAYE regulations. See *Note 58* in Annex 2.

2778. Similar clarifications have been made in sections 689(1)(d) and 691(1)(c).

2779. Section 203B(5) applies section 839 of ICTA to give the meaning of connected persons. Section 718 does that for this Act as a whole so no provision to that effect is needed in subsection (4).

Section 688: Agency workers

2780. This section ensures that agency workers are, broadly speaking, treated in the same way as other workers for the purposes of this Part. It derives from section 203L(1A), (1B) and (1C) of ICTA.

2781. Subsection (1) provides that where section 44 (agency workers) applies then this Chapter (except section 691), Chapter 4 and section 710 apply as if the agency employed the worker.

2782. *Subsection (2)* treats the client rather than the agency as the employer if a payment is made by an intermediary of the client.

Section 689: Employee of non-UK employer

2783. This section concerns employees working in the United Kingdom for someone who is not their employer. It derives from section 203C of ICTA.

2784. The section provides for tax to be accounted for under PAYE by the person for whom the employee is working if the employer does not do so. An example is an employee of an overseas company who comes to the United Kingdom to work for a subsidiary but not as an employee of the subsidiary. The employer remains overseas and cannot be required to operate PAYE. It may also be impracticable for it to do so.

2785. *Subsection (1)(d)* follows the approach taken in section 687. See *Note 58* in Annex 2.

2786. *Subsection (4)* deals with the possibility that income is provided to the employee in the form of a voucher, credit card, readily convertible asset or other way which gives rise to a "notional payment". It treats any such notional payments in the same way as actual payments for the purposes of this section. But (as with notional payments generally) there is no requirement to "gross up" the notional payment for PAYE purposes.

Section 690: Employee non-resident etc.

2787. This section makes special provisions for PAYE for employees who are *both* non-resident (or not ordinarily resident) *and* working partly in the United Kingdom and partly not. It derives from section 203D of ICTA.

2788. An employee in these circumstances may be chargeable to income tax on only some of the employment income. Payments which were partly of PAYE income and partly not would not be subject to deductions. This section provides that payments (or a proportion of payments) are subject to PAYE.

2789. *Subsection (2)* provides for a direction to be made, on application by the "appropriate person" (see subsection (3)) to the Inland Revenue. The direction states what proportion of income from that employment is to be subject to PAYE deductions. It contains two minor changes:

- directions under this section affect only PAYE income paid by or on behalf of the employer. This change is then followed through in subsections (3)(b), (7) and (8). See *Change 148* in Annex 1.

- it allows a direction to be made where the income which is not assessable *is* ascertainable. See *Change 149* in Annex 1.

2790. *Subsection (7)* ensures that when a payment to which a direction under subsection (2) applies is made to the employee, PAYE deductions are made from the proportion of the payment specified in the direction. This is achieved by deeming the proportion to be PAYE income.

2791. *Subsection (8)* sets out the position if no direction is made. Then all the payment is subject to PAYE.

2792. *Subsection (9)* makes sure that this section does not affect the employee's tax liability.

2793. *Subsection (10)* is new. It deals with how this section is modified if both it and section 689 apply to the same employment. This could happen if the employer (or an intermediary of the employer) is outside the UK tax net. Section 689 might then lead a person in the United Kingdom for whom the employee is working to have to operate PAYE. See *Change 149* in Annex 1.

Section 691: Mobile UK workforce

2794. This section provides that where, in the case of a contractor providing their employees to a person, it is unlikely that PAYE will be deducted or accounted for, the Board of Inland Revenue may direct that that person must deduct and account for tax. It derives from section 203E of ICTA.

2795. *Subsection (1)* sets out the conditions for the section to apply and labels as the "relevant person" the person for whom the employees work. Subsection (1)(c) follows the approach taken in section 687. See *Note 58* in Annex 2.

2796. *Subsection (2)* sets out what the Board may do by way of a direction. This is broadly to require the relevant person to deduct tax when making payments for the work. This need not be a payment to the employees. It may be a payment to the contractor.

2797. *Subsection (3)* sets out what the direction must do and how it may at any time be withdrawn.

2798. *Subsection (4)* requires the Board to try to give the contractor a copy of any direction.

2799. *Subsection (5)* deals with the effect of a direction under subsection (2). When there are employees of the contractor working for the relevant person then the relevant person is to make deductions in accordance with PAYE regulations from any payment made for the work done (whether a payment to the contractor or another person). This is to be done by treating the amount of the payment attributable to each employee's work as if it were a payment of PAYE income to that employee.

Section 692: Organised arrangements for sharing tips

2800. This section allows the PAYE regulations to make provision for PAYE to be operated on tips which are collected and shared among a group of employees by whoever runs that arrangement; and also to require the employer to operate PAYE in some circumstances if that person fails to operate PAYE properly. It derives from regulation 5 of the Income Tax (Employments) Regulations 1993 (S.I. 1993 No 744).

2801. This section is included in to give readers a more complete set of provisions which deal with who is the "employer" for PAYE purposes.

2802. Regulation 5 originated in SI 1965 No 516. It was introduced then to make clear that a person (other than the employer) who distributes to employees money from an organised arrangement for sharing tips had the same responsibilities as an employer, unless the Board directed otherwise. This legislation was amended by SI 1994 No 775 to make clear what happens if such a person does not operate PAYE properly.

2803. The regulations refer to the person who shares the tips as the "tronc-master". This term is still used in practice in some such schemes. It is not used in this Act as users commented in the course of consultation that it was archaic and/or obscure. The term will be omitted from the regulations when they are rewritten.

2804. These provisions are in the current PAYE regulations and have been for many years but their inclusion in this Act is a minor change in the law. See *Change 150* in Annex 1.

Chapter 4: PAYE: special types of income

Overview

2805. This Chapter treats as payments of PAYE income the provision of PAYE income in the form of cash vouchers and readily convertible assets, and certain non-cash vouchers and credit tokens which are or are for readily convertible assets. It also treats as payments certain share-related employment income.

2806. *Section 693* deals with the receipt of cash vouchers (for example traveller's cheques) by employees. It provides when the payment is made for PAYE purposes. It also provides exceptions to that rule and for the PAYE regulations to make further exceptions.

2807. *Sections 694* to *702* deal with income provided in the form of readily convertible assets, or vouchers or credit tokens for such assets; enhancements to the value of readily convertible assets already held by employees; gains from options on shares which are readily convertible assets, or conditional interests in shares which are readily convertible assets being sold or ceasing to be conditional. These are all circumstances in which there is employment income which is taxable but which would not be a payment for PAYE purposes. The sections treat a payment of PAYE income as made and where necessary provide also how the amount of the payment should be calculated.

Section 693: Cash vouchers

2808. This section provides for PAYE to be operated on the provision of cash vouchers. It derives from section 203I of ICTA and from regulations.

2809. *Subsection (1)* provides that where a cash voucher is chargeable to tax under Chapter 4 of Part 3 of this Act then the provision of the cash voucher is treated as a payment of PAYE income. The amount of the payment is the amount treated as earnings by section 81(1). The subsection also picks up the rule in section 143(1)(a) of ICTA that determines the time of payment. The cash voucher is treated as a payment of PAYE income at the time it is received by the employee.

2810. *Subsections (2)* and *(3)* together keep out of PAYE such things as traveller's cheques used by employees while travelling in the performance of their duties. They deal respectively with vouchers used direct to meet expenses and vouchers used to get cash to meet expenses.

2811. There is also no requirement to operate PAYE on cash vouchers which are subject to a dispensation (see section 96) as Chapter 4 of Part 3 then does not apply to the voucher.

2812. "Cash voucher" is defined in section 721.

Section 694: Non-cash vouchers

2813. This section provides for PAYE to be operated on certain non-cash vouchers. It derives from section 203G of ICTA and from regulations.

2814. *Subsection (1)* provides that, if the conditions of this section are met, then the provision of a non-cash voucher will constitute a payment of PAYE income of an amount equal to the amount treated as earnings under section 87(1).

2815. *Subsection (2)* states when the section applies to a non-cash voucher. This is when either of the conditions in subsections (3) and (4) are met and the voucher is not excluded by PAYE regulations.

2816. But there is no requirement to operate PAYE on non-cash vouchers which are subject to a dispensation (see section 96) as Chapter 4 of Part 3 then does not apply to the voucher.

2817. *Subsection (3)* provides for a non-cash voucher to fall within this section, and therefore within PAYE, if it is exchangeable for a readily convertible asset.

2818. *Subsection (4)* provides that a non-cash voucher falls within this section if it would itself be regarded as a readily convertible asset for the purposes of section 696 but for the fact that section 696 does not apply to non-cash vouchers (because they are dealt with by this section).

2819. *Subsections (5)* and *(6)* derive from regulation 6(1) to (3) and 2(1) of the Income Tax (Employments) (Notional Payments) Regulations 1994 (SI 1994 No 1212). They determine when a payment is made and what "cheque voucher" and "cost of provision" mean.

2820. *Subsection (7)* is the same rule about appropriation of vouchers as in section 82(3).

2821. "Readily convertible asset" is defined in section 702. "Non-cash voucher" is defined in section 721.

Section 695: Credit-tokens

2822. This section provides for PAYE to be operated on certain credit-tokens used by an employee. It derives from section 203H of ICTA and regulations.

2823. *Subsection (2)* derives from paragraph 4 of SI 1994 No 1212. It excludes from the scope of the section credit-tokens used to obtain money to meet expenses which would only be PAYE income because of section 70.

2824. As with vouchers, there is also no requirement to operate PAYE on credit-tokens which are subject to a dispensation (see section 96) as Chapter 4 of Part 3 then does not apply to give rise to an amount treated as earnings under section 94.

2825. "Readily convertible asset" is defined in section 702. "Credit-token" is defined in section 721(1).

Section 696: Readily convertible assets

2826. This section requires provision of PAYE income to an employee in the form of a readily convertible asset to be treated as payment by the employer, and gives the amount of the notional payment. It derives from section 203F of ICTA.

2827. "Readily convertible asset" is defined in section 702.

Section 697: Enhancing the value of an asset

2828. This section treats as the provision of PAYE income in the form of a readily convertible asset anything which enhances the value of an asset which an employee already has if the asset (as enhanced) is a readily convertible asset. It derives from section 203FA of ICTA and regulations.

2829. *Subsection (1)* sets out the circumstances in which this section applies.

2830. *Subsection (2)* then provides for section 696 to apply as if the income were provided in the form of a readily convertible asset. Then (subject to the details of section 696) it will be a "notional payment" on which PAYE must be operated.

2831. *Subsection (4)* derives from paragraph 3B of the Income Tax (Employments) (Notional Payments) Regulations 1994, SI 1994 No 1212. It excludes from this section things which are excluded from readily convertible assets: see section 701(2)(c).

Section 698: PAYE: shares ceasing to be only conditional or being disposed of

2832. This section deals with employment income under section 427 (Charge on interest in shares ceasing to be only conditional or on disposal) – see paragraph 1853. It derives from parts of section 203FB of ICTA.

2833. Section 203FB of ICTA provides, in summary, that PAYE applies to share-related events where the shares are readily convertible assets. It deals with several such events. These are divided here between this section and sections 699 and 700 to make them easier to relate back to the way Chapters 2, 3 and 5 of Part 7 give rise to employment income in such cases. But these are complex events which involve some complex rules.

2834. *Subsections (1)* and *(2)* set out the circumstances in which this section applies.

2835. *Subsection (3)* provides that in those circumstances the event is treated as if a further interest in shares had been provided. PAYE may then apply – although that depends on for example whether or not it is a readily convertible asset.

2836. *Subsection (4)* provides that if section 696 requires PAYE to be operated in these circumstances the amount of the notional payment for PAYE purposes is the amount which is likely to be chargeable under Chapter 2 of Part 7.

2837. *Subsection (5*) applies to this section the meaning given by Chapter 2 of Part 7 to expressions such as "shares" (see section 434).

Section 699: PAYE: conversion of shares

2838. This is the second of the three sections derived from section 203FB of ICTA. It deals with employment income under section 438 on the conversion of convertible shares.

2839. The section takes broadly the same approach as section 698.

Section 700: PAYE: gains from share options

2840. This is the third of the three sections derived from section 203FB of ICTA. It deals with employment income under sections 476 (Charge on exercise, assignment or release of option by employee) and 477 (Charge on employee where option exercised, assigned or released by another person).

2841. The section takes broadly the same approach as sections 698 and 699 but includes minor changes.

2842. *Subsection (3)* deals with the assignment or release of the right to acquire shares. Where this happens the consideration might be a cash payment or an asset. Sections 684 to 691 and 696 could be relevant – depending on whether the consideration is a payment made direct, payment by an intermediary, the provision of an asset or whatever.

2843. Subsection (3)(a) deals with consideration in the form of a payment. It treats as a payment of PAYE income a proportion of the amount chargeable under sections 476 or 477 less any relief likely to be due under section 481. Having regard to the relief which is likely to be due is a minor change to remove an inconsistency in section 203FB. See *Change 151* in Annex 1.

2844. *Subsections (3)* and *(4)* together include a further minor change in the law. This is to ensure the total amount subject to PAYE does not exceed the employment income. See *Change 151* in Annex 1.

2845. *Subsections (6)* and *(7)* give "asset" in this section a meaning which includes cash vouchers and certain non-cash vouchers and credit-tokens. See *Change 152* in Annex 1.

Section 701: Meaning of "asset"
2846. This section defines "asset" for the purposes of Chapter 4. It derives from section 203F(4) and (5) of ICTA and regulations.

Section 702: Meaning of "readily convertible asset"
2847. This section defines "readily convertible asset" in Chapter 4. It derives from parts of sections 203F and 203K of ICTA.

2848. Section 203F(6) defines "money" to include the European currency unit (ECU). That is no longer needed. See *Note 59* in Annex 2.

Chapter 5: PAYE settlement agreements
Overview
2849. This Chapter allows regulations to provide for an employer to agree to pay sums to the Board of Inland Revenue in respect of the income tax on certain earnings of employees. And for the employees to be correspondingly relieved of their liabilities to income tax in respect of those earnings.

2850. *Section 703* is introductory.

2851. *Sections 704* to *706* set parameters within which regulations can be made for PAYE settlement agreements.

2852. *Section 707* provides definitions.

Omitted material
2853. This Chapter derives from section 206A of ICTA. Section 206A was inserted by section 110 of FA 1996, with effect from 29 April 1996.

2854. Section 206A(5) and (7) of ICTA relate to issues likely to arise if regulations within the scope of section 206A of ICTA ("PSA regulations") had effect for the tax year in which the PSA regulations were made.

2855. Section 206A(5) of ICTA allowed the PSA regulations to cover an agreement even though the agreement had been made before the PSA regulations came into force. So, for the tax year in which the PSA regulations came into force, an agreement could be covered even though the agreement had been made before the PSA regulations were made. But because a fresh agreement is entered into for each tax year, section 206A(5) of ICTA was only needed for the year in which PSA regulations were made. As PSA regulations were made on 14 October 1996 and came into force on 5 November 1996 this transitional provision is spent and omitted from this Act.

2856. Section 206A(7) of ICTA allowed the PSA regulations to cover sums accounted for under an agreement, and the income to which the sums related, even though those sums had been accounted for before PSA regulations came into force. So, for the tax year in which the PSA regulations came into force, those sums and that income could be covered even though those sums and that income may have arisen before the PSA regulations were made. This transitional provision is also spent and omitted from this Act because PSA regulations were made on 14 October 1996 and came into force on 5 November 1996.

Section 703: Introduction
2857. This section gives an overview of the Chapter and introduces the term "PAYE settlement agreements" ("PSAs") which is used throughout the Chapter. It derives from section 206A(1) of ICTA.

Section 704: Sums payable by employers under agreements
2858. This section derives from section 206A(2) and (8) of ICTA.

2859. *Subsection (1)* allows PAYE Regulations to provide for an employer to enter into a PSA with the Inland Revenue under which the employer pays certain sums in place of sums that would be payable in the absence of the PSA. Subsection (1)(a) omits "Board of" in front of Inland Revenue – see *Change 158* in Annex 1.

2860. *Subsection (2)* allows PAYE Regulations to make the same sort of provisions about sums payable under a PSA as can be made about other sums payable under the regulations. This ensures that provision can be made for matters such as interest on sums paid late or repayable.

Section 705: Approximations allowed in calculations
2861. This section contains guidance about the ways in which sums to be accounted for under a PSA can be calculated. It recognises that in practice the sums to be paid under a PSA will rarely be precisely equal to what would be the income tax liability of the employees in relation to the earnings covered by a PSA. It does this by permitting PAYE Regulations to recognise approximations as to who receives the earnings, how much those earnings would have been and how much the tax liability would have been on such earnings. It derives from section 206A(3) of ICTA.

Section 706: Exclusions of general earnings from income etc.
2862. This section permits PAYE Regulations to exclude the earnings covered by a PSA from the employees' income for income tax purposes. It also allows the regulations to provide that no part of sums paid by the employer under a PSA are counted as tax paid by an employee. It derives from section 206A(4) of ICTA.

Section 707: Interpretation of this Chapter
2863. This section defines terms used in this Chapter. It derives from section 206A(9) of ICTA.

Chapter 6: Miscellaneous and supplemental

Overview

2864. *Section 708* provides for the PAYE regulations to suspend the normal system of in-year repayments to persons getting jobseeker's allowance or engaged in a trade dispute.

2865. *Section 709* provides that an assessment made more than 12 months after the end of a tax year must, for some income dealt with under PAYE, be made in accordance with the generally prevailing practice at the end of that 12 months.

2866. *Section 710* sets out how employers must try to deduct tax, and must account for it whether or not they can deduct, in respect of "notional payments".

2867. *Section 711* gives a person, who has suffered deduction of tax under PAYE, a right to make a tax return.

2868. *Section 712* defines terms used in this Part and applies section 5 for the purposes of this Part (so it applies to offices as to employments).

Section 708: PAYE repayments

2869. This section allows the PAYE regulations to deny PAYE repayments to persons in two cases. It derives from part of section 204 of ICTA.

2870. *Subsection (1)* gives the two cases in which regulations can prevent PAYE repayments being made to a person. The first case is during periods for which the person has claimed jobseeker's allowance. The second case is when the person is not entitled to jobseeker's allowance solely because of some connection with a trade dispute.

2871. *Subsection (2)* allows regulations to treat the two cases differently.

2872. *Subsection (3)* defines "the trade disputes provisions". This term has been introduced to make the section easier to read than section 204(d). Subsection (3) also sets out what the corresponding enactment in Northern Ireland is (which could not be done at the time section 204(d) was introduced).

2873. Section 204(a), (b) and (c) of ICTA are omitted from this Act as they have no application to the years to which it applies. See *Note 60* in Annex 2.

Section 709: Additional provision for certain assessments

2874. This section provides that assessments must be made on the basis of generally prevailing practice in certain circumstances. It derives from section 206 of ICTA.

2875. The origin of section 206 was section 28(1) of FA 1961. Schedule 4 to the Income Tax Management Act 1964 extended section 28(1) of FA 1961 so that it applied to an assessment under Schedule E where it had previously applied to an

assessment in respect of "emoluments". Section 28(1) of FA 1961 was consolidated first as section 206 of ICTA 1970 and later as section 206 of ICTA. Section 111(2) of FA 1995 removed "under Schedule E" after the words "an assessment to income tax" in section 206 of ICTA.

2876. *Subsection (1)* sets out the circumstances in which the section applies.

2877. *Subsection (2)* sets out the consequences of the section applying.

2878. *Subsection (3)* defines "relevant income" – a term used to make the earlier subsections easier to read.

2879. Section 28(1) of FA 1961 was intended to put individuals who did not receive income tax assessments (because it was thought that all their tax had been settled under PAYE) on a similar footing to others who had received assessments. People who did not get assessments previously had an advantage over other taxpayers. Their tax affairs were not final so they had a much longer period after the end of a tax year in which to take advantage of a Court decision overturning what had earlier been the generally accepted practice. Section 28(1) accordingly set out circumstances in which a "late" assessment to income tax had to be made on the basis of earlier generally accepted practice. This could work to the disadvantage of individuals compared to their position prior to section 28(1). It could also work to their advantage by preventing the individual from being assessed on the basis of a later Court decision that was less favourable than earlier generally accepted practice. In short, it gave them broadly the same finality they would have had with an assessment.

2880. Section 206 of ICTA 1970 was considered in Walters v Tickner (1993) 66 TC 174. That case decided that section 206 could operate as a provision that charges income tax, but it could not do so in relation to an unqualified statutory exemption given to scholarship income.

2881. Since that case was decided the framework within which section 206 operates has been altered by Self Assessment. When the case was decided the Inland Revenue were obliged, subject to the pre-Self Assessment version of 205(1) of ICTA, to make assessments when returns of income were made which were considered to be correct and complete. But under Self Assessment, assessments are normally:

- made by the taxpayer rather than the Inland Revenue; and
- single assessments on all income rather than multiple assessments made on income split into separate Schedules.

2882. Section 111(2) of FA 1995 made a minor amendment to section 206 of ICTA in connection with the imminent start of Self Assessment. The amendment removed the words "under Schedule E" after the opening words "Where an assessment". That minor amendment arguably introduced some uncertainties about how section 206 of

ICTA operates under Self Assessment. This section removes those uncertainties, relating to the income in an assessment that must be based on earlier generally accepted practice. See *Note 61* in Annex 2.

Section 710: Notional payments: accounting for tax

2883. This section sets out how an employer must account for tax on a "notional payment". It derives from section 203J of ICTA.

2884. *Subsection (1)* (with the definition of relevant time in subsection (7)) requires the employer to deduct any tax due on a notional payment from actual payments made at the same time or later in the income tax period.

2885. *Subsection (2)* defines notional payment and extends references to employer in this section.

2886. *Subsections (3)* and *(4)* require the employer to account for tax which cannot be deducted from actual payments.

2887. *Subsection (5)* provides power for PAYE regulations to determine the time when any notional payment is made, to apply any provisions of the regulations to notional payments (with or without modifications), and to deal with matters about the collection and recovery of amounts accounted for in respect of notional payments.

2888. *Subsection (6)* provides for the employee to be treated as having paid the tax accounted for on a notional payment. It also provides *when* the employee is treated as having paid the tax: see *Change 153* in Annex 1.

2889. *Subsection (7)* derives from regulations 7 and 8 of the Income Tax (Employments) (Notional Payments) Regulations, SI 1994 No 1212. It defines the relevant time for subsections (1) and (4).

2890. *Subsection (8)* derives from regulation 2 of the Income Tax (Employments) Regulations 1993, SI 1993 No 744. It provides that "income tax period" takes the same meaning as in the PAYE regulations. It is the tax month or (for some small employers) quarter.

Section 711: Right to make a return

2891. This section gives a person a right to a notice under section 8 of TMA 1970 if that person has had PAYE deductions or repayments. A notice under section 8 of TMA 1970 in turn obliges that person to make a tax return. The section derives from section 205(4) of ICTA.

2892. *Subsection (1)* sets out the conditions that must be satisfied for a person to give notice to the Inland Revenue.

2893. *Subsection (2)* provides a time limit within which notice can be given to the Inland Revenue.

2894. *Note 62* in Annex 2 explains why section 205(1) to (3) and (5) of ICTA are not needed and are not rewritten in this Act. Section 205(4) ICTA is however rewritten in response to requests made during consultation leading up to this Act. The requests were to preserve, as a matter of principle, any rights to make a tax return that it gives to some taxpayers until such time as there is an explicit general right for all taxpayers to submit a tax return.

Section 712: Interpretation of this Part
2895. This section provides definitions and interpretation. It derives from section 203L(1) of ICTA.

2896. *Subsection (1)* provides various definitions for the purposes of this Part. The definitions of "employee" and "employer" are different from those used elsewhere in this Act in order to relate a notional payment to a particular employment with a particular employer or former employer.

2897. *Subsection (2)* applies sections 4 and 5 to this Part so that "employment" has the same meaning as in the employment income Parts of this Act (see *Note 1* in Annex 2); and that references to employees include office-holders and so on.

Part 12: Payroll giving
Overview
2898. The next three sections describe the circumstances in which a deduction may be available for charitable giving via the payroll. They derive from the provisions in section 202 of ICTA.

Section 713: Donations to charity: payroll deduction scheme
2899. This section describes the arrangements between the person it characterises as "the payer" and the individual from whose PAYE income that payer withholds the donations. The section derives from section 202(1) and (2) and part of (5) of ICTA.

2900. *Subsection (1)* sets out the basic circumstances for payroll giving to be possible. An individual asks the person making payments of PAYE income to him or her to deduct authorised charitable donations from those payments. Tax relief is available on the donations made.

2901. *Subsection (2)* removes the possibility of circularity in the operation of this section.

2902. Section 202(2) provides that the donations " … shall … be allowed to be deducted as expenses incurred in the year of assessment in which they are withheld". Under the structure of this Act, the amounts that are withheld do not need to be characterised as "expenses". *Subsections (3)* and *(4)* simply refer to a deduction being

allowed in calculating the amount of the individual's income that is charged to tax. The particular manner of that deduction depends on the type of income from which the amount is withheld and is described in subsection (4). Those provisions refer to deductions being allowed in calculating "net taxable" earnings/income of the specified type for "the relevant tax year". That fixes the tax year in which the deduction is due to that in which the income (from which the amount is withheld) is charged to tax. See *Change 154* in Annex 1.

2903. *Subsection (5)* defines "relevant tax year" for the purposes of parts of the preceding subsection.

Section 714: Meaning of "donations"

2904. This section defines what is meant by "donations". It also records the meanings of supporting terms that are used in that definition. The section derives from section 202(3), (4), (5), (6) and (11) of ICTA.

2905. *Subsection (1)* contains the definition of "donations", where two (or possibly three) requirements that need to be fulfilled are identified.

2906. *Subsection (2)* contains definitions of three terms used in the preceding subsection.

2907. Section 202(4)(a) of ICTA refers to "a person ("the agent")", although that term is not further defined there. The Act recognises the reality that the agent will be a "body". See *Change 155* in Annex 1.

2908. This Act provides for the Inland Revenue, as opposed to the Board in the source legislation, to approve a scheme for payroll giving. See *Change 158* in Annex 1.

2909. *Subsection (3)* provides for the Inland Revenue, as opposed to the Board in the source legislation, to approve an agent for payroll giving. That reflects the Inland Revenue's practice on the application of section 202(3) whereby the power of the Board is delegated to the technical specialist. See *Change 158* in Annex 1.

Section 715: Approval of schemes: regulation by Treasury

2910. This section describes the powers reserved for the Treasury to regulate certain matters relating to payroll giving. It derives from section 202(8), (9) and (10) of ICTA.

2911. *Subsection (1)* provides for the Treasury to make regulations governing how the Inland Revenue, as opposed to the Board in the source legislation, grant or withdraw approval of a scheme or agent. See *Change 158* in Annex 1.

2912. Section 202(9)(a) refers to a notice "served on" a participating employer or agent by the Board. *Subsection (3)(a)(i)* instead refers to a notice the Inland Revenue "give to" such an employer or agent. See *Changes 156* and *158* in Annex 1.

Part 13: Supplementary provisions

2913. This Part includes various supplementary provisions grouped under the following general headings:

- Alteration of amounts;
- Orders and regulations;
- Interpretation; and
- Amendments, repeals, citation etc.

Section 716: Alteration of amounts by Treasury order

2914. This section provides that sums of money in certain specified sections may be increased or further increased by an order from the Treasury.

2915. *Subsection (1)* introduces the right to increase or further increase the sums of money mentioned in the sections in subsection (2) by Treasury order. It derives from sections 191A, 200A(6), 828(1) and paragraph 24(10) of Schedule 11A to ICTA.

2916. *Subsection (2)* sets out the sections that are subject to such an order. It derives from sections 191A, 200A(6), 828(1) and paragraph 24(10) of Schedule 11A to ICTA. There is also some new material. See *Changes 29, 56, 59, 78, 79* and *96* in Annex 1.

2917. *Subsection (3)* sets out further implications where an order is made in respect of section 241(3)(a) or (b). It derives from section 200A(6) of ICTA.

2918. *Subsection (4)* sets out further implications where an order is made in respect of section 287(1). It derives from paragraphs 24(1) and (10) of Schedule 11A to ICTA.

Section 717: Orders and regulations made by Treasury or Board

2919. This section sets out how any Treasury order or regulations under this Act are to be made.

2920. *Subsection (1)* provides that orders or regulations made by the Treasury or the Board of Inland Revenue under this Act must be exercised by statutory instrument. It derives from section 828(1) of ICTA.

2921. *Subsection (2)* sets out the one exception to subsection (1) of the section and relates to overseas Crown employment. See *Change 4* in Annex 1.

2922. *Subsection (3)* explains that a statutory instrument issued in accordance with subsection (1) is subject to annulment in pursuance of a resolution of the House of Commons. It derives from section 828(3) of ICTA.

2923. *Subsection (4)* sets out the one exception to subsection (3) of the section and relates to deductions for professional membership fees. See *Change 85* in Annex 1.

Section 718: Connected persons
2924. This section applies the same meaning of connected person as set out in section 839 of ICTA for the purposes of this Act. It derives from sections 140(2), 140H(9), 146(11), 161(3), 162(10), 187(6), 200B(7), 200C(8), 203B(5), 596A(16) and paragraph 4(4) of Schedule 7 to ICTA, paragraph 129(2) of Schedule 8 to FA 2000 and paragraph 71(2) of Schedule 14 to FA 2000. See also *Change 59* in Annex 1.

Section 719: Control in relation to a body corporate
2925. This section applies the same meaning of control in relation to a body corporate as set out in section 840 of ICTA for the purposes of this Act. It derives from sections 140F(7), 187(2), paragraph 8(2) of Schedule 11 and paragraph 4(2) of Schedule 12AA to ICTA; section 87(3) of FA 1988; paragraph 129(1) of Schedule 8 to FA 2000; and paragraphs 13(3), 15(2) and 59(3) of Schedule 14 to FA 2000. See also *Changes 133* and *157* in Annex 1.

Section 720: Meaning of "the Inland Revenue" etc.
2926. This section provides definitions of "Inland Revenue" and "the Board of Inland Revenue" for the purposes of this Act.

2927. *Subsection (1)* defines "the Inland Revenue" as any officer of the Board of Inland Revenue. It derives from paragraph 124 of Schedule 8, paragraph 20 of Schedule 12 and paragraph 68 of Schedule 14 to FA 2000. See also *Change 158* in Annex 1.

2928. *Subsection (2)* defines "the Board of Inland Revenue" as the Commissioners of Inland Revenue. The term "Commissioners of Inland Revenue" is defined in the Inland Revenue Regulation Act 1890.

2929. *Subsection (3)* sets out how section 4A of the Inland Revenue Regulation Act 1890 provides for some devolution of the Board's powers.

Section 721: Other definitions
2930. This section provides a list of definitions for the purposes of this Act.

2931. *Subsection (1)* contains new drafting material and sets out each definition. In connection with the definition of "personal representatives", see *Change 159* in Annex 1.

2932. *Subsection (2)* deals with the meaning of "assignment" in the application of this Act to Scotland. It is new.

2933. *Subsection (3)* defines the meaning of "domiciled in the United Kingdom" for the purposes of this Act. It is new.

2934. *Subsection (4)* defines the members of a person's family for the purposes of this Act. It derives from sections 148(5), 149(3), 157(3), 159AA(3) and 159AC(3) of ICTA and also contains new material.

2935. *Subsection (5)* defines the members of a person's family or household for the purpose of this Act. It derives from sections 148(5), 168(4), 191B(16), 197G(6), 200AA(4), 203F(6) and paragraph 26 of Schedule 11A to ICTA and paragraph 21(3) of Schedule 12 to FA 2000 and also contains new material.

2936. In connection with the application of a "person's family or household" to costs and expenses of personal security assets and services, see *Note 39* in Annex 2.

2937. *Subsection (6)* excludes certain statutory provisions in interpreting "child" or "children" for the purposes of this Act. It derives from section 831(4) of ICTA and corrects a small mistake in that section. See *Note 63* in Annex 2.

Section 722: Consequential amendments
2938. This section advises that Schedule 6 contains consequential amendments.

Section 723: Commencement and transitional provisions and savings
2939. This section sets out when the Act has effect. This is subject to the transitional provisions and savings that are listed in Schedule 7.

Section 724: Repeals and revocations
2940. This section makes repeals (*subsection (1)*) and revocations (*subsection (2)*). The affected enactments and instruments are listed in Parts 1 and 2 of Schedule 8.

Section 725: Citation
2941. This section provides the name under which the Act may be cited.

SCHEDULE 1: ABBREVIATIONS AND DEFINED EXPRESSIONS
Part 1: Abbreviations of Acts and instruments
2942. Part 1 provides a list of abbreviations referring to other Acts.

Part 2: Index of defined expressions
2943. Part 2 lists expressions defined in the Act.

SCHEDULE 2: APPROVED SHARE INCENTIVE PLANS

Overview

2944. This Schedule, which is introduced in Chapter 6 of Part 7, deals with some of the topics involved in rewriting the legislation relating to share incentive plans (or "SIPs" for short). SIPs were earlier known as employee share ownership plans (or "ESOPs" for short).

2945. Nearly all the source legislation relating to SIPs is contained in Schedule 8 to FA 2000 (referred to in the notes on this Schedule as "Schedule 8"). Schedule 8 was introduced by section 47 of FA 2000; and amended, to a certain extent, by Schedule 13 to FA 2001 (introduced by section 61 of that Act). Further amendments to Schedule 8 have been made by section 39 of FA 2002 and by the Employee Share Schemes Act 2002.

2946. The new legislation relating to SIPs, the majority of which is contained in Chapter 6 of Part 7 and in this Schedule, is called "the SIP code" - a term introduced in section 488. Chapter 6 of Part 7 deals with the tax advantages that an approved SIP provides, and with the tax charges that may arise in certain circumstances.

2947. This Schedule contains further provisions relating to SIPs. After the Introductory Part (Part 1) it deals with the following matters:

- it specifies the requirements that a SIP must meet before it may be "approved" for the purposes of the SIP code (in Parts 2 to 9);

- it deals with the procedural aspects of the approval of plans and with the withdrawal of approval (in Part 10); and

- it deals with supplementary matters (in Part 11).

2948. The majority of the provisions in this Schedule are concerned with the various requirements that a SIP must meet before it may be "approved". The general policy adopted has been (first) to place the various Parts in an order consistent with that to be found in the rewritten legislation relating to other share schemes; but also (secondly) to deal with those requirements that all SIPs must meet before dealing with the requirements that are not essential. The various requirements have accordingly been placed in a different order from that found in Schedule 8. Part 2 of this Schedule accordingly deals with the general requirements that apply in all cases; Part 3 with the requirements relating to the eligibility of individual employees; and Part 4 with the types of shares that may be awarded. The following Parts then deal with free shares (Part 5), partnership shares (Part 6), matching shares (Part 7) and cash dividends and dividend shares (Part 8). Part 9 is the final Part of this Schedule concerned with the requirements for approval, and deals with the trustees.

2949. Each of Parts 2 to 9 lists, at an early point, the requirements relevant for that Part. Users may find it helpful to be able to refer to these lists. In some cases (for

example, in paragraph 6) these lists simply reproduce the source legislation; but in other cases (for example, in paragraph 70) it has been necessary to devise new material.

Part 1: Introduction
2950. This Part, which consists of paragraphs 1 to 5, is introductory. It indicates the contents of this Schedule (in *paragraph 1*) and introduces various terms of general application (in *paragraphs 2* to *5*).

Paragraph 1: Approval of share incentive plans (SIPs)
2951. This paragraph indicates the contents of this Schedule (in *sub-paragraph (1)*), and the Parts into which it is divided (in *sub-paragraphs (2)* to *(4)*). The opening paragraphs of Schedules 3, 4 and 5 have been organised in the same manner.

2952. This paragraph is new. It aims to help users to understand the subject matter of the Schedule and to locate relevant material.

Paragraph 2: SIPs: free shares and partnership shares
2953. In this paragraph, *sub-paragraph (1)* sets out the central definition of "share incentive plan" (or "SIP" for short), a definition derived from that of "employee share ownership plan" in paragraph 1(1) of Schedule 8. In the source legislation, that sub-paragraph was followed by a provision relating to matching shares; but in this Act the proposition set out here appears on its own, and the provision relating to matching shares has been postponed until the following paragraph.

2954. *Sub-paragraph (2)* contains three definitions:

- the definition of "the company" derives from paragraph 1(4) of Schedule 8;
- the definition of "plan requirements" is new; and
- the definition of "the trustees" is a new feature of these introductory provisions, introducing a term that will be used before the requirements relating to the trustees are dealt with in Part 9 of this Schedule.

Paragraph 3: Matching shares
2955. This paragraph introduces the concept of "matching shares". It derives from paragraph 1(2) and (3) of Schedule 8.

2956. *Sub-paragraph (2)* now refers to "free shares, partnership shares, and matching shares", as opposed to "the kinds of shares mentioned in sub-paragraphs (1) and (2)"; and states that "the plan may provide for the company to decide" as opposed to "it may leave it for the company to decide".

Paragraph 4: Group plans
2957. This paragraph is concerned with group plans. It derives from paragraph 2 of Schedule 8.

2958. In *sub-paragraph (3)* the term "constituent company" replaces the term "participating company". This change, which is in alignment with corresponding changes made in Schedules 3, 4 and 5, has been made on the basis that these Schedules necessarily make numerous references to "participants" and to people who "participate" - so that the use of another term is advantageous.

Paragraph 5: Meaning of "award of shares", "participant" etc.
2959. This paragraph defines various expressions to be found in the SIP code. It derives from paragraph 3 of Schedule 8.

2960. These definitions are set out in an order that differs somewhat from that found in the source legislation, because *sub-paragraph (2)* derives from the full-out words at the end of paragraph 3(2) of Schedule 8.

2961. In paragraph 3(2) of Schedule 8, the source legislation provides for the definition of "the individual award". This term is not used in this Act, as it appears in one place only: in paragraph 53(5) of this Schedule (derived from paragraph 43(4) of Schedule 8). The wording of paragraph 53(5) has been amended accordingly.

Part 2: General requirements
2962. It was mentioned, in the overview to the explanatory notes for this Schedule, that the contents of this Schedule could be divided into three categories. This Part is the first of eight that deal with the first category: the requirements that a SIP must meet before it may be approved. This Part, which consists of paragraphs 6 to 12, deals with general requirements that all SIPs must meet.

Paragraph 6: General requirements for approval: introduction
2963. This paragraph lists the general requirements that must be met before a SIP may be approved. It derives from paragraph 6 of Schedule 8.

Paragraph 7: The purpose of the plan
2964. This paragraph deals with the purpose of a SIP. It derives from paragraph 7 of Schedule 8.

Paragraph 8: All-employee nature of plan
2965. This paragraph contains provisions designed to ensure as many employees as possible are eligible to benefit in an award of shares under a SIP. It derives from paragraph 8 of Schedule 8.

2966. *Sub-paragraph (1)*, in its final full-out words, adds a second "is" to the material that deriving from the final full-out words of paragraph 8(1) of Schedule 8,

so that the sub-paragraph now ends "is invited to do so". This addition brings this sub-paragraph into better alignment with *sub-paragraph (5)*.

2967. *Sub-paragraph (2)* introduces a definition of a "UK resident taxpayer", drawing on material in paragraph 8(1)(b) of Schedule 8. This definition is then used again in sub-paragraph (5)(b).

2968. *Sub-paragraphs (3)* and *(4)* deal with the material in paragraph 8(2) of Schedule 8, which has two sentences.

2969. *Sub-paragraph (6)* substantially recasts and shortens paragraph 8(4) of Schedule 8.

Paragraph 9: Participation on same terms
2970. This paragraph states that a SIP must provide that all employees who participate in it must do so on the same terms. It derives from paragraph 9 of Schedule 8.

2971. *Sub-paragraph (3)* recasts paragraph 9(3) of Schedule 8, replacing two sentences with a single sentence.

2972. In *sub-paragraph (5)*, the cross-references to the provisions dealing with performance allowances have been placed in paragraphs of their own.

2973. *Sub-paragraph (7)* is new. This provision makes explicit that, in the case of partnership shares, the requirements of this paragraph are not infringed because a deduction of the same percentage of salary will result in employees with larger salaries having larger amounts deducted and receiving awards of more shares. This provision accords with Inland Revenue practice on this point.

Paragraph 10: No preferential treatment for directors and senior employees
2974. This paragraph provides that the SIP must not have the effect of conferring benefits mainly on directors or more highly paid employees. It derives from paragraph 10 of Schedule 8.

2975. *Sub-paragraphs (2)* and *(3)* contain the material that is presently in paragraph 10(2) of Schedule 8. The material has been divided in order to make it easier to follow and to understand.

2976. In s*ub-paragraph (1)* the words "no feature of the plan must have or be likely to have the effect" in paragraph 10(1) of Schedule 8 have been replaced by the words "no feature of the plan has or is likely to have the effect".

2977. *Sub-paragraph (4)* sets out, in full, the proposition that is contained in paragraph 10(3) of Schedule 8, instead of providing a reference to paragraph 9(3) of that Schedule.

2978. *Sub-paragraphs (1)(b)* and *(3)(a)* now refer to "the higher or highest levels of remuneration". These changes have been made to achieve greater alignment in the legislation: in this case an alignment with paragraph 8(1)(b) of Schedule 3.

Paragraph 11: No further conditions
2979. This paragraph provides that a SIP must not impose additional conditions on an employee's participation in an award of shares under the plan. It derives from paragraph 11 of Schedule 8.

2980. A reference to conditions "required or authorised by this Schedule" replaces a reference to conditions "required or permitted by this Schedule". This change brings the wording used into alignment with that used elsewhere (for example, in paragraph 8(4) of this Schedule).

Paragraph 12: No loan arrangements
2981. This paragraph provides that the arrangements for the plan must not be associated in any way with any provision made for loans to employees. It derives from paragraph 12 of Schedule 8.

2982. *Sub-paragraphs (1)* and *(2)* both derive from paragraph 12(1) of Schedule 8. The material has been divided to make it easier to follow and to understand.

2983. In *sub-paragraph (3)*, the words "For the purposes of sub-paragraph (1)" have been replaced by the words "In sub-paragraph (1)".

Part 3: Eligibility of individuals
2984. This Part is the second of eight that deal with the requirements that a SIP must meet before it may be approved. This Part, which consists of paragraphs 13 to 24, deals with requirements relating to the eligibility of individuals.

2985. Four such requirements are listed in paragraph 13; but those four differ widely in the amount of statutory material devoted to them. The requirements in paragraphs 14 and 18 need one paragraph each; but paragraph 15 is supplemented by paragraphs 16 and 17; and paragraph 19 is supplemented by paragraphs 20 to 24.

Paragraph 13: Eligibility of individuals: introduction
2986. This paragraph lists the plan requirements relating to the eligibility of individuals. The paragraph is the counterpart of paragraph 6, and is new.

Paragraph 14: Time of eligibility to participate
2987. This paragraph states (in *sub-paragraph (1)*) that the SIP must provide that an individual may only participate in an award of plan shares if the individual is eligible to participate in the award at the appropriate time. The expression "the appropriate time" is new, and has been devised to help to make the rest of this paragraph easier to understand.

2988. *Sub-paragraphs (2)* to *(6)* specify "the appropriate time" in the case of the various different classes of plan shares. Each class of plan shares has been made the subject of a separate sub-paragraph; and in cases involving matching shares (see *sub-paragraphs (5)* and *(6)*) the provisions in paragraph 13(1)(b) of Schedule 8 have been supplemented by those in paragraph 13(2).

2989. *Sub-paragraphs (7)* and *(8)* deal with the meaning of the expression "eligible to participate".

2990. This paragraph derives from paragraph 13 of Schedule 8. The material in that paragraph has been substantially recast.

Paragraph 15: The employment requirement

2991. This is the first of three paragraphs setting out the employment requirement in paragraph 14 of Schedule 8. Following the amendments made by paragraph 2 of Schedule 13 to FA 2001, this paragraph is now long, and may usefully be subdivided. This paragraph derives from paragraph 14(1) of Schedule 8.

2992. After the introductory *sub-paragraph (1)*, *sub-paragraph (2)* deals with the core of the employment requirement. The SIP must provide that an individual may not participate in an award of shares unless employed by the company (or, in the case of a group plan, by a constituent company) (*sub-paragraph (2)(a)*). And if the plan provides for a qualifying period, the individual must have been employed throughout that period (*sub-paragraph (2)(b)*) by a qualifying company.

2993. *Sub-paragraph (3)* then provides that, in the SIP code, "the employment requirement" means the requirement specified in *sub-paragraph (2)*.

2994. *Sub-paragraph (4)* is a drafting addition, indicating that the terms "qualifying period" and "qualifying company" receive further attention in paragraphs 16 and 17 respectively. The wording of this sub-paragraph is in alignment with wording used elsewhere (for example in paragraph 19(3) of this Schedule).

Paragraph 16: Qualifying periods

2995. This paragraph supplements paragraph 15, and specifies various qualifying periods that may apply. The paragraph derives from paragraph 14(2) to (5) of Schedule 8.

2996. The material in *sub-paragraphs (2)* and *(3)* has been substantially recast to produce a result similar to that achieved in paragraph 14.

Paragraph 17: Meaning of "qualifying company"

2997. This paragraph also supplements paragraph 15, and deals with the meaning of the expression "qualifying company". The paragraph derives from paragraph 14(1A) and (1B) of Schedule 8, inserted by paragraph 2 of Schedule 13 to FA 2001.

2998. It may not be obvious what is achieved by *sub-paragraph (3)(c)(ii)*, but this provision has a role to play. A qualifying company may fall within paragraph (a) or paragraph (b); or within paragraph (c)(i) as an associated company of a company within paragraph (a) or (b); or within paragraph (c)(ii) as an associated company of an associated company within paragraph (c)(i) (and so on indefinitely).

Paragraph 18: Requirement not to participate in other SIPs

2999. This paragraph restricts the ability of an individual to participate in an award of shares under more than one SIP in a tax year.

3000. The paragraph derives from paragraph 16 of Schedule 8. In that Schedule, paragraphs 17 to 22 supplement paragraph 15; so, to improve the narrative "flow", this paragraph now appears before the paragraphs rewriting paragraphs 15 and 17 to 22, which now constitute one single uninterrupted "block".

3001. The title to this paragraph has been changed to make it simpler.

3002. In *sub-paragraph (1)* the word "eligible" has been added to bring this provision into alignment with paragraphs 15(1) and 19(1).

3003. *Sub-paragraph (1)* combines and abbreviates paragraph 16(1) and (2) of Schedule 8. References to approved profit sharing schemes in paragraph 16(1) of Schedule 8 have been removed. *See Change 160* in Annex 1.

Paragraph 19: The "no material interest" requirement

3004. This paragraph states that the SIP must provide that an individual is not eligible to participate in an award of shares if the individual has (or has recently had) a "material interest" in a company with specified characteristics. In determining whether the individual has such a "material interest", it is necessary to consider the interests of the individual's "associates". This paragraph is accordingly then supplemented by paragraphs 20 and 21 (which deal with the meaning of "material interest") and by paragraphs 22 to 24 (which deal with the meaning of "associate"). This paragraph derives from paragraph 15 of Schedule 8.

3005. As the paragraphs in this Part of Schedule 8 have now been placed in a different order (see the explanatory notes relating to paragraph 18), this paragraph is now followed immediately by the paragraphs that supplement it.

3006. In *sub-paragraph (3)*, the wording of the two paragraphs has been brought into alignment.

Paragraph 20: Meaning of "material interest"

3007. This paragraph supplements paragraph 19. It contains the definition of "material interest" and is in its turn supplemented by paragraph 21. This paragraph derives from paragraph 17 of Schedule 8.

3008. *Sub-paragraphs (2)* and *(3)* separate out the two alternatives which, at present, are combined in the lengthy paragraph 17(1) of Schedule 8. In this Act, the two alternatives are called a material interest in the share capital of the company, and a material interest in the assets of a close company.

Paragraph 21: Material interest: options and interests in SIPs

3009. This paragraph supplements paragraph 20, and contains further provisions dealing with the meaning of the expression "material interest". The paragraph derives from paragraph 18 of Schedule 8 (in *sub-paragraphs (1)* to *(5)*) and from paragraph 19 of Schedule 8 (in *sub-paragraph (6)*).

3010. *Sub-paragraphs (3)* and *(4)* both derive from paragraph 18(2) of Schedule 8. This sub-paragraph has been divided to make the text easier to understand.

3011. In *sub-paragraph (6)*, the reference to "any approved profit sharing scheme" (in paragraph 19 of Schedule 8) has been omitted. The legislation relating to approved profit sharing schemes has not been rewritten; but, in this Act, paragraph 87 of Schedule 7 (transitionals and savings) preserves the effect of this reference.

Paragraph 22: Meaning of "associate"

3012. This paragraph also supplements paragraph 19. It contains the definition of "associate" and is in its turn supplemented by paragraphs 23 and 24. This paragraph derives from paragraph 20 of Schedule 8.

3013. In *sub-paragraph (1)* references to an "individual" replace references to a "person"; and in *sub-paragraph (1)(c)* different words are used to describe the relevant company.

3014. *Sub-paragraph (2)* is new. This provision links sub-paragraph (1)(c) with paragraphs 23 and 24 of this Schedule.

3015. In *sub-paragraph (3)* the definition of "relative" has been slightly amended.

Paragraph 23: Meaning of "associate": trustees of employee benefit trust

3016. This paragraph supplements paragraph 22 and contains provisions that apply where an individual is interested as a beneficiary of an employee benefit trust. The paragraph derives from paragraph 21 of Schedule 8.

3017. This paragraph has counterparts in Schedules 3, 4 and 5. Chapter 11 of Part 7 (supplementary provisions) defines the expression "employee benefit trust", and deals with further matters arising when payments from employee benefit trusts are made. In the later sub-paragraphs of this paragraph there are references to provisions in Chapter 11 of Part 7 and to the contents of that Chapter.

3018. The defined term "relevant company" in paragraph 21 of Schedule 8 has been omitted. This definition is not in fact used.

Paragraph 24: Meaning of "associate": trustees of discretionary trust
3019. This paragraph also supplements paragraph 22 and contains provisions that apply where an individual is interested as an object of a discretionary trust. The paragraph derives from paragraph 22 of Schedule 8.

3020. The defined term "relevant company" in paragraph 22 of Schedule 8 has been omitted. It is possible to rewrite this paragraph without making use of this definition.

3021. *Sub-paragraphs (1)* and *(2)* recast the material in paragraph 22(1) and (2). *Sub-paragraph (1)* deals with all the conditions (which, at present, are distributed between sub-paragraphs (1) and (2)); and *sub-paragraph (2)* states the main rule (which, at present, is contained in the full-out words at the end of sub-paragraph (2)).

Part 4: Types of shares that may be awarded
3022. This Part is the third of eight that deal with the requirements that a SIP must meet before it may be approved. This Part, which consists of paragraphs 25 to 33, deals with requirements relating to the types of shares that may be awarded.

3023. This Part of the Schedule imposes requirements that all SIPs must meet. It has therefore been placed at an earlier point in this Schedule than in Schedule 8 (where it is Part 8 of that Schedule). This change has the consequence that the order of Parts in Schedules 2 to 5 is in closer alignment.

3024. Within this Part, five requirements are listed in paragraph 25(1). Of these, the requirement imposed by paragraph 29 (prohibited shares) is now dealt with at an earlier point, thus enabling the requirement in paragraph 30 (only certain kinds of restriction allowed), which has further supplementary paragraphs, to be dealt with last.

3025. This Part is now entitled "Types of shares that may be awarded" as opposed to "Types of shares that may be used" (the title to Part 8 of Schedule 8).

Paragraph 25: Types of shares that may be awarded: introduction
3026. This paragraph is introductory, and derives from paragraph 59 of Schedule 8.

3027. *Sub-paragraph (1)* lists the requirements relating to types of shares that must be met before a SIP may be approved. The paragraph follows the source legislation and, unlike paragraphs 6 and 13 (for example), contains no reference to "plan requirements". This divergence may be explained by the fact that the requirements imposed in this Part of this Schedule are not matters that must be dealt with in the plan documentation.

3028. *Sub-paragraph (2)* then defines shares that may be awarded under the plan as "eligible shares". This definition is in a new sub-paragraph.

Paragraph 26: Shares must be part of ordinary share capital of certain companies

3029. This paragraph provides that the shares that may be awarded must be part of the ordinary share capital of a company with characteristics specified in this paragraph. The paragraph derives from paragraph 60 of Schedule 8.

Paragraph 27: Requirement as to listing etc.

3030. This paragraph provides that the shares that may be awarded must fall within one of the three categories specified in *sub-paragraph (1)*.

3031. The paragraph derives from paragraph 61 of Schedule 8, dividing that paragraph into two sub-paragraphs with the object of making its contents easier to follow. The definition of "listed company" in *sub-paragraph (2)* is new, and this sub-paragraph contains most of the material from paragraph 61(c).

Paragraph 28: Shares must be fully paid up and not redeemable

3032. This paragraph provides that eligible shares must be fully paid up and not redeemable. It derives from paragraph 62 of Schedule 8.

3033. In *sub-paragraph (2)*, the words "for the purposes of sub-paragraph (1)(a)" have been moved to the beginning of the sentence. This change brings this sub-paragraph into better alignment with *sub-paragraph (3)*, and makes it easier to grasp the relationship with sub-paragraph (1). *Sub-paragraph (2)* also contains new additional wording to make it clear that the payment of cash is to be made to the company whose shares are being issued.

3034. *Sub-paragraphs (4)* and *(5)* abbreviate the material in paragraph 62(4) and (5) of Schedule 8. In that Schedule, it is provided that sub-paragraph (1)(b) does not apply in relation to shares in a co-operative. The term "co-operative" is then defined as "a registered industrial and provident society which is a co-operative society"; and the terms "registered industrial and provident society" and "co-operative society" then receive definitions of their own. (This legislation was amended while the Finance Act 2000 was before Parliament.).

3035. In this Act the term "co-operative" has been omitted. It is provided instead (in *sub-paragraph (4)*) that *sub-paragraph (1)(b)* does not apply to shares in a registered industrial and provident society which is a co-operative society; and then, as before, the terms "registered industrial and provident society" and "co-operative society" are defined. This procedure enables the term "co-operative" to be omitted.

Paragraph 29: Prohibited shares

3036. This paragraph specifies types of shares that may not be awarded under a SIP. The paragraph derives from paragraph 67 of Schedule 8.

3037. The title of this paragraph is now "prohibited shares" as opposed to "prohibited companies". The new wording should provide a better indication of what is being prohibited.

3038. This paragraph now refers to a "service company" as opposed to an "employer company". The new term is more descriptive and accords better with actual commercial usage. The expression "the employer company" is used elsewhere in this Act to mean the employee's employer.

3039. Amendments have been made to *sub-paragraphs (1)(b)* and *(4)(b)* with a view to making those provisions easier to understand.

3040. *Sub-paragraph (4)* has wording differing from that in the source legislation. Schedule 1 to the Interpretation Act 1978 provides that "'person' includes a body of persons corporate or unincorporate"; and the view is taken that there can be no doubt that the word "person" includes a partnership.

Paragraph 30: Only certain kinds of restriction allowed

3041. This paragraph limits the restrictions to which eligible shares may be subject. Certain restrictions, however, are permitted, and these are specified in paragraphs 31 to 33, which supplement this paragraph. This paragraph derives from paragraph 63 of Schedule 8.

3042. In *sub-paragraph (1)* the order in which the three paragraphs appear has been changed to make the references to paragraphs 31 to 33 (which supplement this paragraph) more prominent, and to make the references to the paragraphs dealing with holding periods (which only appear later in this Schedule) less prominent.

3043. *Sub-paragraph (2)*, which rewrites paragraph 63(2) of Schedule 8, now divides that material into two sentences.

3044. The opening words of *sub-paragraph (3)* differ from those of the corresponding provision in the source legislation, and now include a reference back to *sub-paragraph (2)*. This has led to a further variation in the order of the sub-paragraphs in this paragraph; in paragraph 63 of Schedule 8, what is now *sub-paragraph (4)* preceded what is now *sub-paragraph (3)*.

Paragraph 31: Permitted restrictions: voting rights

3045. This paragraph supplements paragraph 30. It derives from paragraph 64 of Schedule 8.

Paragraph 32: Permitted restrictions: provision for forfeiture

3046. This paragraph also supplements paragraph 30 and deals with the circumstances in which free or matching shares may be subject to provision for forfeiture.

3047. This paragraph derives from sub-paragraphs (1) to (5) of paragraph 65 of Schedule 8. (Paragraph 65(6) of Schedule 8 is a definition of "provision for forfeiture" applying for the purposes of the SIP code generally. This definition has now been moved to paragraph 99(1) of this present Schedule.)

3048. *Sub-paragraph (1)* combines sub-paragraph (1) and the first part of sub-paragraph (2) of paragraph 65 in Schedule 8. The words "in the following circumstances" have been removed.

3049. *Sub-paragraph (2)* gives a complete list of the events within paragraph 87(2) of Schedule 8. Although the amount of text is increased and there is duplication, the view has been taken that it is more helpful to set the relevant material out again than to refer users to section 498(2).

3050. In *sub-paragraph (2)*, the reference at the beginning of this provision has been confined to sub-paragraph (1)(a). The reference can only be to paragraph (a) of sub-paragraph (1); and in the interests of clarity this cross-reference is more precise. Sub-paragraph (2)(d) reorganises the material in paragraph 87(3)(d) of Schedule 8.

Paragraph 33: Permitted restrictions: pre-emption conditions
3051. This paragraph also supplements paragraph 30 and deals with the circumstances in which pre-emption conditions may be permitted. The paragraph derives from paragraph 66 of Schedule 8.

Part 5: Free shares
3052. This Part is the fifth of eight that deal with the requirements that a SIP must meet before it may be approved. This Part, which consists of paragraphs 34 to 42, deals with requirements relating to free shares. A SIP does not have to provide for free shares to be appropriated to employees (it may provide for partnership shares to be acquired for employees - see paragraph 2(1)), so it may be expected that there will be SIPs to which the provisions of this Schedule do not apply.

Paragraph 34: Free shares: introduction
3053. This paragraph is introductory. It derives from paragraphs 23 and 25 of Schedule 8.

3054. *Sub-paragraph (1)* sets out the requirements that must be met by all SIPs that provide for free shares. This sub-paragraph expands paragraph 23 of Schedule 8 by specifying the relevant requirements, a procedure now adopted throughout this Schedule.

3055. *Sub-paragraph (2)* sets out the additional requirements that must be met by SIPs that provide both for free shares and for performance allowances (a term defined in paragraph 34(4)).

3056. *Sub-paragraph (4)* recasts the definition of "performance allowances" in paragraph 25(1) of Schedule 8.

3057. This paragraph follows the other introductory paragraphs in the various Parts of this Schedule by providing that a SIP must "meet" plan requirements, as opposed to "complying" with them.

Paragraph 35: Maximum annual award
3058. This paragraph specifies the maximum annual award for which the plan must provide. It derives from paragraph 24 of Schedule 8.

3059. There is a sub-paragraph for each individual proposition; and in *sub-paragraphs (2)* and *(4)*, the opening words "For this purpose", which occurred in the corresponding places in the earlier legislation, have been omitted.

Paragraph 36: The holding period
3060. This paragraph states that the plan must require the company to specify a period ("the holding period") during which a participant is bound to permit the free shares to remain in the hands of the trustees, and is bound not to dispose of the beneficial interest in those shares.

3061. This paragraph derives from paragraph 31 of Schedule 8. This paragraph has been placed somewhat earlier in this part of this Schedule, as the requirement set out in this paragraph applies whether or not the SIP makes provision for performance allowances (see paragraph 34(2)).

3062. *Sub-paragraph (3)* joins the two separate sentences in paragraph 31(3) of Schedule 8.

3063. *Sub-paragraphs (4)* and *(5)* divide the material presently contained in paragraph 31(4) of Schedule 8.

Paragraph 37: Holding period: power of participant to direct trustees to accept general offers etc.
3064. This paragraph provides that a participant may give directions of various types to the trustees during the holding period.

3065. This paragraph derives from paragraph 32 of Schedule 8. There has been a significant amount of reorganisation; and this paragraph is now divided into sub-paragraphs.

3066. *Sub-paragraph (1)* derives from the opening words of paragraph 32.

3067. *Sub-paragraphs (2)* and *(3)* derive from paragraphs (a) and (d) of paragraph 32 respectively. In *sub-paragraph (3)*, the words "as a result of" replace the words "pursuant to".

3068. *Sub-paragraphs (4)* to *(6)* rewrite paragraphs (b) and (c) of paragraph 32; but that material is now organised differently, with *sub-paragraph (5)* containing a definition of a "general offer".

Paragraph 38: Performance allowances: general application
3069. This paragraph states that a SIP that provides for performance allowances must provide for such allowances for all qualifying employees. The paragraph derives from paragraph 26 of Schedule 8.

3070. The expression "qualifying employee" is defined in paragraph 8(6) of this Schedule.

Paragraph 39: Performance allowances: targets and measures
3071. This paragraph specifies the performance targets and performance measurements that must be set where the SIP provides for performance allowances. The paragraph derives from paragraph 27 of Schedule 8.

3072. The material dealing with performance targets has now been placed before the material dealing with performance measures. This has resulted in some reorganisation of the contents of this paragraph, and an amendment to its title.

Paragraph 40: Performance allowances: information to be given to employees
3073. This paragraph specifies the information that must be given to employees if the SIP provides for performance allowances. The paragraph derives from paragraph 28 of Schedule 8.

3074. In *sub-paragraph (1)(a)* the words "each qualifying employee who has accepted an invitation to participate in the award" replace the words "each employee participating in the award". See *Change 161* in Annex 1.

Paragraph 41: Performance allowances: method one
3075. This paragraph deals with the first method of calculating performance allowances. It derives from paragraph 29 of Schedule 8.

3076. *Sub-paragraphs (1)* and *(2)* derive from paragraph 29(1) of Schedule 8. *Sub-paragraph (1)* is designed to correspond to *sub-paragraph (1)* in paragraph 42.

Paragraph 42: Performance allowances: method two
3077. This paragraph deals with the second method of calculating performance allowances.

3078. *Sub-paragraphs (1), (2), (4)* and *(5)* derive from paragraph 30 of Schedule 8; and *sub-paragraphs (3)* and *(6)* derive from paragraph 118(2)(c) and (4) of that Schedule.

3079. The material in *sub-paragraphs (3)* and *(6)* seems better placed here than in a paragraph dealing with disqualifying events, which has itself now been placed in Part 10 of this Schedule (Approval of plans). *See Note 64* in Annex 2.

Part 6: Partnership shares

3080. This Part is the fifth of eight that deal with the requirements that a SIP must meet before it may be approved. This Part, which consists of paragraphs 43 to 57, deals with requirements relating to partnership shares. A SIP does not have to provide for partnership shares to be acquired for employees (it may provide for free shares to be appropriated to employees - see paragraph 2(1)), so there may well be SIPs to which the provisions of this Part of this Schedule do not apply.

Paragraph 43: Partnership shares: introduction

3081. This paragraph is introductory.

3082. In Schedule 8, the requirements relating to partnership shares are introduced in paragraph 33. But that paragraph merely states that if a plan provides for partnership shares, it must comply with the requirements of that Part of Schedule 8. *Sub-paragraph (1)* follows an alternative, more helpful, procedure and (adopting the procedure used elsewhere in this Schedule) indicates the provisions that apply.

3083. *Sub-paragraph (1)* nevertheless departs from the introductory wording used at the beginning of the majority of the other Parts of this Schedule. This is because a number of the paragraphs in this Part of the Schedule are permissive as opposed to mandatory - that is, they deal with provisions which the plan may contain, as opposed to provisions that the plan must contain.

3084. *Sub-paragraph (3)* deals with a general point relating to the acquisition of partnership shares. This provision derives from paragraph 39(2) of Schedule 8; but it has now been moved so that this general point is dealt with early on.

3085. *Sub-paragraph (4)* contains the definition of the word "salary". This definition is in paragraph 48 of Schedule 8; and it has been amended by paragraph 3 of Schedule 13 to FA 2001. The ambit of this definition has, however, been widened, so that this definition, instead of applying only for the purposes of the provisions relating to partnership shares, applies for the purposes of the SIP code generally. *See Note 65(A)* in Annex 2.

Paragraph 44: Partnership share agreements

3086. This paragraph states that the SIP must provide for qualifying employees to enter into partnership share agreements. (The definition of "qualifying employee" may be found in paragraph 8(6) of this Schedule.) This paragraph derives from paragraph 34 of Schedule 8.

3087. This paragraph now has three sub-paragraphs. *Sub-paragraph (2)* deals with the definition of the term "partnership share agreements" and the ambit of that definition.

3088. Paragraph 34 of Schedule 8 referred to "the company" on three different occasions, with the company being defined elsewhere in that Schedule, in relation to a SIP, as the company which established the plan (as it is in paragraph 2(2) of this Schedule). One of those three occasions referred to the employee authorising the company to deduct part of the employee's salary. However, in the case of a group plan, an employee might be employed by a group company which had not established the SIP; and, in such a case, the reference to authorising "the company" to make deductions from salary would not work well.

3089. *Sub-paragraph (1)(a)*, read with *sub-paragraph (3)*, accordingly provides for the authorisation to make deductions from the employee's salary to be given to the company by reference to which the employee meets the employment requirement in relation to the plan. See *Change 162* in Annex 1.

Paragraph 45: Deductions from salary

3090. This paragraph states that the SIP must provide for a partnership share agreement to be given effect by deductions from the employee's salary. Amounts so deducted are referred to in the SIP code as "partnership share money". This paragraph derives from paragraph 35 of Schedule 8.

3091. The rewritten paragraph has six sub-paragraphs (as opposed to the four in paragraph 35 of Schedule 8); but in the rewritten legislation each sub-paragraph consists of a single sentence. (In the case of sub-paragraph (3), two separate sentences have been joined.)

3092. In sub-paragraph (2), the term "partnership share money" now applies to the entirety of the SIP code, instead of being confined to one part of Schedule 8, as was the case in FA 2000. In other contexts the expression was undefined; but it is considered that the definition provided here would have been held to apply in those other contexts also. See *Note 65(B)* in Annex 2.

Paragraph 46: Maximum amount of deductions

3093. This paragraph specifies the maximum amount of partnership share money that may be deducted. The paragraph derives from paragraph 36 of Schedule 8.

3094. In the second sentence of *sub-paragraph (2)*, the word "This" has been replaced by the more specific "10% of the employee's salary".

3095. In *sub-paragraphs (3)* and *(4)*, two sub-paragraphs, each one sentence long, now replace a single sub-paragraph with two sentences. In *sub-paragraph (4)* there have been changes in the detail of the wording.

Paragraph 47: Minimum amount of deductions
3096. This paragraph specifies the minimum amount of partnership share money that may be deducted. The paragraph derives from paragraph 37 of Schedule 8.

3097. In *sub-paragraph (1)*, the words "under a partnership share agreement" replace the words "in pursuance of the partnership share agreement"; and in *sub-paragraph (3)*, the words "may be" have been added at the end.

Paragraph 48: Notice of possible effect of deductions on benefit entitlement
3098. This paragraph states that the SIP must provide that the company may not enter into a partnership share agreement unless the employee is given a notice relating to the possible effect of deductions on social security benefits. The paragraph derives from paragraph 38 of Schedule 8.

3099. That paragraph provides authority to make regulations, and regulations have been made. They are the Employee Share Ownership Plans (Partnership Shares - Notice of Effects on Benefits, Statutory Sick Pay and Statutory Maternity Pay) Regulations 2000 (SI 2000 No 2090).

Paragraph 49: Partnership share money held for employee
3100. This paragraph states that the SIP must provide that partnership share money must be paid to the trustees and held by them on the employee's behalf. The paragraph derives from paragraph 39(1), (3) and (4) of Schedule 8.

3101. In *sub-paragraph (1)* the words "in accordance with" have been replaced by the word "under".

3102. *Sub-paragraph (3)* has been amended to take account of the amendments made by article 107 of the Financial Services and Markets Act 2000 (Consequential Amendments) (Taxes) Order 2001 (SI 2001 No 3629).

3103. In *sub-paragraph (4)*, the word order has been changed. The subject of the sentence has been placed first, followed immediately by the main verb, and the condition has been moved to the end of the sentence.

Paragraph 50: Application of money deducted where no accumulation periods
3104. This paragraph specifies how partnership share money must be applied if the SIP does not provide for an accumulation period. The paragraph derives from paragraph 40 of Schedule 8.

3105. The five sub-paragraphs have, however, been placed in a different order. The major proposition has been placed first (*sub-paragraph (1)*); and this is followed by the proposition relating to the market value of the shares (*sub-paragraph (2)*). It is only these two sub-paragraphs that are affected by the operation of paragraph 53 (restrictions on number of shares awarded), so this limitation is dealt with next (*sub-paragraph (3)*). The definition of the expression "the acquisition date" is dealt with

next (*sub-paragraph (4)*) in a location that follows the two sub-paragraphs in which the expression is used (as opposed to being placed between those two sub-paragraphs). The provision dealing with surplus partnership money is now placed at the end (*sub-paragraph (5)*).

Paragraph 51: Accumulation periods
3106. This paragraph contains provisions that apply if the SIP provides for an accumulation period. The paragraph derives from paragraph 41 of Schedule 8.

3107. The material in Schedule 8 has been rearranged, with a view to making the main propositions more prominent and easier to understand. *Sub-paragraph (2)* derives from the opening words of paragraph 41(2) of Schedule 8; and *sub-paragraphs (3)* and *(4)* reorganise all the other material in paragraph 41(2) and (3) of that Schedule.

3108. At the end of *sub-paragraph (4)(b),* the words "all individuals entering into partnership share agreements" have replaced the words "all individuals who are eligible to participate in the award". The new wording is intended to be a more accurate statement of the legislative intention. See *Change 163* in Annex 1.

3109. *Sub-paragraph (5)* is arranged somewhat differently from paragraph 41(4) of Schedule 8.

Paragraph 52: Application of money deducted in accumulation period
3110. This paragraph contains provisions that govern how partnership share money deducted may be applied during an accumulation period. The paragraph derives from paragraph 42 of Schedule 8.

3111. The material in this paragraph has been rearranged. After the introductory proposition (*sub-paragraph (1)*), the central propositions are now in *sub-paragraphs (2)* and *(3)*; those propositions are followed by a limitation that applies to those two sub-paragraphs (*sub-paragraph (4)*), and then by a definition with the same ambit (*sub-paragraph (5)*).

3112. *Sub-paragraph (4)* provides for sub-paragraphs (2) and (3) (instead of the paragraph as a whole) to be subject to paragraph 53; and sub-paragraph (5) provides for the definition of "the acquisition date" to apply in both sub-paragraphs (2) and (3) (instead of in sub-paragraph (2) only as in paragraph 42 of Schedule 8).

3113. In sub-paragraph (2) the words "under a partnership share agreement" have been added; and in *sub-paragraph (7)* the constituent parts of this provision have been reorganised, and the words "to be" have been added in the expression "is to be paid".

Paragraph 53: Restriction on number of shares awarded
3114. This paragraph provides that the SIP may authorise the company to specify the maximum number of shares to be included in an award of partnership shares.

3115. This paragraph derives from paragraph 43 of Schedule 8, presenting the material in a somewhat different order.

3116. The wording of sub-paragraph (5) has been modified to deal with the removal of the expression "the individual award" (an expression introduced in paragraph 3 of Schedule 8), which made its one and only appearance at this point. The new wording includes the expression "on behalf of each employee".

Paragraph 54: Stopping and re-starting deductions
3117. An employee is entitled both to stop deductions under a partnership share agreement and to restart those deductions. This paragraph sets out the requirements that the SIP must contain to deal with these matters.

3118. This paragraph derives from paragraph 44 of Schedule 8. The material is presented in a somewhat different order, with the new order following the order in which events may be expected to occur.

3119. *Sub-paragraphs (1)* and *(3)* refer to deductions "under" a partnership share agreement and not to deductions "in pursuance of" a partnership share agreement.

3120. *Sub-paragraph (7)* retains the requirement that a notice under this paragraph should be a notice in writing, but moves that requirement to a sub-paragraph of its own.

Paragraph 55: Withdrawal from partnership share agreement
3121. This paragraph sets out the requirement that a SIP must provide that an employee may give notice to withdraw from a partnership share agreement. The paragraph derives from paragraph 45 of Schedule 8.

3122. *Sub-paragraph (1)* has been rewritten to emphasise that it is the notice that may be given at any time rather than the withdrawal from the plan that may be effected at any time.

3123. *Sub-paragraph (4)* retains the requirement that a notice under this paragraph should be a notice in writing, but moves that requirement to a sub-paragraph of its own.

Paragraph 56: Repayment of partnership share money on withdrawal of approval or termination
3124. This paragraph sets out the requirement that a SIP must provide that partnership share money held on behalf of an employee must be paid over to that employee in certain circumstances. The paragraph derives from paragraph 46 of Schedule 8.

3125. This material has been placed in a different order. Provisions relating to the withdrawal of approval are dealt with before the provisions relating to the issue of a plan termination notice.

Paragraph 57: Access to partnership shares
3126. This paragraph sets out the requirement that a SIP must provide that, when partnership shares have been awarded to an employee, the employee may withdraw any or all of those shares from the plan. The paragraph derives from paragraph 47 of Schedule 8.

3127. *Sub-paragraph (2)* has been expanded by the addition of the words "If the employee does so" at the beginning of this provision.

Part 7: Matching shares
3128. This Part is the sixth of eight that deal with the requirements that a SIP must meet before it may be approved. This Part, which consists of paragraphs 58 to 61, deals with requirements relating to matching shares. A SIP does not have to provide for matching shares - defined earlier in this Schedule as shares that may be appropriated without payment to employees in proportion to the partnership shares acquired by them (see paragraph 3(1)). There will therefore probably be SIPs to which the provisions of this Part of this Schedule do not apply.

Paragraph 58: Matching shares: introduction
3129. This paragraph is introductory, setting out the requirements that a SIP must meet if it provides for matching shares. It derives from paragraph 49 of Schedule 8..

3130. This paragraph lists the requirements contained in the following paragraphs of Part 7 of this Schedule, introducing the individual paragraphs that will follow (as in paragraph 6 of Schedule 8) as opposed to stating that the plan "must comply with the requirements of this Part of this Schedule" (as in paragraph 49 of Schedule 8).

Paragraph 59: General requirements for matching shares
3131. This paragraph sets out the general requirements relating to matching shares that must be contained in the SIP. The paragraph derives from paragraph 50 of Schedule 8.

Paragraph 60: Ratio of matching shares to partnership shares
3132. This paragraph sets out the ratio of matching shares to partnership shares that must be specified in the partnership share agreement. The paragraph derives from paragraph 51 of Schedule 8.

Paragraph 61: Holding period for matching shares
3133. This paragraph applies the provisions relating to the holding period for free shares to matching shares. The paragraph derives from paragraph 52 of Schedule 8.

3134. The rewritten paragraph is more closely aligned with paragraph 67 of this Schedule than is the case with the corresponding provisions in Schedule 8.

Part 8: Cash dividends and dividend shares

3135. This Part is the seventh of eight that deal with the requirements that a SIP must meet before it may be approved. This Part, which consists of paragraphs 62 to 69, deals with the treatment of cash dividends. The SIP may provide that, where the company so directs, the cash dividends must be applied in acquiring further plan shares, known as "dividend shares". The application of cash dividends in this way is referred to as "reinvestment" in the SIP code.

3136. Although it would be more consistent to begin each Part of this Schedule by listing the plan requirements that must be met, there are difficulties in beginning this Part in this way. The plan may or may not contain a direction authorising reinvestment; and the company may or may not give a direction for reinvestment to take place. The list of provisions that apply if the trustees are authorised to carry out reinvestment is therefore postponed until paragraph 63.

Paragraph 62: Reinvestment of cash dividends

3137. This paragraph sets out propositions that are of central importance for this Part of this Schedule. A SIP may provide that, where the company so directs, the trustees must apply all cash dividends in respect of plan shares in acquiring further plan shares on behalf of participants. This application of cash dividends is referred to as "reinvestment" in the SIP code, and the further plan shares acquired are referred to as "dividend shares".

3138. *Sub-paragraphs (1)* to *(4)* of this paragraph derive from sub-paragraphs (1), (2) and (4) of paragraph 53 of Schedule 8; and *sub-paragraph (5)* derives from paragraph 56(5) of that Schedule. (Paragraph 53(3) of Schedule 8 is the source for paragraph 69 in this Schedule.).

3139. Sub-paragraph (1) contains a reference to "the trustees", so permitting the use of a verb in the active, and not the passive, voice; and sub-paragraph (4) contains additional concluding words to make its meaning easier to grasp.

3140. *Sub-paragraph (5)* consists of a proposition placed considerably earlier than in the corresponding Part of Schedule 8, in the interests of user-friendliness.

Paragraph 63: Requirements to be met as regards cash dividends

3141. This paragraph lists the paragraphs in this Part that apply if the trustees of the SIP are directed to apply cash dividends in acquiring further plan shares. It is new.

3142. *Sub-paragraph (3)* provides that the SIP must in any event meet the requirement contained in paragraph 69.

Paragraph 64: Limit on amount reinvested
3143. This paragraph specifies a limit for total dividend reinvestment that must be included in the plan. It derives from paragraph 54 of Schedule 8.

3144. *Sub-paragraph (2)(b)* has new wording, including a mention of "approved SIPs", and this has permitted the removal of the two further sub-paragraphs from the source legislation.

Paragraph 65: General requirements as to dividend shares
3145. This paragraph sets out the general requirements relating to dividend shares that the plan must meet. It derives from paragraph 55 of Schedule 8.

3146. In *paragraph (a)*, the words "in the same company" have been added at the beginning. It is likely that these words would be implied if the point ever arose; but the addition of these words put the point beyond any doubt. See *Note 66* in Annex 2.

Paragraph 66: Acquisition of dividend shares
3147. This paragraph sets out the conditions relating to the acquisition of dividend shares that a SIP must meet. The acquisition must take place on "the acquisition date". The paragraph derives from sub-paragraphs (1) to (4) of paragraph 56 of Schedule 8. (Paragraph 56(5) of Schedule 8 is the source of paragraph 62(5) of this Schedule.)

3148. The definition of "the acquisition date" has now been placed at the end of this paragraph (in *sub-paragraph (4)*); and there have been changes in the detail of the wording at various places in this paragraph.

3149. The second sentence of paragraph 56(2) of Schedule 8 has been omitted. This sentence merely stated a proposition that was true in any case, and has accordingly been removed on the basis that it is unnecessary.

Paragraph 67: Holding period for dividend shares
3150. This paragraph applies the provisions relating to the holding period for free shares to dividend shares. It derives from paragraph 57 of Schedule 8.

3151. The paragraph is more closely aligned with paragraph 61 of this Schedule than is the case with the corresponding provisions in Schedule 8.

Paragraph 68: Reinvestment: amounts to be carried forward
3152. This paragraph contains provisions that apply when an amount is not reinvested. The paragraph derives from paragraph 58 of Schedule 8.

3153. *Sub-paragraphs (1)* to *(3)* all derive from paragraph 58(1) of Schedule 8. In order to make the legislation easier to understand that provision is divided into a number of separate propositions; and, as a result, there have been changes in the detail of the wording. In *sub-paragraphs (4)(b)* and *(c)*, cross-references have been added.

Paragraph 69: Cash dividends where no requirement to reinvest
3154. This paragraph sets out the provision that a SIP must make for cash dividends that are not required to be reinvested under the plan. The dividends must be paid over to participants as soon as practicable.

3155. This paragraph derives from paragraph 53(3) of Schedule 8; but that sub-paragraph is now dealt with separately to take account of the circumstances in which it applies (see paragraph 63(3) of this Schedule).

3156. The material in paragraph 53(3) of Schedule 8 has been reorganised and divided into two sub-paragraphs to make it easier to understand. The definition of "distributable cash dividends" is new.

Part 9: Trustees
3157. This Part is the last of eight that deal with the requirements that a SIP must meet before it is approved. This Part, which consists of paragraphs 70 to 80, deals with the requirements relating to the trustees. All SIPs must have trustees; but, in accordance with the general policy of placing the various Parts of Schedules 2 to 5 in an order displaying overall consistency, this Part is now the final Part that deals with the requirements to be met.

Paragraph 70: Requirements etc. relating to trustees: introduction
3158. This paragraph is introductory. It is new, being designed to fulfil the same purpose of introducing paragraphs in Part 9 of this Schedule as is played by other corresponding early paragraphs in each of Parts 2 to 8 of this Schedule.

3159. In Part 9 of this Schedule, there are two paragraphs that impose plan requirements that must be met, and these are listed in *sub-paragraph (1)*. However, the majority of the paragraphs relate to the powers and duties of the trustees, and these are listed in *sub-paragraph (2)*.

Paragraph 71: Establishment of trustees
3160. This paragraph sets out the requirements and duties that a SIP must contain regarding the establishment and duties of the trustees. The paragraph derives from paragraph 68 of Schedule 8.

3161. *Sub-paragraph (1)* has been reworded to make it clear that the body of trustees should consist of persons resident in the United Kingdom.

3162. *Sub-paragraph (3)* provides for the introduction of the term "the trust instrument". Schedule 8 contains no formal introduction of this term, although the term is used extensively in the following paragraphs of this Part.

3163. *Sub-paragraphs (5)* and *(6)* incorporate provisions deriving from the Employee Share Schemes Act 2002.

Paragraph 72: Duty to act in accordance with participant's directions
3164. This paragraph provides that the trust instrument must require the trustees to act in accordance with a participant's directions.

3165. The paragraph is the first of three that derive from paragraph 71 of Schedule 8. That paragraph is lengthy; and its contents are divided up in the new legislation, to make its contents more accessible. This paragraph derives from sub-paragraphs (1) and (2) of paragraph 71.

Paragraph 73: Duty not to dispose of plan shares
3166. This paragraph provides that the trust instrument must require the trustees not to dispose of plan shares during the holding period (although this general rule is subject to certain exceptions). (The expression "the holding period" is defined in paragraph 36 of this Schedule.)

3167. The paragraph is the second of three that derive from paragraph 71 of Schedule 8. This paragraph derives from paragraph 71(3).

3168. In *sub-paragraph (2)*, the reference to a participant ceasing to be in relevant employment is explained further in paragraph 95.

Paragraph 74: Duty to make payments to participants
3169. This paragraph provides that the trust instrument must require the trustees to make payments to participants in various specified circumstances.

3170. The paragraph is the third of three that derive from paragraph 71 of Schedule 8. This paragraph derives from paragraph 71(4).

3171. *Sub-paragraph (1)* reorganises the material in the first sentence of paragraph 71(4). In *sub-paragraph (2)(c)*, the expression "PAYE obligations" is defined in paragraph 99(1) of this Schedule.

Paragraph 75: Duty to give notice of award of shares etc.
3172. This paragraph provides that the trust instrument must require the trustees to give various notices to employees. The paragraph derives from paragraph 70 of Schedule 8.

3173. *Sub-paragraph (3)* now has three paragraphs, as opposed to the corresponding provision in the source legislation, which had two paragraphs, one of which had two sub-paragraphs of its own. This enables sub-paragraphs (2), (3) and (4) to be brought into better alignment.

3174. *Sub-paragraph (6)* reproduces the definition of "foreign cash dividend" in paragraph 129(1) of Schedule 8. Although that definition is expressed to apply for the whole of Schedule 8, it is only needed for the purposes of this paragraph; and it has, accordingly, been moved.

Paragraph 76: Power of trustees to borrow
3175. This paragraph states that the trust instrument may provide the trustees with powers to borrow. The paragraph derives from paragraph 69 of Schedule 8.

Paragraph 77: Power of trustees to raise funds to subscribe for rights issue
3176. This paragraph gives the trustees powers to deal with rights arising under a rights issue. The paragraph derives from paragraph 72(1) of Schedule 8; and it gives a separate sub-paragraph to each sentence in that earlier provision.

3177. The expression "rights arising under a rights issue", the subject of paragraph 72(2) of Schedule 8, occurs in more than one place; and, accordingly, has now been defined for the purposes of the SIP code generally (in paragraph 99(1) of this Schedule).

Paragraph 78: Acquisition by trustees of shares from employee share ownership trust
3178. This paragraph contains provisions that apply where the SIP acquires shares from an employee share ownership trust. The paragraph derives from paragraph 76 of Schedule 8.

3179. *Sub-paragraph (2)* is now organised slightly differently; and *sub-paragraph (2)(a)* contains additional words explaining the reference to "relevant shares", a term left unexplained in the source legislation. See *Note 65(C)* in Annex 2.

Paragraph 79: Meeting by trustees of PAYE obligations
3180. This paragraph sets out the requirement that the SIP must make provision to ensure that trustees meet their PAYE obligations. The paragraph derives from paragraph 73 of Schedule 8.

3181. The title to this paragraph has been amended to include a reference to the trustees.

3182. *Sub-paragraph (1)* now has three paragraphs, as opposed to the corresponding provision in the source legislation, which had two paragraphs, one of which had two sub-paragraphs of its own.

3183. *Sub-paragraph (4)* is explanatory only; but is retained in order to assist the reader.

Paragraph 80: Other duties of trustees in relation to tax liabilities
3184. This paragraph provides that the trust instrument must set out other duties of trustees in relation to tax liabilities.

3185. The paragraph derives from paragraph 75 of Schedule 8 (in sub-paragraphs (1) to (3)) and paragraph 90 of Schedule 8 (in sub-paragraph (4)).

3186. The material in this paragraph has now been arranged rather differently and in particular the two duties placed on the trustees by the trust instrument have now been separated to become *sub-paragraphs (1)* and *(3)*.

3187. *Sub-paragraphs (4)* and *(5)* deal with administrative matters and derive from provisions in paragraphs 90, 92 and 93 of Schedule 8.

Part 10: Approval of plans

3188. It was mentioned, in the overview to the explanatory notes for this Schedule, that the contents of this Schedule could be divided into three categories. Parts 2 to 9 of this Schedule deal with the first category: the requirements that must be met before a SIP may be "approved" for the purposes of the SIP code. This Part deals with the second category: procedural matters relating to the obtaining of approval and the withdrawal of approval. In doing so, this Part brings together material in Parts 1 and 13 of Schedule 8.

Paragraph 81: Application for approval

3189. This paragraph deals with the mechanics of the application for approval of a SIP. The paragraph derives from paragraph 4 of Schedule 8.

3190. This paragraph makes two changes to the law. The first change is in *sub-paragraph (2)*, where it is provided that the application must be in writing. This requirement is not contained in Schedule 8, but there is such a requirement for the SAYE and CSOP schemes. The second change is in *sub-paragraph (3)*, which is new. It provides that once the Inland Revenue have decided whether or not to approve the plan, they must give notice of their decision to the company. See *Change 164* in Annex 1.

Paragraph 82: Appeal against refusal of approval

3191. This paragraph provides that a company may appeal to the Special Commissioners if the Inland Revenue refuse to approve the SIP. It derives from paragraph 5 of Schedule 8.

3192. *Sub-paragraphs (3)* and *(4)* divide the material in paragraph 5(3) of Schedule 8.

Paragraph 83: Withdrawal of approval

3193. This paragraph contains provisions relating to the withdrawal of approval of an approved SIP.

3194. The paragraph is the first of two rewriting paragraph 118 of Schedule 8. Paragraph 118 is lengthy, and has been divided for ease of comprehension. This paragraph derives from sub-paragraphs (1) and (7) of paragraph 118 and deals with the mechanics and implications of the withdrawal of approval. The withdrawal of approval depends on the occurrence of a "disqualifying event"; and paragraph 84 deals with the meaning of this expression.

3195. *Sub-paragraph (2)(b)* makes it clear that the "later time" must be a time specified in the notice. *Sub-paragraphs (3)* and *(4)* rewrite paragraph 118(7) of Schedule 8, providing a separate sub-paragraph for each proposition.

Paragraph 84: Disqualifying events for purposes of paragraph 83
3196. This paragraph specifies what is meant by a "disqualifying event".

3197. The paragraph is the second of two rewriting paragraph 118 of Schedule 8. It derives from sub-paragraphs (2) to (6) of that paragraph.

3198. *Sub-paragraph (1)(f)* and *(g)* constitute a splitting of the material to be found in paragraph 118(2)(f) of Schedule 8.

3199. *Sub-paragraph (6)* extends the scope of the expression "key feature". In paragraph 118 there is a definition of this expression (in sub-paragraph (3)(a)). This definition, however, applies only for the purposes of sub-paragraph (2)(b), but the expression is used again, without explanation, in sub-paragraph (6)(a)(i). The scope of this definition has been expanded so that it now applies to the whole of this paragraph. See *Note 65(D)* in Annex 2.

Paragraph 85: Appeal against withdrawal of approval
3200. This paragraph provides that a company may appeal to the Special Commissioners if the Inland Revenue withdraw approval of a SIP.

3201. The paragraph derives from paragraph 119 of Schedule 8. *Sub-paragraphs (1)* and *(2)* reorganise the material from that paragraph to a certain extent.

Part 11: Supplementary provisions
3202. It was mentioned, in the overview to the explanatory notes for this Schedule, that the contents of this Schedule could be divided into three categories. Parts 2 to 9 of this Schedule deal with the first category (the requirements that must be met before a SIP may be "approved" for the purposes of the SIP code) and Part 10 with the second category (procedural matters). This is the eleventh and final Part of this Schedule, and deals with the third category (supplementary provisions). This Part of this Schedule is derived from material in Part 13 of Schedule 8.

Paragraph 86: Company reconstructions
3203. This paragraph deals with company reconstructions, and is the first of two that derive from paragraph 115 of Schedule 8. This paragraph derives from sub-paragraphs (1) and (2) of paragraph 115, and deals with the meaning of the expression "company reconstruction". The consequences of company reconstructions are dealt with in paragraph 87 of this Schedule.

3204. *Sub-paragraph (3)(a)* is new; and specifies the consequences of the making of what is now termed an "excluded issue of shares". This material is not contained in

the source legislation; but the new material is merely declaratory of the law in order to make those consequences explicit. See *Note 67* in Annex 2.

3205. In *sub-paragraph (4)*, the label "excluded issue of shares" is new.

Paragraph 87: Consequences of company reconstructions
3206. This paragraph deals with the consequences of company reconstructions, and is the second of two that derive from paragraph 115 of Schedule 8. This paragraph derives from sub-paragraphs (3) to (8) of paragraph 115.

3207. This paragraph presents the legislation in a somewhat different order; and, in particular, the sub-paragraph containing definitions (*sub-paragraph (7)*) has been placed at the end. As a result of the rewriting of the legislation contained in the SIP code, *sub-paragraph (2)(d)* has wording that differs from that to be found in the source legislation.

3208. In this paragraph, the label "corresponding shares" has been replaced by the label "corresponding old shares".

Paragraph 88: Treatment of shares acquired under rights issue
3209. This paragraph contains provisions that apply where the trustees exercise rights arising under a rights issue. The paragraph derives from paragraph 116 of Schedule 8.

3210. The order in which the material is presented has been changed substantially. *Sub-paragraph (1)* now specifies the circumstances in which this paragraph applies; and *sub-paragraph (2)* now deals with the "basic" case (where the rights are exercised), leaving later sub-paragraphs to deal with other cases.

3211. In paragraph 116 of Schedule 8, paragraph 116(5) is concerned with the meaning of the expression "rights arising under a rights issue", and provides a cross-reference to another provision in Schedule 8. This expression is now defined in paragraph 99(1) of this Schedule for the purposes of the SIP code generally.

Paragraph 89: Termination of plan
3212. This paragraph contains provisions relating to the termination of a plan; and this may be done if the company issues a plan termination notice. The paragraph derives from paragraph 120 of Schedule 8.

3213. *Sub-paragraph (2)* now has four paragraphs, as opposed to the corresponding provision in the source legislation which had three paragraphs, one of which had two sub-paragraphs of its own. In *paragraph (d)* the word "into" has been added after the word "entered".

Paragraph 90: Effect of plan termination notice
3214. This paragraph deals with the effect of a plan termination notice. The paragraph derives from paragraph 121 of Schedule 8.

3215. The first sentence of paragraph 121(3) has been rewritten as *sub-paragraph (3)*. The second sentence of paragraph 121(3) has, however, been omitted, on the basis that it is unnecessary.

3216. *Sub-paragraph (7)* has been rewritten, to bring the subject, verb and direct object of this sentence closer together.

3217. In *sub-paragraph (8)* the words "doing the following in the case of each participant" have been added.

3218. *Sub-paragraph (9)* has been amended to provide that where a participant has died, the references to a participant in the entirety of this paragraph (as opposed to sub-paragraph (8)) are to the participant's personal representatives. See *Change 165* in Annex 1.

Paragraph 91: Jointly owned companies
3219. This paragraph contains provisions that apply in the case of a jointly owned company, an expression defined in *sub-paragraph (5)*. The paragraph derives from paragraph 127 of Schedule 8, a paragraph that has been amended by section 39(5) of FA 2002.

Paragraph 92: Determination of market value
3220. This paragraph explains how market value is determined for the purposes of the SIP code. The paragraph derives from paragraph 125 of Schedule 8.

3221. Each proposition in this paragraph now appears in its own sub-paragraph.

3222. In *sub-paragraph (3)*, the constituent parts of the sentence have been rearranged; and this sub-paragraph concludes with a reference to agreed matters "stated" in the agreement.

Paragraph 93: Power to require information
3223. This paragraph is concerned with information powers. It derives from paragraph 117 of Schedule 8.

3224. *Sub-paragraph (1)* reorganises the material in paragraph 117(1). The reorganisation includes the addition of paragraphing.

3225. *Sub-paragraph (3)* has been redrafted, with a view to clarifying the period within which information must be provided.

3226. Paragraph 117(4) of Schedule 8 has not been rewritten in this Schedule. The matter dealt with in that sub-paragraph, the addition of an entry in the table in section 98 of TMA 1970, is dealt with by means of consequential amendment to that section in Schedule 6 to this Act.

Paragraph 94: Meaning of "associated company"
3227. This paragraph explains the meaning of the expression "associated company" for the purposes of the SIP code. The paragraph derives from paragraph 126 of Schedule 8. The words "at a given time" have been added in *sub-paragraph (1)*.

Paragraph 95: Meaning of participant ceasing to be in relevant employment
3228. This paragraph explains the meaning of a participant ceasing to be in relevant employment for the purposes of the SIP code. The paragraph derives from paragraph 123 of Schedule 8.

3229. The words "for the purposes of the SIP code" have been added in *sub-paragraphs (1)* and *(2)*; and the word order has been changed in s*ub-paragraph (3)*.

Paragraph 96: Meaning of shares being withdrawn from plan
3230. This paragraph explains when shares are withdrawn from a plan for the purposes of the SIP code.

3231. This paragraph is the first of two that derive from paragraph 122 of Schedule 8. That paragraph is lengthy, and with a view to making its provisions more accessible, it has been divided for the purposes of this Act. This paragraph derives from sub-paragraphs (1) and (2) of paragraph 122.

Paragraph 97: Meaning of shares ceasing to be subject to plan
3232. This paragraph explains when shares cease to be subject to a plan for the purposes of the SIP code.

3233. This paragraph is the second of two that derive from paragraph 122 of Schedule 8, deriving in this case from sub-paragraphs (3) to (5) and (7) of that paragraph. (Paragraph 122(6) of Schedule 8 has been rewritten as section 508.)

3234. *Sub-paragraph (2)* derives from paragraph 122(4) of Schedule 8. This material has been reorganised, and paragraphs have been added.

Paragraph 98: Meaning of "the specified retirement age"
3235. This paragraph provides for a new definition (that of "the specified retirement age") to apply for the purposes of the SIP code. This new provision derives from paragraph 87(4) of Schedule 8.

Paragraph 99: Minor definitions
3236. This paragraph contains minor definitions. It derives from paragraph 129 of Schedule 8.

3237. In *sub-paragraph (1)*, amendments have been made to the detail of the wording of the definition of "plan shares".

3238. The definition of "provision for forfeiture" is now in sub-paragraph (1), having been moved from paragraph 65(6) of Schedule 8.

3239. The definition of "redundancy" is also now in sub-paragraph (1), having been moved from paragraph 87(3) of Schedule 8.

3240. There is also a new definition of "rights arising under a rights issue" in sub-paragraph (1). This definition brings together the partial definitions that may be found in different places in Schedule 8.

3241. The definition of "foreign cash dividend", which may be found in paragraph 129(1) of Schedule 8, has been removed. That definition is used only once (see paragraph 75 of this Schedule), and is dealt with there.

Paragraph 100: Index of defined expressions
3242. This paragraph consists of an index of expressions defined or explained for the purposes of the SIP code. It is in the same form as the index in paragraph 130 of Schedule 8.

SCHEDULE 3: APPROVED SAYE OPTION SCHEMES
Overview
3243. This Schedule, which is introduced in Chapter 7 of Part 7, deals with the rules relating to approved SAYE option schemes. The legislation relating to SAYE option schemes, which is contained in Chapter 7 of Part 7 and in this Schedule, is called "the SAYE code", a term introduced in section 516. Chapter 7 of Part 7 deals with the tax exemptions available for participants in an approved SAYE option scheme.

3244. The legislation relating to these schemes derives from Schedule 9 to ICTA: many of the definitions are supplied by section 187 of ICTA.

3245. This Schedule contains further provisions relating to SAYE option schemes. After the introductory Part (Part 1) it deals with the following matters:

- it specifies the requirements that a SAYE option scheme must meet in order to be "approved" for the purposes of the SAYE code (in Parts 2 to 7);
- it deals with the procedural aspects of the approval of schemes and the withdrawal of approval (in Part 8); and
- it deals with supplementary matters (in Part 9).

3246. The majority of the provisions in this Schedule are therefore concerned with the various requirements that SAYE option schemes must meet before they may be

"approved". On this topic the general policy has been to place the various Parts in an order consistent with that to be found in the legislation relating to other share schemes. The various requirements have been placed in a different order from that found in Schedule 9 to ICTA. Part 2 of this Schedule accordingly deals with the general requirements that apply in all cases; Part 3 with the requirements relating to the eligibility of individual employees; and Part 4 with the types of shares to which schemes can apply. The following Parts then deal with requirements relating to linked savings schemes (Part 5), share options (Part 6) and the exchange of options (Part 7).

3247. Where it seems helpful the opportunity has been taken to list the requirements relevant for a Part. This procedure is the same as that adopted in Schedule 2 for the SIP code and Schedule 5 for the EMI codes, where the procedure represents a development of layout in Schedule 8 and Schedule 14 to FA 2000.

3248. Share options are described as being granted rather than obtained in most contexts. This ties in with the terminology in EMI.

3249. Where appropriate references have been changed from "person" to "individual".

Part 1: Introduction
Paragraph 1: Approval of SAYE option schemes
3250. This paragraph indicates the contents of this Schedule (in *sub-paragraph (1))* and the sub-paragraphs into which it is divided (in *sub-paragraphs (2) to (4)*). It mirrors the opening paragraphs of Schedules 2, 4 and 5. The paragraph has no counterpart in the present legislation. The intention is to help users to understand the subject matter of the Schedule and to locate relevant material.

Paragraph 2: SAYE option schemes
3251. This paragraph contains definitions that apply generally for the purposes of the SAYE code. It derives from section 185(2) of ICTA and also from various paragraphs of Schedule 9 to ICTA, including paragraph 8, and continues the introductory theme.

3252. *Sub-paragraph (1)* contains the central definition of "SAYE option scheme", set out earlier in section 516(4).

3253. *Sub-paragraph (2)* contains the definition of the word "participate", and derives from paragraph 26 of Schedule 9 to ICTA. This sub-paragraph also introduces the term "scheme organiser". It is preferable to the term "grantor" (the term used in ICTA) as the company that sets up the scheme does not have to be the person who actually grants the option. There is also a definition of "participant".

Paragraph 3: Group schemes
3254. This paragraph is concerned with group schemes, and derives from paragraph 1(3) and (4) of Schedule 9 to ICTA.

3255. *Sub-paragraph (1)* provides that a SAYE option scheme established by a company that controls other companies (a "parent company") may extend to all or any of those other companies. If the scheme does so extend, it is called a "group scheme", as before (see *sub-paragraph (2)*).

3256. In *sub-paragraph (3)*, the term "constituent company" replaces the term "participating company". This change, which reflects corresponding changes made in Schedules 2 and 4, has been made on the basis that these Schedules necessarily make numerous references to "participants" and to people who "participate", so that the use of another term is advantageous.

3257. ESC B27 enables certain jointly owned companies to participate in group schemes. *Sub-paragraph (4)* is a signpost to paragraph 46, which gives statutory effect to that concession.

3258. In order to distinguish the meaning from more usual uses of "parent company", the top company in a group scheme has the label "parent scheme company".

Part 2: General requirements for approval

Paragraph 4: General requirements for approval: introduction

3259. This paragraph derives from part of paragraph 1(1) of Schedule 9 to ICTA. The difference stems from the new approach of providing its own introduction to each type of requirement. This new layout is also a feature of the succeeding Parts of this Schedule.

Paragraph 5: General restriction on contents of scheme

3260. This paragraph derives from paragraph 2(1) of Schedule 9 to ICTA. It sets out the proposition in that sub-paragraph (that a scheme must not contain features, which are neither essential nor reasonably incidental to the specified purpose of the scheme).

Paragraph 6: All-employee nature of scheme

3261. This paragraph derives from paragraph 2(3)(a) and part of paragraph 26(1) of Schedule 9 to ICTA. As a whole the new paragraph makes it clear that a SAYE scheme has to be open to a wide category of employees and directors but can be even more comprehensive in its approach.

3262. The new entry in sub-*paragraph (2)(d)* contains a cross-reference to paragraph 11. This makes it clear that a scheme must not allow participation by anyone with a material interest.

3263. In *sub-paragraph (3)* the words "any description of employees or former employees" have been replaced by "any description of persons" who meet or have met the conditions in *sub-paragraph (2)*. The inclusion of former employees covers circumstances where the employee has left a group scheme company for an associated company, which is not within the group scheme. The wording confirms that the

provision applies to directors and secondly makes it clear that former employees can meet the required conditions. See *Change 166* in Annex 1.

3264. *Sub-paragraph (4)* emphasises the "let-out" in paragraph 2(3)(a) of Schedule 9 to ICTA. The words "any provision required *or authorised*" by the provisions of this Schedule may also be found in the SIP code (see Schedule 2) and more properly reflect the various ways the rules are expressed.

Paragraph 7: Participation on similar terms
3265. This paragraph derives from the final part of paragraph 26(1) and from paragraph 26(2) of Schedule 9 to ICTA.

3266. This paragraph provides that there must be similar terms for every person who participates in the scheme, but that certain factors, such as length of service, may be taken into account. The definition of "participate" is in paragraph 2(2).

3267. Although, in general, references to "rights" have been changed to "share options", in the context of *sub-paragraph (2)* "rights" has been retained to make it clear that this covers the full participatory rights, that is the rights to obtain as well as to exercise share options.

Paragraph 8: No preferential treatment for directors and senior employees
3268. This paragraph derives from paragraph 2(3)(b) and (4) Schedule 9 to ICTA. The provision is intended to prevent a group of companies from arranging among its members to set up a scheme to favour the highly paid. These are described in the heading as "senior" to avoid the confusion with earlier benefits legislation, which referred to higher paid employees.

3269. The arrangement envisaged here is the setting up of a scheme in which the only group companies participating would be those employing the persons in the group whom it was designed to benefit on a selective basis. The wide definition of "a group of companies" *in sub-paragraph (2)* (rewriting paragraph 2(4) of Schedule 9 to ICTA) may accordingly go beyond the group companies in the group scheme.

Part 3: Eligibility of individuals to participate in scheme
Paragraph 9: Requirements relating to the eligibility of individuals: introduction
3270. This paragraph lists the two requirements relating to the eligibility of individuals and partly derives from paragraph 1(1) of Schedule 9 to ICTA.

Paragraph 10: The employment requirement
3271. This paragraph derives from paragraph 26(3) of Schedule 9 to ICTA and provides that the individual must be a director or an employee of the scheme organiser (or a constituent company in a group scheme) at the time of participation in the scheme. The effect of ESC B27, which is now codified in paragraph 46 of this Schedule, is that employment in jointly owned companies as defined there can also qualify.

3272. There are exceptions to this rule. Paragraphs 19 and 21(1)(e) and (f) of Schedule 9 to ICTA are applied so that rights under the scheme may be exercised after changes have occurred which would otherwise mean the requirement was not met. No reference is made in the source legislation to paragraph 18 of Schedule 9 to ICTA. This paragraph which is rewritten as paragraph 32 of this Schedule, allows the option to be exercised up to one year after the option holder dies.

3273. It is the practice to treat schemes as if paragraph 18 of Schedule 9 to ICTA did not infringe the requirement. The scope of the disregard is made clear in *sub-paragraph (2)* by stating that this requirement is not infringed by a provision required or authorised by this Schedule. See *Note 68* in Annex 2.

Paragraph 11: The "no material interest" requirement
3274. This paragraph derives from paragraph 8 of Schedule 9 to ICTA and from section 187(3) of ICTA and there are some drafting changes.

3275. It is the introductory provision which precludes admission into the scheme of an individual with a "material" interest in a close company whose shares are subject to the option or its parent company (or certain members of a consortium).

3276. The exact length of the preceding 12-month period has been clarified. It is expressed so as to include the "trigger date", that is the date when the test is made. By so including it explicitly, the period is shorter by one day and so in favour of the taxpayer.

3277. The interests of the option holder are aggregated with those of any associates. "Associate" is defined in paragraphs 14 to 16 of this Schedule.

3278. The definition of close companies is subject to sections 414 and 415 of ICTA and there is now a short explanatory summary of those sections.

Paragraph 12: Meaning of "material interest"
3279. The definition of material interest is imported here from section 187(3) of ICTA. The capped percentage is applied to both the straightforward control through share capital and other more indirect routes. The layout mirrors the similar rules in the new (FA 2000) schemes.

3280. Unlike in the new (FA 2000) schemes this provision applies to close companies only, see paragraph 11(1). Redundant wording in section 187(3) of ICTA has been removed (the reference to "where the company is a close company").

Paragraph 13: Material Interest: options and interests in SIPs
3281. This paragraph extends the previous paragraph; shares subject to an option are to be counted for the material interest test. This derives from paragraph 38 of Schedule 9 to ICTA. Under *sub-paragraph (3)* if the shares of an option holder which

have not yet been issued are taken into account the total share capital is similarly increased.

3282. A disregard has been introduced for the unappropriated shares held by trustees of a SIP trust on the lines of the EMI code and similar to that contained in paragraph 39 of Schedule 9 to ICTA for approved profit sharing (APS) schemes. See *Change 167* in Annex 1.

3283. Paragraph 39 of Schedule 9 to ICTA (the disregard for shares held in APS schemes) has not been reproduced in this Schedule. It is contained in Part 8 of Schedule 7 (Transitionals and savings).

Paragraph 14: Meaning of "associate"

3284. This paragraph also supplements paragraph 12 of this Schedule. It contains the definition of "associate"; and is in its turn supplemented by paragraphs 15 and 16 of this Schedule. The paragraph derives from sections 187(3) and 417(3) and (4) of ICTA (in the first two cases, parts of those subsections), and continues the pattern of bringing into the main text the ancillary explanations needed to understand the expression "material interest".

3285. The company in *sub-paragraph (1)(c)* is identified as the company mentioned in paragraph 11(2) of this Schedule. This is also copied in later paragraphs to which it is relevant. This makes explicit both interpretation and practice, thereby limiting the scope of the definition of associate in the case of a trust or estate. The term "personal representatives" is defined in section 721(1). See *Change 159* in Annex 1.

3286. In *sub-paragraph (3)*, the definition of "relative" has been slightly amended.

Paragraph 15: Meaning of "associate": trustees of employee benefit trust

3287. This paragraph supplements paragraph 14 of this Schedule and contains provisions that apply where an individual is interested as a beneficiary of an employment benefit trust. The paragraph derives from paragraph 40 of Schedule 9 to ICTA.

3288. This paragraph has counterparts in Schedules 2, 4 and 5 to this Act. Chapter 11 of Part 7 (Supplementary provisions) defines the expression "employee benefit trust", and deals with further matters arising when payments from employee benefit trusts are made. There are references to provisions in that Chapter in the later provisions of this paragraph.

3289. *Sub-paragraph (3)* is new. It is modelled on EMI and SIP and amplifies the approach in paragraph 40(1) of Schedule 9 to ICTA, now reflected in *sub-paragraph (2)* of this paragraph. This ensures that the test in sub-paragraph (2) works satisfactorily.

Paragraph 16: Meaning of "associate": trustees of discretionary trust
3290. This derives from paragraph 37 of Schedule 9 to ICTA (and sub-paragraph (3) of section 187(4) of ICTA) and provides a disregard from association where an individual disclaims an interest in a discretionary trust.

3291. Paragraph 37(2) of Schedule 9 to ICTA and the reference to 14 November 1986 in paragraph 37(3) have not been rewritten as these are spent.

3292. The references to disclaimers or releases executed "under seal" (from sub-paragraphs (3) and (5) of the paragraph 37) have been omitted, because section 1 of the Law of Property (Miscellaneous Provisions) Act 1989 abolished the requirement for a seal in the case of deeds executed by an individual.

Part 4: Shares to which schemes can apply
Paragraph 17: Requirements relating to shares that may be subject to share options: introduction
3293. This is the introductory paragraph to this Part derived from but also elaborating on paragraph 9 of Schedule 9 to ICTA. These requirements relate to the type of shares that can be subject to approved options within the scheme.

3294. In *sub-paragraph (2)*, a new label is attached to these shares, "eligible" shares. The shares are those "which may be acquired by the exercise of" the options. This is in line with the reference to acquisition in paragraph (9)(1) of Schedule 9 to ICTA, (and the SIP definition of eligible shares).

Paragraph 18: Shares must be ordinary shares of certain companies
3295. This paragraph provides that eligible shares must form part of the ordinary share capital of a company with characteristics specified in this paragraph. The paragraph derives from paragraph 10 of Schedule 9 to ICTA.

Paragraph 19: Requirements as to listing
3296. This follows paragraph 11 of Schedule 9 to ICTA, but the interpretation of paragraph 11(c) is assisted by its division into *sub-paragraph (1)(c)* and *(2)* which introduces a new label, "a listed company".

3297. Eligible shares have to be in a listed company, a company under the control of a listed company or in an independent company.

Paragraph 20: Shares must be fully paid up and not redeemable
3298. This paragraph provides that eligible shares must be fully paid up and not redeemable. It derives from part of paragraph 12(1) of Schedule 9 to ICTA.

Paragraph 21: Only certain kinds of restriction allowed
3299. This paragraph takes the material from the rest of paragraph 12 of Schedule 9 to ICTA and covers the rules about the kind of restrictions permitted for eligible shares.

3300. Broadly restrictions are not allowed unless they apply to all shares in the same class. There is an exception. This is contained in *sub-paragraphs (2)* and *(3)* and derives from sub-paragraphs (2) and (3) of paragraph 12 of Schedule 9 to ICTA. This allows companies to require ex-employees to dispose of their shares; this will usually be to the existing shareholders.

3301. In *sub-paragraph (2)(a)* and *(b)* "or offered for sale" covers the situation in which employees cannot actually secure the sale of their shares. See *Change 168* in Annex 1.

3302. In *sub-paragraph (5)* a reference to section 74(4) of the Financial Services and Markets Act 2000 has been inserted to update the reference to the Model Code issued by the Stock Exchange, in paragraph 13(2) of Schedule 9 to ICTA. See also *Change 168* in Annex 1.

3303. *Sub-paragraph (6)* enacts the contents of a Revenue Press Release, concerning the "directors veto", issued on 11 June 1985. See also *Change 168* in Annex 1.

3304. There is a new *sub-paragraph (7)*, which gives statutory effect to the Inland Revenue's interpretation of the reference in paragraph 12 of Schedule 9 to ICTA to "articles of association". See also *Change 168* in Annex 1, which refers to *Note 44* in Annex 2.

Paragraph 22: Requirements as to other shareholdings

3305. This paragraph imposes a requirement relating to the majority of the issued share capital of the same class as the eligible shares. The paragraph derives from paragraph 14(1) and (3) of Schedule 9 to ICTA. Its purpose is to prevent the manipulation of a company's share capital.

3306. This paragraph provides that the majority of the shares in the same class as the eligible shares must be either "employee-control shares" or "open market shares". The label "open market shares" is new, and has been introduced to help understanding. Paragraph 14(2) has not been rewritten as it is concerned with APS.

Part 5: Requirement for linked savings scheme

Paragraph 23: Requirements as to linked savings scheme: introduction

3307. This paragraph lists the requirements relating to linked savings schemes that must be met before a SAYE option scheme may be approved. This is partly derived from paragraph 1(1) of Schedule 9 to ICTA.

Paragraph 24: Payment for shares to be linked to approved savings schemes

3308. This paragraph derives from paragraph 16(1) of Schedule 9 to ICTA. It introduces the link with a certified contractual savings scheme, "the CCS scheme", defined in *sub-paragraph (2)*. The money used to exercise an option cannot exceed the repayments and interest from the CCS scheme.

3309. The contents of sub-paragraphs (2) and (3) of paragraph 16 of Schedule 9 to ICTA are spent.

3310. The words "to them", which carried no obvious meaning and are therefore redundant, have been deleted.

Paragraph 25: Requirements as to contributions to savings schemes
3311. This paragraph derives from paragraph 24 of Schedule 9 to ICTA. It supplements the previous paragraph by ensuring that the contributions under the CCS scheme will result in a repayment that will meet the option price. It also sets a maximum and caps a minimum for monthly contributions.

3312. "The option price" has been defined as "the amount payable" to reflect the overall cost of the acquisition of shares on exercise of the option. A further clarification has been introduced, the reference to "the maximum number of shares" that can be acquired under the option, to identify the option price more precisely.

Paragraph 26: Repayments under a savings scheme: whether bonuses included
3313. This paragraph derives from part of paragraph 17 of Schedule 9 to ICTA. It also supplements paragraph 24 of this Schedule by determining what happens to the bonus element of repayments.

3314. There is a reference to the distinction between the maximum and other bonuses, which helps understanding of the application of paragraph 30 of this Schedule.

3315. To deal with any potential confusion in the references to schemes, a SAYE option scheme has been identified in *sub-paragraph (3)*.

Part 6: Requirements etc. relating to share options
Paragraph 27: Requirements etc. relating to share options: introduction
3316. This is another introductory paragraph, based on paragraph 1(1) of Schedule 9 to ICTA. It lists the requirements relating to share options.

Paragraph 28: Requirements as to price for acquisition of shares
3317. This paragraph derives from paragraph 25 of Schedule 9 to ICTA; and contains the rule that the exercise price for the option must be not less than 80% of the market value of the shares at the time of the grant of the option. *Sub-paragraph (2)* allows this price to be fixed in advance of the grant if agreed between the Inland Revenue and the scheme organiser.

3318. The decision was taken to retain "manifestly" in *sub-paragraph (1)*. The word is interpreted to mean variations of "evidently", "clearly" and "obviously".

3319. *Sub-paragraph (3)* extends the scope for changes, which are permitted to occur as a result of a variation in the share capital. Paragraph 25 of Schedule 9 to

ICTA refers only to price, but in reality the number and description of the shares may be affected. This and the necessity of getting Inland Revenue approval in advance (*sub-paragraph (4)*) have been recognised in practice. See *Change 169* in Annex 1.

Paragraph 29: Share options must not be transferable
3320. This paragraph provides that the participant may not transfer share options. It derives from part of paragraph 22 of Schedule 9 to ICTA.

3321. There is a new *sub-paragraph (2)* which provides a signpost to paragraph 32 which deals with the position after the death of a participant.

Paragraph 30: Time for exercising options: general
3322. This paragraph derives from the remaining parts of paragraphs 17 and 22 of Schedule 9 to ICTA. It sets out the start and the end of the period during which an option must be exercised, and then indicates the various exceptions to this rule.

Paragraph 31: Requirement to have a "specified age"
3323. This paragraph, which derives from paragraph 8A of Schedule 9 to ICTA, explains what is meant by the expression "specified age" and indicates the paragraphs of this Schedule where this definition is relevant.

Paragraph 32: Exercise of options: death
3324. This paragraph derives from paragraph 18 of Schedule 9 to ICTA. The paragraph allows the exercise of an option after the option holder's death.

3325. The reference to the period of six months after the bonus date in *sub-paragraph (b)* now makes it clear that this rule applies to a death on the bonus date.

Paragraph 33: Exercise of options: reaching specified age without retiring
3326. This paragraph applies where an option holder reaches the specified age, but has not retired. The paragraph derives from paragraph 20 of Schedule 9 to ICTA and also part of paragraph 22 of that Schedule.

Paragraph 34: Exercise of options: scheme-related employment ends
3327. This paragraph derives from paragraphs 19 and 21(1)(e) of Schedule 9 to ICTA, and draws on material in paragraph 22 of that Schedule.

3328. The paragraph deals with the various circumstances in which an employee may leave "scheme-related employment", a term defined in *sub-paragraph (7)*.

3329. The effect of the various situations has been clarified and one more significant revision to the situation set out in former paragraph 21(1)(e). This is to link new *sub-paragraph (5)* to *sub-paragraph (4),* to emphasise that this provision is required to enable the option to be exercised within the first three years (though income tax relief is not available in these circumstances).

3330. Paragraph 21(3) of Schedule 9 to ICTA is spent.

Paragraph 35: Time when scheme-related employment ends
3331. This derives from paragraph 23 of Schedule 9 to ICTA. The import of the definition of associated company derives from section 187(2) of ICTA.

3332. This is in part an anti-avoidance provision and complex in application. The position has been clarified: an employee is not regarded as leaving the group scheme until that employee has left any associated company of the scheme organiser.

3333. As regards *sub-paragraph (3)*, the reference in paragraph 23 of Schedule 9 to ICTA to a company under the grantor's control has been omitted, because such a company is also an "associated company".

3334. There is a new *sub-paragraph (5)*, to make it quite clear that paragraph 32 of this Schedule, rather than the rules in this paragraph, govern the situation after the death of an option holder.

Paragraph 36: Exercise of options: employment in associated company at bonus date
3335. This paragraph derives from paragraph 21(1)(f) of Schedule 9 to ICTA. It enables a person who, on the bonus date, is an employee of a company that is an associated company but not a constituent company to exercise the options within six months of that date. Paragraph 21(4) has not been rewritten. It is covered by the transitional provisions in Schedule 7 to this Act.

Paragraph 37: Exercise of options: company events
3336. This paragraph derives from the remaining parts of paragraph 21 of Schedule 9 to ICTA. It deals with a number of events, which can occasion early exercise of an option.

3337. This paragraph brings out more clearly when the relevant date occurs in relation to these events. The expression "the relevant date" is introduced in *sub-paragraph (1)*.

Part 7: Exchange of share options
Paragraph 38: Exchange of options on company reorganisation
3338. This paragraph is the first of two that rewrite paragraph 15 of Schedule 9 to ICTA. The remainder of that paragraph is rewritten in paragraph 39 of this Schedule.

3339. This paragraph explains the circumstances in which there may be a "rollover" of share options. The layout is similar to that in paragraph 39 of Schedule 5 to this Act (EMI).

3340. Sub-paragraphs (5) to (8) of paragraph 15 of Schedule 9 to ICTA have not been rewritten as they are spent.

Paragraph 39: Requirements about share options granted in exchange

3341. This completes the picture introduced in paragraph 38 of this Schedule and reproduces the part of paragraph 15 of Schedule 9 to ICTA which sets out the rules on the new options that can be received on exchange.

3342. Paragraph 15(4) of Schedule 9 to ICTA has been divided, and has been rewritten as *sub-paragraphs (5) and (6)* of this paragraph.

3343. The cross-reference to paragraph 10(b) and (c) of Schedule 9 to ICTA at the end of paragraph 15(1) of that Schedule has been replaced by a cross-reference to paragraph 18 in *sub-paragraph (2)(b)* and the meaning of this has been clarified. The new options can relate to shares in the acquiring company or in a company which controls the acquiring company.

Part 8: Approval of schemes

Paragraph 40: Application for approval

3344. This paragraph deals with the mechanics of the application for approval of a SAYE option scheme. The paragraph derives from part of paragraph 1(1) and paragraph 1(2) of Schedule 9 to ICTA.

3345. *Sub-paragraph (3)* states that, after the Inland Revenue have reached their decision, they must give notice of their decision to the scheme organiser. See *Change 170* in Annex 1.

Paragraph 41: Appeal against refusal of approval

3346. This paragraph derives from most of paragraph 5 of Schedule 9 to ICTA. (Sub-paragraph (c) of paragraph 5 relates to approved profit sharing schemes.) The procedure, in paragraph 5 of Schedule 9 to ICTA, is that a "matter" is referred to the Special Commissioners for them to "hear and determine the matter in like manner as an appeal" if the Inland Revenue refuse to approve the scheme. *Sub-paragraph (1)* provides that the scheme organiser may appeal to the Special Commissioners.

3347. The change to a straightforward appeal procedure is intended to simplify matters. Section 48(2) of TMA 1970 provides that various provisions of that Act, as regards proceedings before the Commissioners, apply to "appeals other than appeals against assessments" and to "proceedings…to be heard and determined in the same way as an appeal". For the purposes of this paragraph of Schedule 3, there is therefore no real difference in law or practice between provisions that refer to an appeal and those that refer to proceedings where the Special Commissioners shall "hear and determine the matter in like manner as an appeal". See *Change 171* in Annex 1.

3348. *Sub-paragraphs (3) and (4)* now provide that the Special Commissioners may specify the date from which the scheme is to be treated as approved. See *Change 171* in Annex 1.

Paragraph 42: Withdrawal of approval
3349. This paragraph derives from paragraph 3(1) of Schedule 9 to ICTA. The rewritten legislation includes the use of a new label, a "disqualifying event". This expression does not occur in Schedule 9 to ICTA, but it does occur in the SIP code and in the EMI code.

3350. *Sub-paragraph (1)* has been expanded to include a requirement that the Inland Revenue give notice of their withdrawal of approval. See *Change 170* in Annex 1.

3351. In *sub-paragraph (3)*, it is made clear that SAYE option holders are protected in relation to their existing approved options if approval of a scheme is withdrawn.

3352. Paragraphs 3(2) and (3) of Schedule 9 to ICTA relate to approved profit sharing schemes.

Paragraph 43: Approval ineffective after unapproved alteration
3353. This paragraph derives from paragraph 4 of Schedule 9 to ICTA. An unapproved alteration to an approved SAYE option scheme is ineffective after the date of the alteration. The rule is clarified by the addition of the words "of the scheme" in the final line of *sub-paragraph (1)*.

3354. *Sub-paragraph (2)* is new. It introduces an express requirement for the Inland Revenue to notify the scheme organiser of their decision to approve or not to approve an alteration. See *Change 170* in Annex 1.

Paragraph 44: Appeal against withdrawal of approval etc.
3355. This paragraph derives from paragraph 5 of Schedule 9 to ICTA.

3356. As in the case of paragraph 41, *sub-paragraph (2)* provides that the scheme organiser may appeal to the Special Commissioners, as opposed to requiring the Special Commissioners to "hear and determine the matter in like manner as an appeal". See *Change 171* in Annex 1.

3357. The change to a straightforward appeal procedure is intended to simplify matters. Section 48(2) of TMA 1970 provides that various provisions of that Act, as regards proceedings before the Commissioners, apply to "appeals other than appeals against assessments" and to "proceedings…to be heard and determined in the same way as an appeal". For the purposes of this paragraph of Schedule 3, there is therefore no real difference in law or practice between provisions that refer to an appeal and those that refer to proceedings where the Special Commissioners shall "hear and determine the matter in like manner as an appeal".

3358. The contents of paragraph 5(b) of Schedule 9 to ICTA have not been reproduced. This provision refers to the situation where the Board approved a SAYE scheme subject to a condition and considers that the condition has not been met. There

is no longer any reference in the legislation to a conditional approval and no practical experience of paragraph 5(b) operating.

Part 9: Supplementary provisions
Paragraph 45: Power to require information
3359. This paragraph derives from paragraph 6 of Schedule 9 to ICTA and gives the Inland Revenue power to obtain information. The words "think necessary" have been replaced with "reasonably require". See *Change 172* in Annex 1.

3360. This provision, as set out in *sub-paragraph (2)(a)(ii)*, also covers liability to capital gains tax.

3361. *Sub-paragraph (3)* clarifies the operation of the time limit for providing information by making the period run from the date of the notice. Also the period has been extended from 30 days to 3 months. See *Change 172* in Annex 1.

Paragraph 46: Jointly owned companies
3362. This paragraph gives statutory effect to ESC B27, so far as it relates to SAYE option schemes. It corresponds to paragraph 34 in Schedule 4 to this Act, for CSOP schemes. See *Change 173* in Annex 1.

Paragraph 47: Meaning of "associated company"
3363. This paragraph derives from the definition of associated company in section 187(2) of ICTA.

Paragraph 48: Minor definitions
3364. This paragraph takes definitions from section 187(2) and (7) of ICTA.

Paragraph 49: Index of defined expressions
3365. This paragraph consists of an index of expressions defined or explained for the purposes of the SAYE code.

SCHEDULE 4: APPROVED CSOP SCHEMES
Overview
3366. This Schedule, which is introduced in Chapter 8 of Part 7, deals with the rules relating to approved CSOP option schemes. The legislation relating to CSOP option schemes, which is contained in Chapter 8 of Part 7 and in this Schedule, is called "the CSOP code", a term introduced in section 521. Chapter 8 of Part 7 deals with the tax exemptions available for participants in an approved CSOP option scheme.

3367. The legislation relating to these schemes derives from Schedule 9 to ICTA; many of the definitions are supplied by section 187 of ICTA.

3368. This Schedule contains further provisions relating to CSOP option schemes. After the introductory Part (Part 1) it deals with the following matters:

- it specifies the requirements that a CSOP option scheme must meet in order to be "approved" for the purposes of the CSOP code (in Parts 2 to 6);

- it deals with the procedural aspects of the approval of schemes and the withdrawal of approval (in Part 7); and

- it deals with supplementary matters (in Part 8).

3369. The majority of the provisions in this Schedule are therefore concerned with the various requirements that CSOP option schemes must meet before they may be "approved". On this topic the general policy has been to place the various Parts in an order consistent with that to be found in the legislation relating to other share schemes. The various requirements have been placed in a different order from that found in Schedule 9 to ICTA. Part 2 of this Schedule deals with the general requirements that apply in all cases; Part 3 with the requirements relating to the eligibility of individual employees; and Part 4 with the types of shares to which schemes can apply. The following Parts then deal with requirements relating to share options (Part 5) and the exchange of options (Part 6).

3370. Where it seems helpful the opportunity has been taken to list the requirements relevant for a Part. This procedure is the same as that adopted in Schedule 2 for the SIP code and Schedule 5 for the EMI codes, where the procedure represents a development of layout in Schedule 8 and Schedule 14 to FA 2000.

3371. Share options are described as being granted rather than obtained in most contexts. This ties in with the terminology in EMI.

3372. Where appropriate references have been changed from "person" to "individual".

Part 1: Introduction
Paragraph 1: Approval of CSOP schemes
3373. This paragraph indicates the contents of this Schedule (in *sub-paragraph (1)*) and the sub-paragraphs into which it is divided (in *sub-paragraphs (2)* to *(4)*). It mirrors the opening paragraphs of Schedules 2, 3 and 5. This paragraph has no counterpart in the present legislation. The intention is to help users to understand the subject matter of the Schedule and to locate relevant material.

Paragraph 2: CSOP schemes
3374. This paragraph contains definitions that apply generally for the purposes of the CSOP code. It derives from section 185(2) of ICTA and also from various paragraphs of Schedule 9 to ICTA, including paragraph 8, and continues the introductory theme.

3375. *Sub-paragraph (1)* contains the central definition of a "CSOP scheme", set out earlier in section 521(4).

3376. *Sub-paragraph (2)* contains the definition of "participate" and derives from paragraph 26 of Schedule 9 to ICTA, for SAYE. This sub-paragraph also introduces the term "scheme organiser". It is preferable to the term "grantor" (used in ICTA) as the company that sets up the scheme does not have to be the person who actually grants the option. There is also a definition of "participant".

Paragraph 3: Group Schemes
3377. This paragraph is concerned with group schemes, and derives from paragraph 1(3) and (4) of Schedule 9 to ICTA.

3378. *Sub-paragraph (1)* provides that a CSOP option scheme established by a company that controls other companies (a "parent company") may extend to all or any of those other companies. If the scheme does so extend, it is called a "group scheme" as before (see *sub-paragraph (2)*).

3379. In *sub-paragraph (3)*, the term "constituent company" replaces the term "participating company". This change, which reflects corresponding changes made in Schedules 2 and 3, has been made on the basis that these Schedules necessarily make numerous references to "participants" and to people who "participate", so that the use of another term is advantageous.

3380. ESC B27 enables certain jointly owned companies to participate in group schemes. *Sub-paragraph (4)* is a signpost to paragraph 34, which gives statutory effect to that concession.

3381. In order to distinguish the meaning from more usual uses of "parent company", the top company in a group scheme has the label "parent scheme company".

Part 2: General requirements for approval
Paragraph 4: General requirements for approval: introduction
3382. This paragraph derives from part of paragraph 1(1) of Schedule 9 to ICTA. The difference stems from the new approach of providing its own introduction to each type of requirement. This new layout is also a feature of the succeeding Parts of this Schedule.

Paragraph 5: General restriction on contents of scheme
3383. This paragraph derives from paragraph 2(1) of Schedule 9 to ICTA. It sets out the proposition in that sub-paragraph (that a scheme must not contain features, which are neither essential nor reasonably incidental to the specified purpose of the scheme).

Paragraph 6: Limit on value of shares subject to options
3384. This paragraph derives from paragraph 28 of Schedule 9 to ICTA. It caps the total value of options, which a person can obtain under CSOP schemes, at £30,000.

3385. In contrast to limits imposed in the EMI option scheme, if an option takes someone over the £30,000 limit, none of the option can qualify.

3386. In *sub-paragraph (2)*, it is made clear that options which have already been exercised do not have to be included in the £30,000 limit.

Part 3: Eligibility of Individuals to participate in Scheme
Paragraph 7: Requirements relating to the eligibility of individuals: introduction
3387. This paragraph lists the two requirements relating to the eligibility of individuals and partly derives from paragraph 1(1) of Schedule 9 to ICTA.

Paragraph 8: The employment requirement
3388. This paragraph derives from paragraph 27 of Schedule 9 to ICTA (part of sub-paragraph (1) and sub-paragraph (4) of that paragraph). It requires a CSOP scheme to be only open to qualifying employees, defined in *sub-paragraph (2)* as employees other than directors, and to full-time directors of a company in the group scheme. The reference to the qualifying employee (who is not required to work full-time) has been made clearer by inserting an "a" before qualifying employee in *sub-paragraph (1)*.

3389. The effect of ESC B27, now codified by paragraph 34 of this Schedule, is that employment in a jointly owned company as defined there can also qualify.

Paragraph 9: The "no material interest" requirement
3390. This paragraph derives from paragraph 8 of Schedule 9 to ICTA and from section 187(3) of ICTA and there are some drafting changes.

3391. It is the introductory provision, which precludes admission into the scheme of an individual with a "material" interest in a close company whose shares are subject to the option or its parent company (or certain members of a consortium).

3392. The exact length of the preceding 12-month period has been clarified. It is expressed so as to include the "trigger date", that is the date when the test is made. By so including it explicitly, the period is shorter by one day and so in favour of the taxpayer.

3393. The interests of the option holder are aggregated with those of any associates. "Associate" is defined in paragraphs 12 to 14 of this Schedule.

3394. The definition of close companies is subject to sections 414 and 415 of ICTA and there is now a short explanatory summary of those sections.

Paragraph 10: Meaning of "material interest"
3395. The definition of material interest is imported here from section 187(3) of ICTA. The capped percentage is applied to both the straightforward control through share capital and other more indirect routes. The layout mirrors the similar rules in the new (FA 2000) schemes.

3396. Unlike in the new (FA 2000) schemes this provision applies to close companies only, see paragraph 9(1) of this Schedule. Redundant wording in section 187(3) of ICTA has been removed (the reference to "where the company is a close company").

Paragraph 11: Material Interest: options and interests in SIPs

3397. This paragraph extends the previous paragraph; shares subject to an option are to be counted for the material interest test**.** This derives from paragraph 38 of Schedule 9 to ICTA. Under *sub-paragraph (3)* if the shares of an option holder which have not yet been issued are taken into account the total share capital is similarly increased.

3398. A disregard has been introduced for the unappropriated shares held by trustees of a SIP trust on the lines of that in the EMI code and similar to that contained in paragraph 39 of Schedule 9 to ICTA for approved profit sharing schemes (APS). See *Change 167* in Annex 1.

3399. Paragraph 39 of Schedule 9 to ICTA, the disregard for shares held in APS, has not been reproduced in this Schedule. It is contained in Part 8 of Schedule 7 to this Act (Transitionals and savings).

Paragraph 12: Meaning of "associate"

3400. This paragraph also supplements paragraph 10 of this Schedule. It contains the definition of "associate"; and is in its turn supplemented by paragraphs 13 and 14 of this Schedule. The paragraph derives from sections 187(3) and 417(3) and (4) of ICTA (in the first two cases, parts of those subsections), and continues the pattern of bringing into the main text the ancillary explanations needed to understand the expression "material interest".

3401. The company in *sub-paragraph (1)(c)* is identified as the company mentioned in paragraph 9(2) of this Schedule. This is also copied in later paragraphs to which it is relevant. This makes explicit both interpretation and practice, thereby limiting the scope of the definition of "associate" in the case of a trust or estate. The term "personal representatives" is defined in section 721(1). See *Change 159* in Annex 1.

3402. In *sub-paragraph (3)*, the definition of "relative" has been slightly amended.

Paragraph 13: Meaning of "associate": trustees of employee benefit trust

3403. This paragraph supplements paragraph 14 of this Schedule and contains provisions that apply where an individual is interested as a beneficiary of an employee benefit trust. The paragraph derives from paragraph 40 of Schedule 9 to ICTA.

3404. This paragraph has counterparts in Schedules 2, 3 and 5 to this Act. Chapter 11 of Part 7 (Supplementary provisions) defines the expression "employee benefit trust", and deals with further matters arising when payments from employee

benefit trusts are made. There are references to provisions in this Chapter in the later provisions of this paragraph.

3405. *Sub-paragraph (3)* is new. It is modelled on EMI and SIP and amplifies the approach in paragraph 40(1) of Schedule 9 to ICTA, now reflected in *sub-paragraph (2)* of this paragraph. This ensures that the test in sub-paragraph (2) works satisfactorily.

Paragraph 14: Meaning of "associate": trustees of discretionary trust
3406. This derives from paragraph 37 of Schedule 9 to ICTA (and sub-paragraph (3) of section 187(4) of ICTA) and provides a disregard from association where the individual disclaims an interest in a discretionary trust.

3407. Paragraph 37(2) of Schedule 9 to ICTA and the reference to 14 November 1986 in paragraph 37(3) of that Schedule have not been rewritten as these are spent.

3408. The references to disclaimers or releases executed "under seal" (from paragraph 37(3) and (5) of Schedule 9 to ICTA) have been omitted, because section 1 of the Law of Property (Miscellaneous Provisions) Act 1989 abolished the requirement for a seal in the case of deeds executed by an individual.

Part 4: Shares to which schemes can apply
Paragraph 15: Requirements relating to shares that may be subject to share options: introduction
3409. This is the introductory paragraph to this Part derived from but also elaborating on paragraph 9 of Schedule 9 to ICTA. These requirements relate to the type of shares that can be subject to approved options within the scheme.

3410. In *sub-paragraph (2)*, a new label is attached to these shares, "eligible" shares. The shares are those "which may be acquired by the exercise of" the options. This is in line with the reference to acquisition in paragraph (9)(1) of Schedule 9 to ICTA, (and the SIP definition of eligible shares).

Paragraph 16: Shares must be ordinary shares of certain companies
3411. This paragraph provides that eligible shares must form part of the ordinary share capital of a company with characteristics specified in this paragraph. The paragraph derives from paragraph 10 of Schedule 9 to ICTA.

Paragraph 17: Requirements as to listing
3412. This follows paragraph 11 of Schedule 9 to ICTA, but the interpretation of paragraph 11(c) is assisted by its division into *sub-paragraph (1)(c)* and *(2)* which introduces a new label, "a listed company".

3413. Eligible shares have to be in a listed company, a company under the control of a listed company or in an independent company.

Paragraph 18: Shares must be fully paid up and not redeemable
3414. This paragraph provides that eligible shares must be fully paid up and not redeemable. It derives from part of paragraph 12(1) of Schedule 9 to ICTA.

Paragraph 19: Only certain kinds of restriction allowed
3415. This paragraph takes the material from the rest of paragraph 12 of Schedule 9 to ICTA and covers the rules about the kind of restrictions permitted for eligible shares.

3416. Broadly restrictions are not allowed unless they apply to all shares in the same class. There is an exception. This is contained in *sub-paragraphs (2)* and *(3)* and derives from sub-paragraphs (2) and (3) of paragraph 12 of Schedule 9 to ICTA. This allows companies to require ex-employees to dispose of their shares; this will usually be to the existing shareholders.

3417. In *sub-paragraph (2)(a) and (b)* "or offered for sale" covers the situation in which employees cannot actually secure the sale of their shares. See *Change 168* in Annex 1.

3418. In *sub-paragraph (5)* a reference to section 74(4) of the Financial Services and Markets Act 2000 has been inserted to update the reference to the Model Code issued by the Stock Exchange, in paragraph 13(2) of Schedule 9 to ICTA. See also *Change 168* in Annex 1.

3419. In CSOP there is a provision in *sub-paragraph (6)* dating from FA 1988 ensuring that certain terms of loans are not regarded as a restriction on shares. This provision was not applied to SAYE.

3420. *Sub-paragraph (7)* enacts the contents of a Revenue Press Release, concerning the "directors veto", issued on 11 June 1985. See also *Change 168* in Annex 1.

3421. There is a new *sub-paragraph (8)*, which puts into the legislation the Inland Revenue's interpretation of the reference in paragraph 12 of Schedule 9 to ICTA to "articles of association". See also *Change 168* in Annex 1, which refers to *Note 44* in Annex 2.

Paragraph 20: Requirements as to other shareholdings
3422. This paragraph imposes a requirement relating to the majority of the issued share capital of the same class as the eligible shares. The paragraph derives from paragraph 14(1) and (3) of Schedule 9 to ICTA. Its purpose is to prevent the manipulation of a company's share capital.

3423. This paragraph provides that the majority of the shares in the same class as the eligible shares must be either "employee-control shares" or "open market shares". The label "open market shares" is new, and has been introduced to help understanding. Paragraph 14(2) has not been rewritten as it is concerned with APS.

Part 5: Requirements etc. relating to share options
Paragraph 21: Requirements etc. relating to share options: introduction
3424. This is another introductory paragraph, based on paragraph 1(1) of Schedule 9 to ICTA. It lists the requirements relating to share options. The "etc." refers to the voluntary provisions, which are authorised by paragraphs 24 and 25 of this Schedule.

Paragraph 22: Requirements as to price for acquisition of shares.
3425. This paragraph derives from paragraph 29 of Schedule 9 to ICTA and contains the rule that the exercise price must be not less than the market value of the shares at the time of the grant of the option. *Sub-paragraph (2)* allows this price to be fixed in advance of the grant if agreed between the Inland Revenue and the scheme organiser.

3426. The word "manifestly" is retained in *sub-paragraph (1)*. The word is interpreted to mean variations of "evidently", "clearly" and "obviously".

3427. *Sub-paragraph (3)* extends the scope for changes, which are permitted to occur as a result of a variation in the share capital. Paragraph 25 of Schedule 9 to ICTA refers only to price, but in reality the number and description of the shares may be affected. This and the necessity of getting Inland Revenue approval in advance (*sub-paragraph (4)*) have been recognised in practice. See *Change 169* in Annex 1.

Paragraph 23: Share options must not be transferable
3428. This paragraph provides that the participant may not transfer share options. It derives from part of paragraph 27(2) of Schedule 9 to ICTA.

3429. There is a new *sub-paragraph (2)* which provides a signpost to paragraph 25 of this Schedule which deals with the position after the death of a participant.

Paragraph 24: Exercise of options: ceasing to be director or employee
3430. This derives from part of paragraph 27(1) of Schedule 9 to ICTA and permits a scheme to allow an option holder to exercise options after ceasing to be a full-time director or qualifying employee.

Paragraph 25: Exercise of options: death
3431. This derives from the other part of paragraph 27(2) of Schedule 9 to ICTA (part is reflected in paragraph 23 of this Schedule). It allows a scheme to provide for the exercise of an option after the option holder dies.

Part 6:Exchange of share options
Paragraph 26: Exchange of options on company reorganisation
3432. This paragraph is the first of two that rewrite paragraph 15 of Schedule 9 to ICTA. The remainder of that paragraph is rewritten in paragraph 27 of this Schedule.

3433. This paragraph explains the circumstances in which there may be a "rollover" of share options. The layout is similar to that in paragraph 39 of Schedule 5 to this Act (EMI).

3434. Sub-paragraphs (5) to (8) of paragraph 15 of Schedule 9 to ICTA have not been rewritten as they are spent.

Paragraph 27: Requirements about share options granted in exchange

3435. This completes the picture introduced in paragraph 26 of this Schedule and reproduces the part of paragraph 15 of Schedule 9 to ICTA which sets out the rules on the new options that can be received on exchange.

3436. Paragraph 15(4) of Schedule 9 to ICTA has been divided, and has been rewritten as *sub-paragraphs (5) and (6)* of this paragraph.

3437. The cross-reference to paragraph 10(b) and (c) of Schedule 9 to ICTA at the end of paragraph 15(1) of that Schedule has been replaced by a cross-reference to paragraph 16 in *sub-paragraph (2)(b)* and the meaning of this has been clarified. The new options can relate to shares in the acquiring company or in a company which controls the acquiring company.

Part 7: Approval of schemes

Paragraph 28: Application for approval

3438. This paragraph deals with the mechanics of the application for approval of a CSOP option scheme. The paragraph derives from part of paragraph 1(1) and paragraph 1(2) of Schedule 9 to ICTA.

3439. *Sub-paragraph (3)* states that, after the Inland Revenue have reached their decision, they must give notice of their decision to the scheme organiser. See *Change 170* in Annex 1.

Paragraph 29: Appeal against refusal of approval

3440. This paragraph derives from most of paragraph 5 of Schedule 9 to ICTA. (Sub-paragraph (c) of paragraph 5 relates to approved profit sharing schemes.) The procedure, in paragraph 5 of Schedule 9 to ICTA, is that a "matter" is referred to the Special Commissioners for them to "hear and determine the matter in like manner as an appeal" if the Inland Revenue refuse to approve the scheme. *Sub-paragraph (1)* provides that the scheme organiser may appeal to the Special Commissioners.

3441. The change to a straightforward appeal procedure is intended to simplify matters. Section 48(2) of TMA 1970 provides that various provisions of that Act, as regards proceedings before the Commissioners, apply to "appeals other than appeals against assessments" and to "proceedings…to be heard and determined in the same way as an appeal". For the purposes of this paragraph, there is therefore no real difference in law or practice between provisions that refer to an appeal and those that refer to proceedings where the Special Commissioners shall "hear and determine the matter in like manner as an appeal". See *Change 171* in Annex 1.

3442. *Sub-paragraphs (3) and (4)* now provide that the Special Commissioners may specify the date from which the Scheme is to be treated as approved. See *Change 171* in Annex 1.

Paragraph 30: Withdrawal of approval

3443. This paragraph derives from paragraph 3(1) of Schedule 9 to ICTA. The rewritten legislation includes the use of a new label, a "disqualifying event". This expression does not occur in Schedule 9 to ICTA, but it does occur in the SIP code and in the EMI code.

3444. *Sub-paragraph (1)* has been expanded to include a requirement that the Inland Revenue give notice of their withdrawal of approval. See *Change 170* in Annex 1.

3445. Paragraphs 3(2) and (3) of Schedule 9 to ICTA relate to approved profit sharing schemes.

Paragraph 31: Approval ineffective after unapproved alteration

3446. This paragraph derives from paragraph 4 of Schedule 9 to ICTA. An unapproved alteration to an approved CSOP option scheme is ineffective after the date of the alteration. The rule is clarified by the addition of the words "of the scheme" in the final line of *sub-paragraph (1)*.

3447. *Sub-paragraph (2)* is new. It introduces an express requirement for the Inland Revenue to notify the scheme organiser of their decision to approve or not to approve an alteration. See *Change 170* in Annex 1.

Paragraph 32: Appeal against withdrawal of approval etc.

3448. This paragraph derives from paragraph 5 of Schedule 9 to ICTA.

3449. As in the case of paragraph 29 of this Schedule, *sub-paragraph (2)* provides that the scheme organiser may appeal to the Special Commissioners, as opposed to requiring the Special Commissioners to "hear and determine the matter in like manner as an appeal". See *Change 171* in Annex 1.

3450. The change to a straightforward appeal procedure is intended to simplify matters. Section 48(2) of TMA 1970 provides that various provisions of that Act, as regards proceedings before the Commissioners, apply to "appeals other than appeals against assessments" and to "proceedings…to be heard and determined in the same way as an appeal". For the purposes of this paragraph, there is therefore no real difference in law or practice between provisions that refer to an appeal and those that refer to proceedings where the Special Commissioners shall "hear and determine the matter in like manner as an appeal".

Part 8: Supplementary provisions
Paragraph 33: Power to require information
3451. This paragraph derives from paragraph 6 of Schedule 9 to ICTA and gives the Inland Revenue power to obtain information. The words "think necessary" have been replaced with "reasonably require". See *Change 172* in Annex 1.

3452. This provision, as set out in *sub-paragraph (2)(a)(ii)*, also covers liability to capital gains tax.

3453. *Sub-paragraph (3)* clarifies the operation of the time limit for providing information by making the period run from the date of the notice. Also the period has been extended from 30 days to 3 months. See *Change 172* in Annex 1.

Paragraph 34: Jointly owned companies
3454. This paragraph gives statutory effect to ESC B27, so far as it relates to CSOP schemes. It corresponds to paragraph 46 of Schedule 3 to this Act, for SAYE option schemes. See *Change 173* in Annex 1.

Paragraph 35: Meaning of "associated company"
3455. This paragraph derives from the definition of associated company in section 187(2) of ICTA.

Paragraph 36: Minor definitions
3456. This paragraph takes definitions from section 187(2) and (7) of ICTA.

Paragraph 37: Index of defined expressions
3457. This paragraph consists of an index of expressions defined or explained for the purposes of the CSOP code.

SCHEDULE 5: ENTERPRISE MANAGEMENT INCENTIVES
Overview
3458. This Schedule, which is introduced in Chapter 9 of Part 7, deals with the rules relating to qualifying options for the purposes of "the EMI code". The legislation relating to EMI, which is contained in Chapter 9 of Part 7 and in this Schedule, is called "the EMI code". This term was introduced in section 527. Chapter 9 of Part 7 deals with the tax exemptions available in connection with a qualifying EMI option.

3459. The legislation relating to these schemes derives from Schedule 14 to FA 2000 (introduced by section 62 of FA 2000). This Schedule was amended by Schedule 14 to FA 2001 and by SI 2001 No 3799.

3460. This Schedule contains further provisions relating to EMI. After the introductory Part (Part 1) it deals with the following matters:

- it specifies the requirements that must be met in relation to a qualifying EMI option (in Parts 2 to 6);

- it deals with the notification processes (in Part 7); and

- it deals with supplementary matters (in Part 8).

3461. EMI is different from SAYE, CSOP and SIPs in that it is not a "scheme" or a "plan", with an approval procedure and the administrative structure that goes with it. Nevertheless this Schedule follows the pattern in Schedules 8 and 14 to FA 2000 which has been developed in the Schedules in this Act for SAYE, CSOP and SIPs. So where it seems helpful the opportunity has been taken to list the requirements relevant for a Part in an introductory paragraph.

Part 1: Introduction
Paragraph 1: Enterprise management incentives: qualifying options
3462. This paragraph is a scene-setting paragraph explaining how the Schedule applies to determine what share options qualify under EMI and where within the Schedule the various requirements may be found. It derives from paragraph 1(1) and (2) of Schedule 14 to FA 2000.

3463. The connection between "relevant company" and "qualifying company" has been clarified in *sub-paragraph (3)(b)*.

3464. Also there is a new definition of "appropriate time" in *sub-paragraph (4)*. This term is used in the opening paragraphs in Parts 2 to 5 of this Schedule to demonstrate clearly that the requirements have to be met, when the option is granted. There is also a link back to this phrase in paragraph 44(7) of this Schedule, which provides the same clarification for Part 7. Part 6, which deals with company reorganisations, has its own timing rules in paragraph 43 of this Schedule.

Paragraph 2: Meaning of "the relevant company" and "the employer company"
3465. This paragraph defines the EMI terms "the relevant company" and "the employer company". It derives from paragraph 1(3) of Schedule 14 to FA 2000.

Part 2: General requirements
Paragraph 3: General requirements: introduction
3466. This paragraph is introductory and derives from paragraph 8 of Schedule 14 to FA 2000.

Paragraph 4: Purpose of granting the option
3467. This section derives from paragraph 9 of Schedule 14 to FA 2000.

Paragraph 5: Maximum entitlement of employee: financial limit on unexercised options
3468. This paragraph derives from paragraph 10(1) to (3) and (6) to (8) of Schedule 14 to FA 2000 and sets out a limit of £100,000 on the value of shares in respect of which "unexercised qualifying options" are held by each individual employee. If the grant of an option causes this limit to be exceeded, then the option

does not qualify under EMI so far as it relates to that excess. If the limit is already exceeded at the time that further options are granted, those further options do not qualify.

3469. There is no guidance in the legislation on the tax treatment when an option, that includes a qualifying element and a non-qualifying element, is partially exercised. The option agreement itself may provide guidance on this. Otherwise, in practice, the person exercising the option will be able to decide which part of the option was exercised, enabling the relief to be taken in the way that suits the option holder.

3470. This paragraph also contains information about how to arrive at the share values. *Sub-paragraph (6)(a)* makes it clear that the value of the shares for the £100,000 test is frozen at the time when the option is granted. This was the intention of the original clause and is the way the provision has been interpreted. As this is part of the definition of "unexercised qualifying options" it has an impact on the test in paragraph 7(1) of this Schedule and in turn on paragraphs 41 and 43 as well. See *Change 177* in Annex 1.

Paragraph 6: Maximum entitlement of employee: further limit of 3 years
3471. This paragraph derives from paragraph 10(4) to (8) of Schedule 14 to FA 2000. If the limit set out in paragraph 5 has been reached, no further qualifying option can be granted for three years from the date of the grant of the last qualifying option.

Paragraph 7: Maximum value of options in respect of relevant company's shares
3472. This paragraph sets out the limit on the value of shares in the relevant company that can be the subject of unexercised qualifying options. That limit is £3 million. This paragraph derives from paragraph 11 of Schedule 14 to FA 2000.

3473. There is a cross-reference in *sub-paragraph (6)* to the rules about the valuation of the shares subject to the option in paragraph 5(6) to (8) of this Schedule.

Part 3: Qualifying companies
3474. There is a considerable overlap in this Part between EMI and the investment schemes EIS, VCT and CVS, (the Enterprise Investment Scheme, Venture Capital Trusts and the Corporate Venturing Scheme).

Paragraph 8: Qualifying companies: introduction
3475. This paragraph is introductory and derives from paragraph 12 of Schedule 14 to FA 2000.

Paragraph 9: The independence requirement
3476. In order to qualify under EMI, a company must not be under the control of another company. This paragraph sets out the criteria for this independence requirement and derives from paragraph 13 of Schedule 14 to FA 2000.

Paragraph 10: The qualifying subsidiaries requirement
3477. This paragraph stipulates that if a company controls other companies, all the companies that it controls must be "qualifying subsidiaries", as defined in paragraph 11 of this Schedule. This requirement derives from paragraph 14 of Schedule 14 to FA 2000.

Paragraph 11: Meaning of "qualifying subsidiary"
3478. This paragraph derives from paragraph 15 of Schedule 14 to FA 2000.

3479. This paragraph sets out the conditions that must be met if a company is to be a qualifying subsidiary of the company that controls it. The parent company cannot have ownership of less than 75% of a subsidiary.

3480. *Sub-paragraph (3)* extends the reference to "holding company" in *sub-paragraph (2)*. See *Change 174* in Annex 1.

3481. The paragraph also sets out how this requirement applies to particular circumstances such as when a subsidiary company is being wound up.

Paragraph 12: The gross assets requirement
3482. This paragraph sets out the gross assets test that a company must satisfy in order to qualify under EMI. It derives from paragraph 16 of Schedule 14 to FA 2000.

3483. The wording of this gross assets test is very brief. Inland Revenue Statement of Practice 2/00 expands upon it, explaining that gross assets are all the assets shown in a company's balance sheet without any deductions for liabilities, and providing information about the application of United Kingdom accounting practice and which balance sheets should be used.

3484. The test in *sub-paragraph (3)* makes it clear that the computation requires the addition of the value of the gross assets of each member of the group.

Paragraph 13: The trading activities requirement: single company
3485. This paragraph specifies that a single company can only qualify under EMI if it is carrying on (or preparing to carry on) a qualifying trade, and that must be the only purpose for the company's existence, aside from any incidental purpose. The paragraph also makes it clear that the holding and managing of property for the purposes of a qualifying trade may be disregarded. *Sub-paragraph (3)* includes signposts to the definition of "qualifying trade" in paragraph 15 of this Schedule and to the provisions regarding excluded activities in paragraphs 16 to 23 of this Schedule.

3486. The paragraph derives from paragraph 17(1), (4) and (7) of Schedule 14 to FA 2000.

Paragraph 14: The trading activities requirement: parent company
3487. This paragraph derives from the remainder of paragraph 17 of Schedule 14 to FA 2000. It contains the detail of the trading activities requirement for a parent company, which looks at the business of the whole group.

3488. The way "non-qualifying activities" is defined in paragraph 14(5)(c) has enabled the provisions in paragraphs 18 and 19 of this Schedule to be expressed in a positive way.

Paragraph 15: Meaning of "qualifying trade"
3489. This paragraph provides the definition of a qualifying trade as:

- being carried on wholly or mainly in the United Kingdom;
- being carried on with a view to making profits; and
- not including (to any substantial degree) any excluded activities.

3490. The paragraph also explains to what extent research and development activities may be included.

3491. The material derives from paragraph 18 of Schedule 14 to FA 2000.

Paragraph 16: Excluded activities
3492. This paragraph lists the various activities that are excluded activities for the purposes of EMI. Some of these activities are described more fully in subsequent paragraphs of this Schedule, and this paragraph includes signposts to those subsequent explanatory provisions. It derives from paragraph 19 of Schedule 14 to FA 2000.

Paragraph 17: Excluded activities: wholesale and retail distribution
3493. This is an interpretative paragraph which draws the boundary around what may be considered as a wholesale or retail distribution activity. It derives from paragraph 20 of Schedule 14 to FA 2000.

Paragraph 18: Excluded activities: leasing of certain ships
3494. This derives from paragraph 21 of Schedule 14 to FA 2000.

3495. One of the excluded activities listed in paragraph 16 of this Schedule is leasing (including letting ships on charter). This paragraph relaxes this exclusion in specified circumstances. This material derives from paragraph 21 of Schedule 14 to FA 2000. A qualifying trade can include certain kinds of short-term ship leasing, provided that the conditions set out in this paragraph are met. This relaxation does not apply to oil rigs or pleasure craft, the leasing of which remains an excluded activity.

3496. The additional material in *sub-paragraph (2)* makes it clear that the requirements of *sub-paragraph (4)* do not have to be met in relation to oil rigs and pleasure craft.

3497. An error in sub-paragraph (4) of paragraph 21 of Schedule 14 to FA 2000 has been corrected. This part of the rule in Schedule 14 is unworkable in that it is not possible for both the owner and the charterer to be subsidiaries of the company carrying on the trade, which has necessarily to be the owner of the ship.

3498. *Sub-paragraph (6*) is modelled on the approach taken in section 297(7) of ICTA (the Enterprise Investment Scheme). See *Change 175* in Annex 1.

Paragraph 19: Excluded activities: receipt of royalties or licence fees
3499. Another excluded activity listed in paragraph 16 of this Schedule is the receipt of royalties or licence fees. Paragraph 19, which derives from paragraph 22 of Schedule 14 to FA 2000, relaxes this line somewhat and allows a qualifying trade to include the receipt of royalties or licence fees in respect of certain intangible assets as described in this paragraph.

3500. Alterations to paragraph 14 of this Schedule have enabled this provision to be expressed positively.

3501. The reference to "normal accounting practice" has been replaced by "generally accepted accounting practice" in *sub-paragraph (7)*. This is in line with the definition in section 103(1) of FA 2002.

Paragraph 20: Excluded activities: property development
3502. This is an interpretative paragraph, which draws the boundary around what may be considered as property development, one of the excluded activities listed in paragraph 16 of this Schedule. It derives from paragraph 23 of Schedule 14 to FA 2000.

Paragraph 21: Excluded activities: hotels and comparable establishments
3503. One of the excluded activities listed in paragraph 16 of this Schedule is the operation or management of a hotel or comparable establishment (or the management of property used as such). Paragraph 21,which derives from paragraph 24 of Schedule 14 to FA 2000, supplements the rule in paragraph 16.

Paragraph 22: Excluded activities: nursing homes and residential care homes
3504. Another excluded activity listed in paragraph 16 of this Schedule is the operation of a nursing home or a residential care home establishment (or the management of property used as such). Paragraph 22, which derives from paragraph 25 of Schedule 14 to FA 2000, supplements the rule in paragraph 16.

Paragraph 23: Excluded activities: provision of facilities for another business
3505. This paragraph adds to the list of excluded activities given in paragraph 16 of this Schedule, the provision of services to a business carried on by someone else. The exclusion applies if the business receiving the services consists largely of excluded activities (from the paragraph 16 list) and the person with a controlling interest in that business also has a controlling interest in the company providing the services. This material derives from paragraph 26 of Schedule 14 to FA 2000.

3506. To achieve the connection with excluded activities, in paragraph 26(1)(a) of Schedule 14 to FA 2000 there is a reference back to the term in paragraph 19(1) of Schedule 14. A problem with this is that in theory this could encompass activities, described as such in paragraph 19(1), but then "carved out" of this general exclusion (eg certain leasing of ships). It has been made clear that the excluded activities referred to in *sub-paragraph (2)(a)* are those activities after the "carve out" of those which can qualify (such as the leasing of ships in paragraph 18).

Part 4: Eligible employees
Paragraph 24: Eligible employees: introduction
3507. This paragraph is introductory and derives from paragraph 27 of Schedule 14 to FA 2000.

Paragraph 25: The employment requirement
3508. This paragraph derives from paragraph 28 of Schedule 14 to FA 2000 and explains that eligible employees must be employees of the relevant company or of a qualifying subsidiary company (if the relevant company is a parent company).

Paragraph 26: The requirement as to commitment of working time
3509. This paragraph sets out that eligible employees must spend at least 25 hours a week (or at least 75% of their working time, if less) on the business of the relevant company (or of the group if the relevant company is a parent company). Time off for illness and other types of leave are disregarded for the purposes of this test. This paragraph derives from paragraph 29(1) to (4) of Schedule 14 to FA 2000.

3510. One change from the material in paragraph 29 of Schedule 14 to FA 2000 is the reference to the employee as an "individual", in both this and paragraph 27 of this Schedule. It is not possible for anyone other than an individual to be a qualifying employee.

3511. There is also no mention in this paragraph of the closing words of paragraph 29(4) of Schedule 14 to FA 2000, about an employee ceasing to be in relevant employment. These words have been rewritten in section 535(1)(a), with a cross-reference to paragraph 25 of this Schedule.

3512. There is a change to the wording of the "statutory threshold" in *sub-paragraph (1)*, in the reference to the *average* amount per week of the employee's

committed time. See *Change 176* in Annex 1 and the parallel change to section 535, *Change 130*.

3513. Another minor change to the law concerns the 75% element of the "statutory threshold". The wording of paragraph 29(1) of Schedule 14 to FA 2000 did not make it clear that the reference to 75% is a minimum. See *Change 176* in Annex 1.

Paragraph 27: Meaning of "working time"
3514. This paragraph derives from paragraph 29(5) and (6) of Schedule 14 to FA 2000. It sets out what is meant by "working time" for the purposes of paragraph 26 of this Schedule.

Paragraph 28: The "no material interest" requirement
3515. This paragraph sets out that to be "eligible" under EMI, employees cannot have a material interest in the relevant company (or any group company if the relevant company is a parent company). Nor may any associate of the employee have such a material interest if the employee is to be an "eligible employee". This paragraph derives from paragraph 30(1), (2) and (4) of Schedule 14 to FA 2000.

Paragraph 29: Meaning of "material interest"
3516. This paragraph derives from paragraph 31 of Schedule 14 to FA 2000. It sets out what is meant by "material interest" for the purposes of paragraph 28 of this Schedule.

Paragraph 30: Material interest: options and interests in SIPs
3517. This paragraph explains what rights to acquire shares should be taken into consideration in deciding whether an employee has a material interest, and how and when such rights should be counted. It derives from paragraphs 30(3), 32 and 33 of Schedule 14 to FA 2000.

3518. This paragraph includes the part of paragraph 33 of Schedule 14 to FA 2000, which relates to SIPs. The rest of that paragraph that refers to APS (the profit sharing schemes approved under Schedule 9 to ICTA) has not been reproduced in this Schedule. It is contained in Part 8 of Schedule 7 to this Act (Transitionals and savings).

Paragraph 31: Meaning of "associate"
3519. This paragraph derives from paragraph 34 of Schedule 14 to FA 2000. It sets out what is meant by "associate" for the purposes of paragraph 28. The same definition is used for the different share schemes, and has been rewritten in the same way in each of Schedules 2, 3, 4 and 5 to this Act.

3520. The company in *sub-paragraph (1)(c)* is identified as the company mentioned in paragraph 28(2) of this Schedule. This is also copied in later paragraphs to which it is relevant. This makes explicit both interpretation and practice, thereby limiting the scope of the definition of "associate" in the case of a trust or estate.

3521. *Sub-paragraph (2)* is new. It links this paragraph with the two that follow.

3522. The definition of "relative" in s*ub-paragraph (3)* reflects the meaning given to this term in paragraph 26(7) of Schedule 14 to FA 2000.

Paragraph 32: Meaning of "associate": trustees of employee benefit trust
3523. The material interest test in paragraph 28 of this Schedule applies to a wide range of associates. Where an employee has an interest in shares subject to a trust, this includes the trustees of that settlement. If that settlement is an employment benefit trust, paragraph 32 ensures the trustees of that employment benefit trust do not count as associates (unless they do so because of some other link). This paragraph derives from paragraph 35 of Schedule 14 to FA 2000.

3524. Chapter 11 of Part 7 defines the expression "employee benefit trust", and deals with further matters arising when payments from employee benefit trusts are made.

Paragraph 33: Meaning of "associate": trustees of discretionary trust
3525. The material interest test in paragraph 28 of this Schedule is applied to a wide range of associates including, potentially, the trustees of a settlement. This paragraph applies where the company shares are held in a discretionary trust (ordinary meaning) of which the employee is a beneficiary but with only a very remote expectation of receiving anything from the trust. In such a case the trustees of that discretionary trust do not count as associates (unless they do so because of some other link). This paragraph derives from paragraph 36 of Schedule 14 to FA 2000.

Part 5: Requirements relating to options
Paragraph 34: Requirements relating to options: introduction
3526. This paragraph is introductory and derives from paragraph 37 of Schedule 14 to FA 2000.

Paragraph 35: Type of shares that may be acquired
3527. This paragraph sets out the requirement that, to qualify, an option may only be capable of being exercised to acquire shares that are:

- part of the ordinary share capital of the company in question;
- fully paid-up; and
- not redeemable.

3528. This paragraph derives from paragraph 38 of Schedule 14 to FA 2000.

Paragraph 36: Option to be capable of exercise within 10 years
3529. This paragraph sets out the requirement that, in order to qualify under EMI, the option must be capable of being exercised within ten years. There is no minimum

exercise period. This paragraph derives from paragraph 39 of Schedule 14 to FA 2000.

Paragraph 37: Terms of option to be agreed in writing

3530. This paragraph sets out the requirement that the option must take the form of a written agreement between the grantor of the option and the employee. It goes on to elaborate on the specific types of terms that have to be covered in that agreement. It derives from paragraph 40 of Schedule 14 to FA 2000.

Paragraph 38: Non-assignability of rights

3531. This paragraph explains that in order to qualify under EMI an option must not include any transferable rights. If the option includes a right for it to be exercised after the employee's death, the right may not extend for more than one year after the employee's death. It is not clear from the source legislation whether the one-year period includes any part or indeed the whole of the day on which the employee died. *Sub-paragraph (b)* clarifies this by referring to "one year after the date of the death" so if, for example, the employee dies at 2 pm on 1 May 2003, the option must be exercised *before* 2 May 2004.

3532. This paragraph derives from paragraph 41 of Schedule 14 to FA 2000.

Part 6: Company reorganisations

Paragraph 39: Company reorganisations: introduction

3533. This paragraph introduces the provisions in the rest of this Part of this Schedule and explains the term "company reorganisation". In this context a "company reorganisation" is broadly where a company acquires control of another company whose shares are subject to an unexercised qualifying share option. This paragraph derives from paragraph 59 of Schedule 14 to FA 2000.

Paragraph 40: Meaning of "qualifying exchange of shares"

3534. Among the ways listed in paragraph 39 of this Schedule for a company to acquire control of another company is by a "qualifying exchange of shares". Paragraph 40 sets out that a "qualifying exchange of shares" is an arrangement under which the new company issues shares in itself in exchange for acquiring all the shares in the old company, subject to certain conditions laid down in this paragraph. This paragraph derives from paragraph 60 of Schedule 14 to FA 2000.

Paragraph 41: Grant of replacement option

3535. Paragraph 41 derives from paragraph 61 of Schedule 14 to FA 2000. It sets out how, if a company reorganisation meets the required criteria set out in the preceding paragraph, a qualifying share option in the old company ("the old option") is exchanged for an equivalent share option in the new company, "the new option", to form a "replacement option". The replacement option must meet certain conditions and must be granted within the time limit outlined in paragraph 42 of this Schedule.

3536. The new *sub-paragraph (6)* makes it clear that when valuing the shares that are subject to the replacement option, for the purpose of the tests in paragraphs 5 to 7 of this Schedule, the value of the shares in the *acquired* company, at the time when the old option was granted, is the measure of the valuation of the shares subject to the new option. See *Change 177* in Annex 1.

Paragraph 42: Period within which replacement option must be granted
3537. This paragraph outlines the time limit on granting the replacement option mentioned in the preceding paragraph. That time limit depends on the circumstances under which the new company acquires control of the old company. The various possibilities are covered *in sub-paragraphs (2)* to *(4)*.

3538. In sub-paragraphs (2) and (3) there is a six-month period time limit. The wording in the source legislation does not make it clear whether or not the six months start running on the day that the change in control occurs, or on the day after. Sub-paragraphs (2) and (3) clarify this by referring to "6 months after the date on which…". So if, for example, the new company acquires control of the old company at 2pm on 1 January 2004, the replacement option must be granted *before* 2 July 2004.

3539. This paragraph derives from paragraph 62 of Schedule 14 to FA 2000.

Paragraph 43: Further requirements to be met as to replacement option
3540. This paragraph sets out various other conditions that must be met if the new option is to qualify as a replacement option for the purposes of EMI. This paragraph derives from paragraph 63 of Schedule 14 to FA 2000.

3541. As noted above, in relation to paragraphs 5 and 41 of this Schedule, the test in *sub-paragraph (3)(b)* (the maximum value of options under paragraph 7) should be applied to the new option and the acquiring company but the shares to be valued are those in the acquired company at the date of the grant of the old option. This is made clear in *sub-paragraph (4)*. See *Change 177* in Annex 1.

Part 7: Notification of option to Inland Revenue
Paragraph 44: Notice of option to be given to Inland Revenue
3542. A further requirement for an option to be a qualifying option is that its grant must be notified to the Inland Revenue within 92 days. This paragraph sets out this requirement, along with particulars of what information has to be included in that notification and who must make it. The wording in the source legislation does not make it clear whether the day upon which the option is granted is counted in the period of 92 days. *Sub-paragraph (1)* clarifies that the 92-day period only starts running the day after the date upon which the option is granted.

3543. This paragraph derives from paragraph 2 of Schedule 14 to FA 2000.

3544. In *sub-paragraph (7)* there is a cross- reference to the term "appropriate time". This is a new definition in paragraph 1 of this Schedule and is helpful in this Part with, for example, the application of paragraph 46(3).

Paragraph 45: Correction of notice by Inland Revenue

3545. This paragraph gives the Inland Revenue authority to amend a notice given to it under the preceding paragraph. This paragraph also sets out how and when such a correction may be made. It derives from paragraph 3 of Schedule 14 to FA 2000.

3546. This paragraph sets out the time within which the Inland Revenue may amend a notice and the time within which the employer company may reject such a correction. The source legislation gives these time limits as "nine months *after* the day on which the notice…was given" and "three months *from* the date of issue of the notice of correction". The time limit in each case starts running from the day after the day mentioned. *Sub-paragraph (4)* make this clearer for the time limit for the employer company by referring to "3 months *after* the date of issue of the notice".

3547. The wording in sub-paragraph (4) of paragraph 3 of Schedule 14 to FA 2000 states that the employer company can give notice rejecting a correction without saying to whom the notice should be given. A reference to the Inland Revenue has been added in *sub-paragraph (4)*. See *Change 178* in Annex 1.

Paragraph 46: Notice of enquiry

3548. This paragraph gives the Inland Revenue authority to enquire whether an option is qualifying or not after a notice has been given under paragraph 44 of this Schedule. The paragraph describes the procedure that should be followed by the Inland Revenue in opening such an enquiry and the time limits for doing so. This paragraph derives from paragraph 4 of Schedule 14 to FA 2000.

3549. *Sub-paragraph (5)* of paragraph 46 of this Schedule makes it clear that a notice of enquiry can be given before the end of the 92-day notification period if the option is notified to the Inland Revenue before then. The closing date remains 12 months after the end of the 92-day period. See *Change 178* in Annex 1.

Paragraph 47: Completion of enquiry: closure notices

3550. This paragraph sets out what happens when an enquiry as described in the preceding paragraph is completed. It provides for the issue of a closure notice, which must include details of the Inland Revenue's decision as to whether the option in question qualifies under EMI. It also sets out how, to whom and when such a closure notice should be issued. This paragraph derives from paragraph 5(1) to (5) of Schedule 14 to FA 2000.

Paragraph 48: Completion of enquiry: application for closure notice to be given

3551. This paragraph derives from paragraph 5(6) to (9) of Schedule 14 to FA 2000. It sets out that the employer company (or in certain circumstances the individual concerned) has a right to apply to the Commissioners for a direction requiring the

Inland Revenue to issue a closure notice as described in paragraph 47 of this Schedule.

Paragraph 49: Effect of enquiry

3552. This paragraph sets out how an enquiry impacts on the qualification of an option under EMI. The Inland Revenue's decision given in the closure notice determines whether an option qualifies, although that decision may be subject to an appeal under paragraph 50 of this Schedule. The paragraph also explains the procedure if there is no enquiry. In this circumstance the option is taken as being a qualifying option under EMI. This paragraph derives from paragraph 6 of Schedule 14 to FA 2000.

Paragraph 50: Appeals

3553. This paragraph sets out that there is a right of appeal to the Commissioners against a decision by the Inland Revenue that either the grant of an option was not properly notified in accordance with paragraph 44 of this Schedule or that the option does not qualify under EMI. The right of appeal lies with the employer company, although if the decision concerns the "commitment of working time" test in paragraph 26 of this Schedule, it is also open to the individual concerned to appeal. This paragraph derives from paragraph 7 of Schedule 14 to FA 2000.

3554. The replacement of employer company or individual in *sub-paragraph (3)* with "appellant" makes it clear that only the appellant has the right to elect that the appeal is heard by the Special Commissioners.

3555. The appeal must be made within a 30 day time limit. The source legislation does not make it clear whether or not the 30 day period starts running on the day that the closure notice is given to the employer company or on the day after. Sub-paragraph (3) clarifies this by referring to "within 30 days after the date when the closure notice is given". So if, for example, the closure notice is given during the course of the day on 1 March 2004 any appeal must be made *before* 1 April 2004.

Part 8: Supplementary provisions

Paragraph 51: Power to require information

3556. In order to carry out an enquiry as described in paragraph 46 of this Schedule, the Inland Revenue may require further information. This paragraph provides the Inland Revenue with the authority to issue a notice to a person requiring that person to provide such information.

3557. In *sub-paragraph (2)(b),* the authority also extends to cover information required to determine the tax liability of a person who has been granted a qualifying option. This covers liability to capital gains tax.

3558. There is a penalty for non-compliance with a notice issued under this paragraph. The consequential amendment to section 98 of TMA 1970 is contained in Schedule 6 to this Act.

3559. In *sub-paragraph (1)(a)* the words "reasonably require" replace the words "think necessary" in sub-paragraph (1)(a) of paragraph 64 of Schedule 14 to FA 2000. This change brings the terminology into line with SIPs (and with comparable provisions in Corporation Tax Self Assessment, known as CTSA). See *Change 179* in Annex 1.

3560. *Sub-paragraph (3)* clarifies the operation of the time limit for providing information by making the minimum three month period start after the date of the notice.

3561. This paragraph derives from paragraph 64 of Schedule 14 to FA 2000.

Paragraph 52: Annual returns
3562. This paragraph sets out that a company must make a return to the Inland Revenue for any year during which its shares are subject to a qualifying option, prescribes when it should make the return and that the return should contain such information as the Inland Revenue may require. It derives from paragraph 65 of Schedule 14 to FA 2000.

3563. The time limit has been changed to "before 7 July" in line with the practice in this Act where it helps to refer to an exact date following the end of the tax year.

3564. As with paragraph 64 of Schedule 14 to FA 2000, there is a penalty for non-compliance with a notice issued under this paragraph. The consequential amendment to section 98 of TMA 1970 is contained in Schedule 6 to this Act.

Paragraph 53: Compliance with time limits
3565. This paragraph allows an extension to the various time limits mentioned throughout the EMI provisions if the person failing to meet a particular time limit has a reasonable excuse for doing so. It derives from paragraph 70 of Schedule 14 to FA 2000.

Paragraph 54: Power to amend by Treasury order
3566. This paragraph allows the Treasury to make an order amending the terms of the trading activities tests for a qualifying company or amending the monetary limits on share values and on a company's gross assets. This paragraph derives from paragraph 69 of Schedule 14 to FA 2000.

3567. The power to amend by Treasury order, as set out in paragraph 69 of Schedule 14 to FA 2000, did not include any power to amend the £100,000 limit on unexercised employee options. Employee options are defined in section 536(2). That limit, which appears in paragraph 47(1)(g) of that Schedule, has been rewritten as section 536(1)(e). The power to amend by Treasury order has been extended to include that £100,000 limit. See *Change 180* in Annex 1.

3568. In practice this limit is only likely to be increased but the new *sub-paragraph (2)* further protects the taxpayer by explicitly matching changes in the paragraph 5 and 6 limits with that in section 536(1)(e).

Paragraph 55: Meaning of "market value" of shares
3569. This paragraph sets out that the "market value" of shares should have the same meaning as in TCGA 1992, subject to the special rule on the valuation of shares subject to restriction or risk of forfeiture in paragraph 5(7) of this Schedule.

3570. Paragraph 55 derives from paragraph 66(1) of Schedule 14 to FA 2000.

Paragraph 56: Determination of market value of shares
3571. Under this paragraph, if a market value has to be determined for the purposes of the EMI provisions, the company and the Inland Revenue may agree upon that market value and the dates by reference to which it must be determined. Alternatively the Inland Revenue have to decide what that market value is, and issue a notice to the company detailing its decision. The employer company has a right to pre-empt that decision by the Inland Revenue and refer the question instead to the Commissioners for their decision. This paragraph derives from paragraphs 66(2) and 67(1), (4) and (5) of Schedule 14 to FA 2000.

Paragraph 57: Appeal against determination of market value of shares
3572. Where the Inland Revenue have decided on a market value of shares under paragraph 56 of this Schedule, and issued a notice setting out that decision, the employer company may appeal against that decision. This paragraph sets out that right of appeal, saying to whom it must be made and when.

3573. The appeal must be made within a 30 day time limit. The wording in the source legislation does not make it clear whether or not the 30 day period starts running on the day that the notice of determination is given to the employer company or on the day after. *Sub-paragraph (2)* clarifies this by referring to "within 30 days after the date when notice of their determination is given". So if, for example, the notice of determination is given during the course of the day on 1 March 2004 any appeal must be made *before* 1 April 2004.

3574. This paragraph derives from paragraph 67(2), (3) and (5) of Schedule 14 to FA 2000.

Paragraph 58: Minor definitions
3575. This paragraph provides a number of definitions of terms used throughout the EMI provisions. It derives from paragraph 71(1) of Schedule 14 to FA 2000.

3576. There is one new term included in this list of definitions: "group of companies". This new term has been used in section 539(2)(b) and in paragraphs 5(1)(b)(ii) and (4)(b), and 6(2)(b) and (3) of this Schedule. See *Note 69* in Annex 2.

Paragraph 59: Index of defined expressions
3577. This paragraph shows where various terms used in the EMI code are defined. The equivalent list for Schedule 14 to FA 2000 is in paragraph 72 of that Schedule.

SCHEDULE 6: CONSEQUENTIAL AMENDMENTS
General
3578. This Schedule makes consequential amendments to other legislation. Many of those amendments are matters of detail, which do not require commentary; but there are also other amendments that are more substantial.

3579. A number of the more substantial amendments in this Schedule are connected with the provisions of Part 7 of this Act (employment income: share related income and exemptions). The majority of the provisions in the SIP code (deriving from Schedule 8 to FA 2000) and in the EMI code (deriving from Schedule 14 to that Act) are concerned with employment income; and, accordingly, appear in this Act – but not all of those provisions fall into this category. The view has been taken that it is more appropriate to move those remaining provisions to other destinations in the Tax Acts than to leave them where they are (see sections 515 and 527(3)). This Schedule makes provision accordingly.

Part 1: Income and Corporation Taxes Act 1988
Paragraph 2
3580. This paragraph substitutes a new section 1(1) of ICTA (the charge to income tax). As a result of the passing of this legislation the charge to income tax will consist in part of Schedules A, D and F, as set out in ICTA, and in part of the new categories of employment income, pension income and social security income for which this Act provides (together with other amounts which, under the Income Tax Acts, are charged to income tax).

Paragraph 4
3581. This paragraph amends section 9 of ICTA, which deals with the computation of income for corporation tax purposes, to reflect the repeal of Schedule E.

Paragraph 5
3582. This paragraph amends section 18 of ICTA so as to re-establish the boundary between income charged under this Act and income charged under ICTA.

3583. In section 18(1)(b) of ICTA the reference to Schedule E is replaced by a reference to the three types of income charged under this Act. This will include some pension and social security income that is charged under Schedule D by ICTA. The amendment ensures that the income is charged only under this Act. A similar amendment is made to the definition of Case VI.

3584. In the definition of Case V the phrase "income consisting of emoluments of any office or employment" is replaced by a general reference to "employment income". Although the latter term covers both the charge on emoluments taxed by

paragraph 1 of section 19(1) of ICTA and the free-standing Schedule E charges taxed by paragraph 5 of section 19(1), the amendment respects the principle that Schedule D is the residual Schedule. Despite using the broader term, Schedule D Case V still covers all of a person's income from abroad except income that is specifically chargeable under other provisions.

Paragraph 6
3585. This paragraph provides for the repeal of section 19 of ICTA, which delineates the charge to income tax under Schedule E.

Paragraph 10
3586. This paragraph inserts three new sections (68A, 68B and 68C) into ICTA. The new sections, which are part of the SIP code, provide for a charge to income tax under Case V of Schedule D where an individual receives benefits under a SIP consisting of foreign cash dividends or dividend shares acquired with such dividends cease to be subject to the plan within three years of acquisition. The new sections derive from material in paragraphs 92 and 93 of Schedule 8 to FA 2000.

Paragraph 12
3587. This paragraph inserts a new section 85B (approved share incentive plans) into ICTA 1988. The purpose of the new section is to introduce Schedule 4AA into ICTA; and the contents of that new Schedule are set out in paragraph 109 of this Schedule.

Paragraph 16
3588. This paragraph amends section 138 of ICTA. That section has itself been repealed, but still applies in respect of shares acquired before 26 October 1987. The two amendments simply adopt appropriate new language for references to "Schedule E".

Paragraph 22
3589. This paragraph provides for the omission of various provisions that are rewritten in this Act. Section 150(a) of ICTA taxes allowances paid under schemes set up under the Job Release Act 1977. The last Order authorising payments under the Job Release Act 1977 was 1987 SI 1339, which extended the effect of the Act to 29 September 1988. So this rule is spent and is not rewritten.

Paragraph 26
3590. This paragraph amends section 186 of ICTA which concerns approved profit sharing ("APS") schemes.

3591. Section 49 of FA 2000 envisages the phasing out of APS schemes. (No new schemes can be approved after 6 April 2001 and the tax advantages cease for shares appropriated after 31 December 2002.) However, the legislation relating to APS schemes needs to be preserved for existing schemes; and the view has been taken that the better approach is to not repeal the APS legislation but to leave it in sections 186 and 187 of, and Schedules 9 and 10 to, ICTA. Those provisions which have

continuing effect are being amended as necessary by this Schedule to reflect the new language introduced in this Act. Outdated references are not being amended where, for all realistic purposes, the provisions are spent.

3592. *Sub-paragraph (4)* amends section 186(5) of ICTA. The amendment is necessary because that provision looks backward and after 5 April 2003 will need to cover charges under both the old and new forms of section 186(3).

Paragraph 28
3593. This paragraph provides for the omission of various provisions that are rewritten in this Act. Section 191 of ICTA exempts some allowances paid under schemes set up under the Job Release Act 1977. The last Order authorising payments under the Job Release Act 1977 was 1987 SI 1339, which extended the effect of the Act to 29 September 1988. So this section is spent and is not rewritten.

Paragraph 34
3594. This paragraph inserts four new sections (251A, 251B, 251C and 251D) into ICTA. The four new sections, which, like sections 68A to 68C of ICTA (see paragraph 10 of this Schedule) are part of the SIP code, provide for charges to income tax under Schedule F where an individual receives benefits under a SIP consisting of UK cash dividends or dividend shares acquired with such dividends cease to be subject to the plan within three years of acquisition. The new sections also derive from material in paragraphs 92 and 93 of Schedule 8 to FA 2000.

Paragraph 36
3595. This paragraph derives from section 595(1)(b) of ICTA and related provisions in sections 595 and 596. The charge to tax in section 595(1)(a) and related provisions have been rewritten in Chapter 1 of Part 6 of the Act. The relief under section 595(1)(b) is being preserved by inserting a new section 266A into ICTA. Sections 595 and 596 of ICTA are being repealed.

Paragraph 44
3596. This paragraph amends section 322 of ICTA so that the section continues to include the foreign income that ICTA charges under Schedule D Case V but which this Act charges under the pension and social security income Parts.

Paragraph 47
3597. This paragraph amends section 332 of ICTA so that the section applies only in respect of deductions against the profits or fees of a minister of religion chargeable under Schedule D and expenses incurred in earning those profits or fees. Section 332(3) provides that particular expenses incurred in connection with an employment, profession or vocation as a minister are deductible from the profits or employment income of a minister. This amendment permits such expenses to be deducted in calculating Schedule D profits only if they relate to an appointment as a minister that is taxable under Schedule D and are incurred in earning those profits. See *Change 90* in Annex 1.

Paragraph 48
3598. This paragraph amends section 336 of ICTA so that the section continues to include the income that ICTA charges under Schedule D but which this Act charges under the pension and social security income Parts.

Paragraph 55
3599. This paragraph amends section 418 of ICTA. Most of the amendments are straightforward.

3600. The amendment to section 418(2)(a) is necessary because of the way the benefits code has been rewritten in this Act. The benefits code applies to all employees unless they are in "lower paid employment" as defined in section 217 of this Act. If they are in lower paid employment some Chapters of Part 3 are excluded from applying to them. The employments for which this exclusion does not apply are those within Chapter II of Part V of ICTA.

Paragraph 65
3601. This paragraph amends section 580A(7)(b) of ICTA. Section 580A exempts annual payments paid under certain types of ill health and employment risk insurance policy. Subsection (7) extends the exemption to income taxed under Schedule E if the payee pays or contributes to the premiums due under a policy taken out by another person on the payee's behalf. This has been amended to refer to employment income and pension income. The effect of the amendment is that the exemption will apply to foreign pensions. See *Change 181* in Annex 1.

Paragraphs 67 to 70
3602. These paragraphs amend sections 588 to 589B of ICTA. These sections provided for an exemption from tax under Schedule E for retraining courses and outplacement counselling, which is rewritten at sections 310 to 312 in this Act. It is rewritten there with several minor changes (including removal of the requirement that the services in question should be provided in the United Kingdom). See *Change 72* in Annex 1.

3603. Sections 588 to 589B also provide for a deduction under Schedule D if the expenses incurred would not otherwise be deductible (sections 588(3) and 589A(8)). They also provide for the expenses to be allowed as expenses of an investment company on a similar basis to allowing for a Schedule D deduction.

3604. Paragraphs 67 to 69 amend those parts of section 588 to 589B that deal with the deduction for Schedule D/management expenses to tie in to the exemptions now contained in sections 310 to 312 of this Act.

3605. This approach allows those parts of sections 588 to 589B which deal with the Schedule E exemptions to appear only in this Act and not in ICTA.

Paragraphs 72 and 73
3606. These two paragraphs amend sections 592(7) and 594(1) of ICTA. Relief for contributions is now expressed as a deduction from employment income and there is a signpost to these provisions in section 327(5). See *Change 154* in Annex 1.

Paragraph 100
3607. This paragraph inserts two new sections (686B and 686C) into ICTA. The new sections, which like sections 68A to 68C of ICTA (see paragraph 10 of this Schedule) are part of the SIP code, provide that section 686 of ICTA (special rates of tax for accumulation and discretionary trusts) has only a limited application to dividend income received by the trustees of an approved SIP. The two new sections derive from paragraph 88 of Schedule 8 to FA 2000.

Paragraph 108
3608. This paragraph amends section 833 of ICTA. The amendments to subsections (4) and (5) of the section concern earned income.

3609. The concept of earned income is nearly obsolete, the last general use for it being to identify a wife's earned income before independent taxation was introduced in 1990. But the concept has a continuing relevance to retirement annuity relief (section 623 of ICTA) and personal pension relief (section 644 of ICTA).

3610. All the remuneration and pensions listed in paragraph (a) of subsection (4) of section 833 are charged to tax under the Act.

3611. All the pensions, annuities and social security payments listed in paragraphs (a) to (d) of subsection (5) of section 833 are charged to tax under the Act.

3612. So the two lists are replaced by a single reference to the Act.

3613. But the Act charges two sorts of income that are not earned income in section 833. These are:

- returned surplus employee additional voluntary contributions (charged under Schedule D Case VI in ICTA); and

- jobseeker's allowance (charged under section 151A of ICTA, which is not mentioned in paragraph (c) of subsection (5) of section 833).

Paragraph 109
3614. This paragraph inserts a new Schedule 4AA into ICTA. The new Schedule, which like sections 68A to 68C of ICTA (see paragraph 10 of this Schedule) is part of the SIP code, deals with corporation tax deductions relating to the setting up and administration of an approved SIP. The new Schedule has 13 paragraphs, which derive from Part 11 (paragraphs 105 to 114) of Schedule 8 to FA 2000. In the new Schedule 4AA, paragraphs 4(9), 9, 10 and 12 derive from provisions inserted in

Schedule 8 to FA 2000 by the Employee Share Schemes Act 2002 with effect from 6 April 2003.

3615. The new Schedule 4AA is introduced by the new section 85B of ICTA (see paragraph 12 of this Schedule). Section 85B falls within Part 4 of ICTA; and in this way the definition of the expression "investment company" in section 130 of ICTA will apply to the new Schedule (see *Note 70* in Annex 2).

Paragraphs 112 and 113
3616. These paragraphs amend and preserve Schedules 9 and 10 to ICTA in relation to approved profit sharing schemes. The retention of this legislation is referred to in the notes on paragraph 26.

3617. The amendments are those necessary to reflect the new language introduced in this Act.

Part 2: Other enactments
Paragraph 126
3618. This paragraph amends section 15 of TMA 1970. The amendments are straightforward and replace terms used in ICTA with those used in this Act.

Paragraph 127
3619. This paragraph substitutes a new section 16A of TMA 1970. This section applies section 15 of TMA 1970, the return of employees' earnings, to agency workers. The new wording accords with the language in this Act and there are signposts to Chapter 7 of Part 2, sections 44 to 47. The change in structure reflects the increased focus on the agency contract in these sections.

Paragraph 137
3620. This paragraph makes certain amendments to the table at the end of section 98 of TMA 1970 (penalties: special returns). Most are self-explanatory.

3621. Sub-paragraph (4)(e) deletes a reference to section 313(5) of ICTA from the second column of that table. Section 73 of FA 1988 replaced what were subsections (1) to (5) of section 313 of ICTA with subsections (1) to (4). As a result there was no longer any subsection (5). The consequential amendment to the table in section 98 of TMA 1970 was missed. This amendment, while not arising from the rewrite of section 313(5), corrects that oversight.

Paragraph 147
3622. This paragraph amends section 24 FA 1974, which extends the Inland Revenue's right to call for a return of the emoluments derived from duties performed in the United Kingdom.

3623. A return issued under section 24 FA 1974 can call for particulars of emoluments "whether or not tax is chargeable on them". This could be read as

requiring the taxpayer to include details of emoluments that would be exempt, even in the case of a UK resident taxpayer working on UK duties for a UK employer. This paragraph removes any uncertainty about the meaning of "whether or not tax is chargeable on them" to make it clear the provision concerns the employee's "general earnings" (whether or not chargeable to tax) and that the return does not have to include income that is exempt.

Paragraphs 157 and 158

3624. These paragraphs amend sections 43 and 44 of FA 1989.

3625. Sections 43 and 44 were introduced as part of the changes made to put the assessment of employment income on a receipts basis. Broadly, they prevent a deduction for employees' pay unless it is paid during the period of account or within nine months after its end. As such, they align more closely the timing of the trading or investment company deduction with that of the charge to tax on the employee.

3626. Both sections contain numerous references to "emoluments".

3627. Rather than making a whole series of consequential amendments replacing the term "emoluments" wherever it occurs in sections 43 and 44 FA 1989 these paragraphs replace each of these two sections with a complete rewrite.

Paragraphs 169 to 185

3628. These paragraphs make amendments to the Social Security Contributions and Benefits Act 1992 ("SSCBA"). Most of the amendments change the ICTA references to Schedule E to the terms used in this Act for employment income and are straightforward.

3629. The term "emoluments" is used in many of the provisions and has been replaced with "general earnings".

3630. The replacement of section 10(7) of SSCBA 1992 with subsections (7), (7A) and (7B) provides the equivalent provision through this Act which ensures that Class 1A NICs are applied only to those benefits which remain chargeable to income tax.

3631. The definitions of all the terms have been placed in section 122 of SSCBA 1992.

Paragraphs 190 to 204

3632. These paragraphs make amendments to the Social Security Contributions and Benefits (Northern Ireland) Act 1992 corresponding to those made to the Social Security Contributions and Benefits Act 1992 by paragraphs 169 to 185 of this Schedule.

Paragraph 210
3633. This paragraph amends section 120 of TCGA 1992 which treats certain amounts chargeable to income tax in relation to shares as additional consideration for the acquisition of those shares under section 38 of TCGA 1992. The amendments mainly reflect the new language and update references.

3634. *Sub-paragraph (2)* expands and rearranges section 120(1) to clarify how it operates and brings in material from FA 1988 so that the second paragraph of section 120(1) can be omitted. The words after the semi-colon in the first paragraph of section 120(1) are thought to be there in order that the relief given by the opening words of section 120(1) works in cases within section 83(1) of FA 1988 (where the shares are acquired by a person connected with the employee). This is made clear in the rewritten provision. The view is taken that no modification of the relief is required in cases to which section 83(2) of FA 1988 applies. See *Note 72* in Annex 2.

3635. *Sub-paragraph (7)* provides for the omission of section 120(6) of TCGA 1992. That provision effectively duplicated section 185(7) of ICTA. It also set out the transitional provisions. The effect of both subsections together with the transitionals now appears in new Schedule 7D to TCGA 1992.

Paragraph 212
3636. This paragraph derives from section 68(4) of FA 1988. It inserts a new section 149C into TCGA 1992 relating to the capital gains treatment of priority share allocations. The income tax provisions are rewritten in Chapter 10 of Part 7 of this Act.

Paragraph 216
3637. This paragraph inserts a new section 238A (approved share schemes and share incentives) into TCGA 1992. The purpose of the new section is to introduce Schedule 7D to TCGA 1992; and the contents of that new Schedule are set out in paragraph 221 of this Schedule.

Paragraph 217
3638. This paragraph inserts a new section 263ZA (former employees: employment-related liabilities) into TCGA 1992. It derives from section 92(6) to (8) of FA 1995.

3639. *Subsections (1)* to *(3)* of the new section 263ZA provide that if a former employee is entitled to deduct an amount under section 555 of the Act (former employee entitled to deduction from total income) but has insufficient total income to absorb the amount deductible, then the excess may be treated as an allowable loss for the purposes of capital gains tax.

3640. *Subsections (4)* and *(5)* set a limit to the amount that can be so deducted.

3641. *Subsection (6)* introduces a small administrative change. It enables a single claim to cover relief against both total income and capital gains. See *Change 182* in Annex 1.

Paragraph 221
3642. This paragraph inserts a new Schedule 7D into TCGA 1992; and the new Schedule deals with the capital gains tax aspects of approved share schemes and share incentives.

3643. Part 1 of the new Schedule deals with the capital gains tax aspects of approved SIPs. This Part forms part of the SIP code and derives from paragraphs 74, 97 to 102 and 104 of Schedule 8 to FA 2000. In this Part of this Schedule, paragraphs 2(4) and 4(6) derive from provisions inserted by the Employee Share Schemes Act 2002 with effect from 6 April 2003.

3644. Part 2 of the new Schedule deals with the capital gains tax aspects of approved SAYE option schemes. This Part forms part of the SAYE code and derives from provisions in section 185 of ICTA.

3645. Part 3 of the new Schedule deals with the capital gains tax aspects of approved CSOP schemes. This Part forms part of the CSOP code and derives from provisions in section 185 of ICTA. It may be noted that section 185(7) of ICTA has been rewritten here together with the transitional provisions in section 120(6) of TCGA 1992. Section 120(6) of TCGA 1992 is now being repealed.

3646. Part 4 of the new Schedule deals with the capital gains tax aspects of enterprise management initiatives. This Part forms part of the EMI code and derives from paragraphs 56 to 58 of Schedule 14 to FA 2000.

Paragraph 241
3647. This paragraph amends paragraph 10(1) of Schedule 2 to the Tax Credits Act 1999. That amended section 71(8) of the Social Security Administration Act 1992 and section 69(8) of the Social Security Administration (Northern Ireland) Act 1992 in order to allow overpayments of tax credits to be collected through PAYE. This amendment replaces the reference to the legislation for PAYE in ICTA with a reference to "PAYE regulations" (defined in section 674(8) of this Act). It includes a minor change: see *Change 183* in Annex 1.

Paragraph 257
3648. This paragraph substitutes a new section 95 of FA 2001. This section provides for exemptions from stamp duty and stamp duty reserve tax in relation to approved SIPs; and the new section is accordingly part of the SIP code. Section 95 of FA 2001 originally operated by inserting a new paragraph 116A in Schedule 8 to FA 2000; but in this substituted version the exemptions have been removed from that Schedule and made free standing.

Paragraphs 268 and 269
3649. These paragraphs set out the consequential amendments that may be needed to some future Northern Ireland legislation. The amendments to the legislation that applies in Great Britain are set out earlier in the Schedule. Paragraphs 183 and 184 apply to legislation introduced by the Employment Act 2002. The enactment of the Northern Ireland provision corresponding to that legislation has been affected by the suspension of the Northern Ireland Assembly.

SCHEDULE 7: TRANSITIONALS AND SAVINGS
Part 1: Continuity of the law
Paragraphs 1 to 7
3650. These paragraphs ensure continuity of the law, despite the fact that this Act repeals and rewrites provisions. Paragraph 2 is included to ensure that provisions in the Act which change the law are not subject to the general proposition about continuity in paragraph 1.

Part 2: Employment income: charge to tax
Paragraph 8
3651. Section 202A(2)(a) of ICTA states that the provisions determining what emoluments are chargeable in a particular year apply "whether or not the emoluments are for that year or for some other year of assessment". The charging provisions in Chapters 4 and 5 of Part 2 of this Act give effect to this statement in the various sections determining taxable earnings in a tax year.

3652. This paragraph ensures that where those charging provisions apply to general earnings for "some other tax year" the reference to some other tax year can include years before 2003-04.

3653. *Sub-paragraphs (3)* and *(4)* derive from the transitional provisions in sections 36 and 39 of FA 1989 which amended Case III of Schedule E as well as inserting paragraph (4A) into section 19(1) of ICTA. They preserve continuity of tax treatment for any general earnings for a tax year before 1989-90 that are remitted to the UK in 2003-04 or later if those earnings would have been within Case III of Schedule E before it was amended in FA 1989.

Paragraphs 9 to 11
3654. A claim to relief for delayed remittances made under section 35 could include delayed remittances relating to earnings for tax years before 2003-04 and the claimant may elect under section 36 to have those delayed remittances attributed to particular earlier years. Paragraphs 9 to 11 deal with the fact that this Act changes the terminology used to describe the income making up the delayed remittances and the charge to tax on them.

Paragraph 12
3655. This paragraph deals with the treatment of disputes as to domicile or ordinary residence which arise after the commencement of this Act, but which relate to income to be charged to tax in the tax year 2002-03 or any earlier tax year. The effect of this transitional is that such disputes will be governed by section 207 of ICTA, and not by sections 42 and 43 of this Act.

Paragraph 13
3656. This paragraph sets out how the provisions in Chapter 7 of Part 2 should be read in relation to times before 6 April 2003, by reference to the ICTA terminology rather than the language of this Act.

Paragraph 14
3657. This paragraph reflects the fact that the changes made to the treatment of construction industry workers in section 134 of ICTA by section 55 of FA 1998 only have effect with regard to payments for services provided on or after 6 April 1998.

Part 3: Employment income: earnings and benefits etc. treated as earnings
Paragraph 15
3658. This paragraph preserves the effectiveness of notifications made before 6 April 2003 for tax years beginning on or after that date. It carries forward the transitional provisions in section 166 of ICTA. It also deals with the change in terminology between the source legislation and this Act where, in the latter, the notification is called a "dispensation". That reflects the commonly used description of the notification. The provisions in the following paragraph may modify the scope of those dispensations.

Paragraph 16
3659. This paragraph modifies the effect of any dispensation that was in force before 6 April 2002 to preserve the modifications that were made to such dispensations by section 58 of FA 2001. Those modifications arose from the enactment of the provisions for mileage allowance payments and mileage allowance relief. From that date any element in a pre-existing dispensation relating to payments made, or benefits or facilities provided, in respect of expenses incurred in connection with the use of a vehicle by an employee for business travel was revoked. This paragraph ensures that such a revocation is retained in the operation of the dispensation on and after 6 April 2003.

Paragraph 17
3660. Section 168(2) of ICTA applies the provisions of Chapter 2 of Part 5 of that Act only to an employment the emoluments of which fall to be assessed under Schedule E. That proviso is also imported into the rules for living accommodation by section 145(8)(b). A similar proviso is contained in section 144(5) of ICTA for vouchers and credit-tokens.

3661. The concept of an employment the emoluments of which fall to be assessed under Schedule E has been reproduced for the purposes of the benefits code in this Act as "a taxable employment under Part 2", defined in section 66(3). In cases where it is necessary to consider whether there is a "taxable employment" before 6 April 2003, paragraph 17 of this Schedule explains how to translate this concept back into the rules in ICTA from which it derives.

Paragraph 18
3662. The general transitional provision for "employment" and related expressions in paragraph 17 does not provide the correct continuity for the use of employment in section 89(1)(c). This paragraph provides the correct replacement terms to ensure continuity.

Paragraph 19
3663. This paragraph concerns notices under section 144(1) of ICTA. It preserves the effectiveness of existing notifications (described as "dispensations" in this Act), subject to the modifications in paragraph 20.

Paragraph 20
3664. This paragraph derives from section 58 of FA 2001. It preserves the modifications that those provisions make to the effectiveness of existing notifications to take account of the introduction of mileage allowance payments and mileage allowance relief.

Paragraph 21
3665. This paragraph derives from section 146(8) of ICTA, which disapplies section 146(6) in cases where the employee first occupied the living accommodation in question before 31 March 1983.

Paragraphs 22
3666. This paragraph deals with capital contributions made by an employee before 6 April 2003 towards the cost of a car, other than a classic car (as dealt with in section 147) or accessories attached to it. The paragraph ensures that those contributions continue to be taken into account in calculating the cash equivalent of the benefit of the car for appropriate tax years beginning on or after that date. The paragraph also deals with changes in terminology between the source legislation and this Act.

Paragraph 23
3667. This paragraph deals with capital contributions made by an employee before 6 April 2003 towards the cost of a classic car (as dealt with in section 147) or accessories attached to it. The paragraph ensures that those contributions continue to be taken into account in calculating the cash equivalent of the benefit of the car for appropriate tax years beginning on or after that date. The paragraph also deals with changes in terminology between the source legislation and this Act.

Paragraph 24
3668. This paragraph deals with the consequences of the changes in terminology between the source legislation and this Act where a van is available to only one employee for a period exceeding 30 days that straddles 6 April 2003. The paragraph ensures that the relevant provisions apply irrespective of that employee's level of earnings ("emoluments" in the source legislation language).

Paragraph 25
3669. *Sub-paragraph (1)* ensures that loans may be employment-related regardless of when they were made, even if that was before FA 1976 (which introduced the beneficial loans provisions) was passed. It derives from section 160(7) of ICTA.

3670. *Sub-paragraph (2)* derives from section 161(7) of ICTA. It has the effect that the provisions of section 188 which apply to "stop loss" arrangements do not apply in the case of a holding of shares acquired before 6 April 1976.

Paragraph 26
3671. This paragraph deals with the change described in *Change 28* in Annex 1 (using Y for the number of days in the tax year in place of 365 days). It prevents the change applying where section 183 applies in relation to section 177 (the fixed rate loan exception) in the case of loans made in a leap year and before 6 April 2003.

Paragraph 27
3672. The charge to tax under section 188 may be in respect of a loan made before 2003-04. This paragraph deals with the fact that this Act changes the terminology used to describe the beneficial loan arrangements and the charge to tax on them, so that a loan made before 2003-04 may be an employment-related loan.

Paragraph 28
3673. This paragraph, deriving from section 162(1) of ICTA makes it clear that Chapter 8 of Part 3 of this Act applies only in relation to shares acquired after 6 April 1976.

Paragraph 29
3674. This paragraph ensures continuity of the law in respect of events prior to 6 April 2003.

3675. *Sub-paragraphs (2)and (3)* provide the continuity of the law in the case of an acquisition of shares prior to 6 April 2003 which gave rise to a notional loan within section 162(1) of ICTA. The amount of the notional loan initially outstanding remains the amount under section 162(1) and is to be used to arrive at the amount of the notional loan outstanding at any subsequent time after 6 April 2003. in accordance with section 194(3).

3676. *Sub-paragraph (4)* translates the reference in section 195(3)(c) to "excluded employment" to the term "an employment to which Chapter 2 of Part 5 of ICTA applies" in the case of a notional loan which first arose before 6 April 2003.

Paragraph 30
3677. This paragraph, deriving from section 162(6) of ICTA, makes it clear that Chapter 9 of Part 3 of this Act applies only in relation to shares acquired after 6 April 1976.

Paragraph 31
3678. The charge to tax under section 199 of this Act may be in respect of a loan made before the tax year 2003-04. This paragraph translates the reference in section 199(4)(b) to "excluded employment" to the term "an employment to which Chapter 2 of Part 5 of ICTA applies" in the case where the shares were acquired before 6 April 2003.

Paragraph 32
3679. Sub-paragraph (2) makes sure that the reference in section 206 of this Act to the cost of a benefit includes the cost of any benefit determined under section 156(5) of ICTA.

3680. *Sub-paragraph (3)* prevents the provisions by which the cash equivalent of the benefit of certain scholarships is chargeable to tax as earnings from applying to scholarships awarded before section 165 of ICTA came into effect in 1983.

Part 4: Employment income: exemptions
Paragraphs 33 and 34
3681. These paragraphs ensure that the overall exemption limit in section 241 operates correctly in respect of a qualifying period of absence which straddles 6 April 2003.

Paragraph 35
3682. This paragraph ensures that amounts in respect of benefits provided or expenses incurred before 6 April 2003 in connection with an employee's change of residence count towards the £8,000 limit on such amounts in tax years beginning on or after that date.

Paragraph 36
3683. This paragraph preserves the effectiveness of any direction that was made before 6 April 2003 as to what is the "relevant day". That direction remains effective for determining what will be the "limitation day" for the purposes of this Act. The paragraph thereby also deals with the change in terminology between the source legislation and this Act.

Paragraph 37
3684. This paragraph preserves the recovery of tax and information powers of section 588(5) to (7) of ICTA, as the section applies before the date on which this Act comes into force, for cases where:

- the employee's or the employer's liability to tax for a year has been determined in accordance with sections 588 and 589 as those sections apply before that date, and

- the failure referred to in section 588(5)(a) and (b), as that section apply before that date, occurs on or after that date.

3685. The paragraph works by disregarding in such circumstances the amendment of section 588(6), and the repeal of sections 588(5)(a) and 589(3) and (4), in Schedules 6 (consequential amendments) and 8 (repeals and revocations) respectively.

Paragraph 38
3686. This paragraph ensures that awards made under ESC A57 are taken into account in calculating the "permitted maximum" under section 322(3), where a financial benefit award under section 321is made for the same suggestion.

Part 5: Employment income: deductions
Paragraph 39
3687. Section 353 provides that a deduction is allowed from earnings charged on remittance where (among other matters) certain expenses are paid in the tax year or in an earlier tax year in which the employee has been resident in the United Kingdom. This paragraph contains provisions designed to ensure continuity where the earlier tax year ended before 6 April 2003, but the deductions fall to be allowed in the tax year 2003-04 or in a later tax year.

Paragraph 40
3688. Sections 373 and 374 provide, in certain circumstances, for deductions from earnings for travel costs and expenses of a non-domiciled employee or of members of his family. The travel in question must end on, or during the period of five years beginning with a date that is a "qualifying arrival date" in relation to the employee. This paragraph contains provisions to ensure that the deductions may be given where the qualifying arrival date was before 6 April 2003, but the costs and expenses of the travel relate to the tax year 2003-04 or to a later tax year.

Part 6: Employment income: income which is not earnings or share-related
Paragraph 41
3689. This paragraph applies to benefits provided by non-approved retirement benefits schemes that were entered into before 1 December 1993 and have not been varied since so as to affect the benefits provided. It derives from the original version of section 596A of ICTA introduced by paragraphs 1, 9 and 18(7) of Schedule 6 to FA 1989.

3690. Section 596A of ICTA was subject to major changes introduced by section 108 FA 1994. Those changes are reflected in the rewrite of section 596A in Chapter 2 of Part 6 of this Act. But the changes do not apply to schemes that existed at 1 December 1993 unless the scheme has been varied with a view to changing the benefits provided. Unaltered pre-December 1993 schemes continue to be taxed by the old rules.

3691. *Sub-paragraph (1)* gives the conditions for the paragraph to apply.

3692. *Sub-paragraph (2)* disapplies section 393(2). That subsection provides that the charge in Chapter 2 of Part 6 of this Act does not apply to pension income. This rule does not appear in the original section 596A of ICTA. In practice there would not be a double charge. If a non-approved retirement benefits scheme paid a pension it would be taxed as a pension. It is more likely that the scheme would provide a lump sum that the recipient would use to buy an annuity that would be taxed under Schedule D Case III.

3693. *Sub-paragraph (3)* disapplies section 394(5). That subsection provides that the charge in Chapter 2 of Part 6 of this Act takes priority over any other charge in the Act. That rule does not appear in the original section 596A of ICTA.

3694. *Sub-paragraph (4)* provides two sections to be substituted for sections 395, 396 and 397 in Chapter 2 of Part 6 of this Act.

3695. *Section 394A* derives from subsections (8) and (9) of the original version of section 596A of ICTA. Tax is not charged on any lump sum financed by contributions paid by the employer provided that the employee has been taxed on those contributions. The difference between this provision and section 396 is that under the original version of section 596A of ICTA there is no requirement for the scheme income and gains to be brought into charge to tax.

3696. *Section 394B* derives from subsections (6) and (7) of the original version of section 596A of ICTA. In the original version of section 596A those subsections deal with a benefit that is also an amount taxed by paragraph 1 of the charge to income tax under Schedule E in section 19(1) of ICTA. Subsection (6) provides that the paragraph 1 charge takes priority. But if the charge under section 596A is greater than the charge as an emolument the additional amount is charged under section 596A.

3697. The new section 394B preserves this effect by comparing the charge under Chapter 2 of Part 6 of this Act with the charge on general earnings.

Paragraph 42

3698. This paragraph ensures that any payments or benefits which were charged under section 148 of ICTA as it was before the changes made in section 58(4) of FA 1998 are not chargeable by virtue of Chapter 3 of Part 6 if the payments continue to be made or the benefits provided after 6 April 2003.

Paragraph 43
3699. This paragraph ensures that the balance of the £30,000 threshold remaining at 5 April 2003 is carried forward to the tax year 2003-04, or, if it has all been used, nothing more is available.

Part 7: Employment income: share-related income
Paragraph 44
3700. This paragraph reflects the fact that when inserting sections 140A to 140C into ICTA, section 50(4) of FA 1998 provided that those sections should only have effect for interests acquired after 16 March 1998.

Paragraph 45
3701. This paragraph adapts section 425(1) of this Act so that it makes sense in relation to times before 6 April 2003. In relation to those times the office or employment in question must be one in respect of which the person is chargeable to tax under Case 1 of Schedule E. This is the same requirement as under section 140H(3) of ICTA.

Paragraph 46
3702. This paragraph ensures that, in computing the amount of the charge under section 428, the amounts which would have been deducted under section 140A(7) of ICTA in respect of charges arising before 6 April 2003 are still allowed.

Paragraph 47
3703. This paragraph provides that the time limit in section 140G of ICTA requiring information about the provision of conditional interests in shares during the tax year 2002-03 to be notified within 30 days of the end of that year of assessment still applies. The extended time limit in section 432 comes into force in respect of conditional interests provided after 5 April 2003. The paragraph also makes it clear that notification is not now required if it has already been given under the corresponding provision in ICTA.

Paragraph 48
3704. This paragraph provides that the time limit in section 140G of ICTA requiring information about potential charges under section 140A of ICTA during the tax year 2002-03 to be notified within 30 days of the end of that year of assessment still applies. The extended time limit in section 433 comes into force in respect of events occurring after 5 April 2003. The paragraph also makes it clear that notification is not now required if it has already been given under the corresponding provision in ICTA.

Paragraph 49
3705. This paragraph reflects the fact that, when inserting sections 140D to 140F into ICTA, section 51(3) of FA 1998 provided that those sections should only have effect in relation to shares acquired after 16 March 1998.

Paragraph 50
3706. This paragraph adapts section 437(1) of the Act so that it makes sense in relation to times before 6 April 2003. In relation to those times the office or employment in question must be one in respect of which the person is chargeable to tax under Case 1 of Schedule E. This is the same requirement as under section 140H(3) of ICTA.

Paragraph 51
3707. This paragraph ensures that, in computing the amount of the charge under section 439, the amounts which would have been deducted under section 140D(6) of ICTA in respect of charges arising before 6 April 2003 are still allowed.

Paragraph 52
3708. This paragraph ensures that the rules specifying what are deductible amounts in section 439 operate correctly where there have been a series of conversions at least one of which occurred before 6 April 2003.

Paragraph 53
3709. This paragraph provides that the time limit in section 140G of ICTA requiring information about potential charges under section 140D of ICTA during the tax year 2002-03 to be notified within 30 days of the end of that year of assessment still applies. The extended time limit in section 445 comes into force in respect of conversions taking place after 5 April 2003. The paragraph also makes it clear that notification is not now required if it has already been given under the corresponding provision in ICTA.

Paragraphs 54 to 56
3710. Paragraph 54 derives from section 77 of FA 1988 which specifies that Chapter 2 of Part 3 of FA 1988 applies to acquisitions of shares, or interests in shares on or after 26 October 1987. There are variations in that general commencement provision and these are rewritten in paragraphs 55 and 56.

Paragraph 57
3711. This paragraph provides that the similar legislation in ICTA to that rewritten in Chapter 4 of Part 7 continues to apply to acquisitions before 26 October 1987.

Paragraph 58
3712. This paragraph ensures that the condition in section 77(2) of FA 1988, which requires earnings from the employment in respect of which the shares are issued to be within Case I of Schedule E, still applies to acquisitions before 6 April 2003. It also reflects the fact that the exemption from this Chapter for certain priority share allocations only applies from 16 January 1991 (by virtue of section 77(4) of FA 1988 which was inserted by section 44 of FA 1991).

Paragraph 59
3713. This paragraph ensures that, in computing the amount of the charge under section 455, the amounts which would have deducted under section 79(6A) and (6B) of FA 1988 in respect of charges arising under section 140A or section 140D of ICTA before 6 April 2003 are still allowed.

Paragraph 60
3714. This paragraph provides that the time limit in section 85(1) of FA 1988 requiring information about acquisitions during the tax year 2002-03 to be notified within 92 days of the end of that year of assessment still applies. It has been rewritten here as "before 7th July 2003". The paragraph also makes it clear that notification is not now required if it has already been given under any of the specified shares provisions in FA 1988 or in ICTA.

Paragraph 61
3715. This paragraph provides that the time limit in section 85(2) of FA 1988 requiring information about chargeable events and chargeable benefits in the 60-day period prior to 6 April 2003 to be notified within 60 days still applies. The extended time limit in section 466 comes into force in respect of chargeable events occurring and chargeable benefits being received after 5 April 2003. The paragraph also makes it clear that notification is not now required if it has already been given under the corresponding provision in FA 1988.

Paragraph 62
3716. This paragraph reflects the fact that the number of years referred to in section 135(2) and (5) of ICTA was changed from seven to ten by section 49 of FA 1998 in relation to share options obtained after 5 April 1998.

Paragraph 63
3717. This paragraph adapts section 473(1) of this Act so that it makes sense in relation to times before 6 April 2003. In relation to those times the office or employment in question must be one in respect of which the person is chargeable to tax under Case 1 of Schedule E. This is the same requirement as under section 140(1) of ICTA.

Paragraphs 64 to 66
3718. These three paragraphs ensure that all amounts that have been chargeable to tax on the receipt of an option before 6 April 2003 are deducted in calculating the taxable amount under section 478 of this Act or the amount of the gain under section 479 or 480 of this Act, where the option is exercised, assigned or released after that date.

Paragraph 67
3719. This paragraph ensures that section 486 of this Act applies where the matter occurred in the tax year 2002-2003 and that in such a case the particulars may be supplied to any officer of the Board of Inland Revenue, not just an inspector as

required by section 136(6) of ICTA. The paragraph also makes it clear that notification is not now required if it has already been given under section 136(6) of ICTA or paragraph 2 of Schedule 14 to FA 2000.

Paragraph 68
3720. This paragraph contains provisions to ensure that an employee share ownership plan which, before 6 April 2003, was approved under Schedule 8 to FA 2000, is treated as a share incentive plan approved under Schedule 2 to this Act.

Paragraph 69
3721. This paragraph contains provisions to ensure continuity of treatment as references to an employee share ownership plan approved under Schedule 8 to FA 2000 are replaced by references to a share incentive plan approved under Schedule 2 to this Act.

Paragraph 70
3722. This paragraph provides that a jointly owned company that was a constituent company in a group scheme immediately before the enactment of FA 2002 may remain a constituent company in that group scheme, and accordingly re-enacts section 39(8) of FA 2002. Section 39(5) of FA 2002 amended the definition of a "jointly owned company" that applies for the purposes of the SIP code.

Paragraph 71
3723. This paragraph contains provisions to ensure that a savings-related share option scheme which, before 6 April 2003, was approved under Schedule 9 to ICTA is treated as an SAYE option scheme approved under Schedule 3 to this Act. This approval has effect even if the scheme does not fully meet the requirements of Schedule 3 so long as it meets the approval requirements of Schedule 9 to ICTA.

3724. Under *sub-paragraph (5)* the effect of the provisions of Schedule 9 to ICTA are preserved, including superseded rules, for a savings-related share option scheme approved before 6 April 2003.

3725. A savings-related share option scheme is defined in *sub-paragraph (6)*.

Paragraph 72
3726. This paragraph ensures that, for the period before 6 April 2003, a reference to a share option granted in accordance with the provisions of an approved SAYE option scheme includes a reference to a right to acquire shares obtained in accordance with the provisions of a savings-related share option scheme.

3727. *Sub-paragraph (2)* reflects the removal from this Act of references to Case I of Schedule E in ICTA. Here the reference is to "earnings" in paragraph 6(2)(c) of Schedule 3 to this Act.

Paragraph 73
3728. This paragraph contains provisions to ensure that a discretionary share option scheme, which, before 6 April 2003, was approved under Schedule 9 to ICTA is treated as a CSOP scheme approved under Schedule 4 to this Act. This approval has effect even if the scheme does not fully meet the requirements of Schedule 4 so long as it meets the approval requirements of Schedule 9 to ICTA.

3729. Under *sub-paragraph (5)* the effect of the provisions of Schedule 9 to ICTA is preserved, including superseded rules, for a discretionary share option scheme approved before 6 April 2003.

3730. A discretionary share option scheme is defined in *sub-paragraph (6)*.

Paragraph 74
3731. This paragraph ensures that, for the period before 6 April 2003, a reference to a share option granted in accordance with the provisions of an approved CSOP scheme includes a reference to a right to acquire shares obtained in accordance with the provisions of a discretionary share option scheme.

Paragraph 75
3732. This paragraph preserves the effect of section 114(9) of and Schedule 16 to FA 1996, in relation to a discretionary share option scheme, as defined in *sub-paragraph (5)*, which was approved before 29 April 1996.

Paragraph 76
3733. This paragraph preserves the effect of section 115 of FA 1996 for rights obtained under a discretionary share option scheme as defined in *sub-paragraph (3)* in the period from 17 July 1995 to 28 April 1996.

Paragraph 77
3734. This paragraph contains provisions to ensure that where, a share option was a qualifying option for the purposes of Schedule 14 to FA 2000 immediately before 6 April 2003, the share option is treated as a qualifying option for the purposes of the EMI code. This applies even where the requirements that had to be met differ from those set out in Schedule 5.

Paragraph 78
3735. This paragraph reflects the change in approach to a disqualifying event arising in relation to the requirement as to commitment of working time. The new approach operates for the tax year 2003-04 onwards.

3736. *Sub-paragraph (2)* reflects the method of determining such an event in paragraph 52 (3) of Schedule 14 to FA 2000.

Paragraphs 79 and 80
3737. These paragraphs, which relate to section 536 and 537 respectively, reflect the fact that the amendments made to the EMI code by Schedule 14 to FA 2001 have effect only after the passing of that Act.

Paragraph 81
3738. This paragraph ensures that the revised wording of section 540 will work satisfactorily in connection with options granted before 6 April 2003.

Paragraph 82
3739. This paragraph reflects changes in statutory references in section 541 (effects on other income tax charges). The changes apply to the provision that sets out the relief in the calculation of a charge on conditional and convertible shares.

Paragraph 83
3740. This paragraph ensures that the new sub-paragraph 41(6) of Schedule 5 applies to replacement options whenever granted.

Paragraph 84
3741. This paragraph provides for continuity in the definition of "employee" for the purposes of Chapter 11 of Part 7 of this Act (employee benefits trusts).

Part 8: Approved profit sharing schemes
Paragraph 85
3742. This paragraph ensures that the requirement for trustees to notify a participant of the facts relating to his tax liability will have effect after 5 April 2003 in a modified form to reflect the new language introduced in this Act.

Paragraph 86
3743. This paragraph preserves the capital gains tax advantages that are available where the trustees of an approved share incentive plan acquire shares from the trustees of an approved profit sharing scheme. It is derived from paragraph 103 of Schedule 8 to FA 2000 and is not being rewritten in Schedule 2 because of the phasing out of APS schemes (see the notes relating to paragraph 26 of Schedule 6 to this Act).

Paragraph 87
3744. An individual who participates in any of the share schemes etc dealt with in Schedules 2 to 5 to this Act must not have a material interest in the company in question. This paragraph provides that, in calculating whether or not such an individual has such a material interest, the interest of the trustees of any approved profit sharing scheme in any shares in the company which have not been appropriated to an individual are to be disregarded, as are any rights exercisable by the trustees as a result of that interest. The provision made by this paragraph has been placed in this Schedule because approved profit sharing schemes are being phased out (see section 49 of FA 2000 and the notes relating to paragraph 26 of Schedule 6 to this Act).

Part 9: Social security income
Paragraph 88
3745. This paragraph has effect if, in relation to certain provisions (listed in sub-paragraph (3)), the repeals made by the Tax Credits Act 2002 have not come fully into force.

Part 10: PAYE
Paragraph 89
3746. This paragraph derives from part of section 203(10) of ICTA which provides part of the powers for PAYE regulations to deal with electronic filing. Sections 132 and 133 of FA 1999 introduced new powers to provide for use of electronic communications. As a consequence part of section 203(10) will be repealed by Schedule 20 to FA 1999 when a Treasury order is made under section 133(4) of that Act. Section 684(2), item 5, anticipates this repeal. This paragraph preserves the position until the order is made.

Part 11: Consequences for corporation tax
Paragraphs 90 to 92
3747. These paragraphs explain how this Act will have effect for the purposes of corporation tax.

3748. A company's accounting period affected by the provisions of this Act may straddle the beginning of the tax year 2003-04. Paragraph 91 provides that in such a case, the company may elect for the law as it stood before 6 April 2003 to apply for the duration of that straddling accounting period.

3749. Most transitional provisions made by this Schedule operate by reference to 6 April 2003 (the beginning of the tax year 2003-04) which is the date on which the Act will first have effect for income tax purposes. Paragraph 91 provides that, in a case where this Act applies for a company's accounting period that begins before 6 April 2003, those transitional provisions will instead operate by reference to the beginning of that accounting period.

3750. Paragraph 92 provides the one exception to this: the existing provisions about corporation tax deductions in relation to SIPs, SAYE option schemes and CSOPs (Part 12 of Schedule 8 to FA 2000 and section 84A of ICTA) will continue to operate until the provisions of this Act come into force on 6 April 2003, regardless of when the company's accounting period begins.

SCHEDULE 8: REPEALS AND REVOCATIONS
3751. This Schedule contains repeals and revocations. Part 1 of the Schedule lists the enactments repealed, and Part 2 the subordinate legislation revoked.

COMMENCEMENT

3752. The Act received Royal Assent on 6 March 2003. Section 723 provides for it to have effect:

- for the purposes of income tax, for the year 2003-04 and subsequent tax years; and

- for the purposes of corporation tax (where the provisions of this Act are used to compute profits for corporation tax purposes of corporate office-holders), for accounting periods ending after 5 April 2003.

HANSARD REFERENCES

3753. The following table sets out the dates and Hansard references for each stage of this Act's passage through Parliament.

Stage	**Date**	**Hansard reference**
House of Commons		
Introduction	5 December 2002	Vol 395 Col 1086
Second Reading Committee	16 January 2003	HC 190 2002/03
Second Reading (formal)	18 January 2003	Vol 396 Col 874
Joint Committee on Tax Law Rewrite Bills – First Report of Session 2002-2003	14 January 2003	HC 287 2002/03 HL 35 2002/03
Third Reading	12 February 2003	Vol 399 Cols 938-972
House of Lords		
Introduction	12 February 2003	Vol 644 Col 751
Second and third readings	25 February 2003	Vol 645 Cols 194–214

Royal Assent – 6 March 2003	House of Lords Hansard Vol 645 Col 921 House of Commons Hansard Vol 400 Col 974

ANNEX 1: MINOR CHANGES IN THE LAW TO BE MADE BY THE ACT

Change 1: Taxable earnings: time when general earnings are received: sections 18 and 31 14

Change 2: Taxable earnings: time when non-money earnings are received: sections 19 and 32 15

Change 3: Taxable earnings: deductions to be made in calculating "chargeable overseas earnings": sections 23 and 24 16

Change 4: Taxable earnings: exception from tax on general earnings from overseas Crown employment subject to United Kingdom tax: section 28 17

Change 5: Taxable earnings: relief for delayed remittances: remittances in respect of which a claim may be made and conditions for granting relief: section 35(1) and (2)18

Change 6: Taxable earnings: relief for delayed remittances: replacement of references to income "arising" with references to income "received": section 35(2) and (4).....19

Change 7: Taxable earnings: election in respect of delayed remittances: election regarding allocation of income to earlier tax years: section 36.....20

Change 8: Board to determine disputes as to domicile or ordinary residence: widening of the availability of the procedure: section 42(3) 21

Change 9: Appeal against Board's decision on domicile or ordinary residence: introduction of a straightforward appeal procedure: section 43(1) 21

Change 10: Application of provisions to agency workers: treatment of services under agency contract: section 44(2).....22

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Change 1: Taxable earnings: time when general earnings are received: sections 18 and 31

This ensures that all money payments in respect of earnings will be subject to the same rules as to when they are to be treated as received.

Section 202A of ICTA contains the general rule that income tax charged under Schedule E in a tax year is charged on emoluments received in that year. Section 202B(1) to (6) of ICTA then lay down a series of rules for deciding when a payment of emoluments is to be treated as received. In effect that time is the earliest of the following times:

- *Rule One*: the time when payment is made of or on account of the emoluments (see section 202B(1)(a)),

- *Rule Two*: the time when the employee becomes entitled to payment of or on account of the emoluments (see section 202B(1)(b)),

- *Rule Three*: where the employee is a director of a company, the earliest time applicable under section 202B(1)(c) to (e) (which refer to the time when sums are credited in the company's accounts, the time when the pay period ends and any later time when the amount of emoluments for the pay period is fixed). For the purposes of section 202B(1)(c) any fetter on the right to draw sums is to be disregarded.

At present there are some money payments that fall to be treated as emoluments but are outside the rules in 202B(1) to (6) of ICTA. These are payments that are caught by section 154 of ICTA (general charge on benefits in kind). They are subject to the rule in section 202B(10), which says that any such payment is to be treated as received in the year mentioned in section 154(1), namely the year in which the benefit consisting of the payment is provided.

The section 202B(1) to (6) rules have been rewritten in sections 18 and 31 of the Act in such a way that they will apply to payments caught by Chapter 10 of Part 3 of the Act (which rewrites section 154 of ICTA). It is thought to be more convenient to have one set of rules applying to all money payments of earnings (the Act is drafted in terms of "earnings" rather than "emoluments"). Sections 19 and 32 of the Act rewrite the rules in section 202B(7) to (11) that apply to the receipt of non-money earnings.

As a result of applying the section 202B(1) to (6) rules to payments within Chapter 10 of Part 3, such payments might in future be treated as received at an earlier time, and hence in an earlier tax year, than would currently be the case under section 202B(10).

This change will not alter the amount charged to tax. The most it will do is affect the timing of that tax liability. In a small minority of cases this could mean a different rate of tax being applied, according to individual circumstances. Any overall tax effect is likely to be negligible.

Change 2: Taxable earnings: time when non-money earnings are received: sections 19 and 32

This identifies the tax year in which deemed earnings are to be treated as received where they are in respect of the private use of a van or in respect of certain payments made by the employer on account of tax.

Section 202B(8) to (11) of ICTA contain the rules for deciding when non-money emoluments are to be treated as received for the purposes of section 202A(1)(a) of that Act. Under section 202A(1)(a) the charge to tax under Cases I and II of Schedule E depends on the year in which emoluments are received.

Section 202B(10) applies to a number of provisions under which amounts are to be treated as emoluments. The rule under that subsection is that the deemed emoluments under any of those provisions are to be treated as received in the tax year referred to in the provision in question.

(A) Among these provisions are sections 157(1) and 158(1) of ICTA, which relate to cars and car fuel. But they do not include section 159AA, which relates to vans available for private use. The result of this omission is that amounts treated as emoluments in respect of the private use of vans fall into the residual category in section 202B(11), which says that emoluments are to be treated as received "at the time when the benefit is provided" rather than in the year in which the van is made available as mentioned in section 159AA(1) (which would be the effect of section 202B(10)).

In fact this is a distinction without a difference because the benefit of the van is provided during the year in which it is made available. The opportunity has therefore been taken to align the rule relating to vans with that relating to cars and car fuel. In rewriting section 202B(10) in subsection (2) of sections 19 and 32 of the Act, that subsection has therefore been expanded so as to apply to amounts treated as earnings in respect of the private use of vans (see Chapter 6 of Part 3 of the Act).

(B) Subsection (2) of sections 19 and 32 of the Act has also been expanded so as to deal with amounts treated as earnings in respect of payments made by the employer on account of tax where no PAYE deduction was possible (see section 222 of the Act). Such payments at present give rise to deemed emoluments under section 144A of ICTA (as amended by Schedule 6 to FA 2002). However, section 202B contains no express provision stating when such deemed emoluments are to be treated as received. As a result, they fall into the residual category in section 202B(11) and are to be treated as received "at the time when the benefit is provided".

It has been decided not to reproduce this position, since it relies on one being able to identify "the time when the benefit is provided", which is arguably not something that emerges with any particular clarity from the wording of section 144A. Instead, subsection (2) of sections 19 and 32 of the Act will have the effect that the deemed earnings are to be treated as received in the year for which they are to be treated as

earnings under section 222(2). However, it is thought that the practical effect of this new approach will be to produce the same result as section 202B(11) of ICTA would produce at the moment in its application to section 144A.

This change has no implications for the amount of income liable to tax or who is liable for tax on it. It is concerned with the timing of tax charges. It is expected to have no practical effect as it is in line with current practice.

Change 3: Taxable earnings: deductions to be made in calculating "chargeable overseas earnings": sections 23 and 24

This enables all available deductions to be taken into account in calculating the amount of "chargeable overseas earnings" which are to be charged on the remittance basis rather than the receipts basis.

Section 192(2) of ICTA provides that where–

- the duties of an office or employment are performed wholly outside the United Kingdom, and

- the emoluments from the office or employment are "foreign emoluments" (i.e. they are emoluments of a person domiciled outside the United Kingdom and the employment is with a foreign employer: see section 192(1)),

the emoluments are excepted from the main charge on employment income under Case I of Schedule E. Although section 192(2) does not specify the basis on which the excepted emoluments are to be charged, the present reality is that they are charged under Case III of Schedule E if they satisfy the conditions of that Case (see further *Note 8*).

Section 192(5) says that the *amount* of the excepted emoluments is the amount remaining after any capital allowance and after any deductions under a series of listed provisions. Those listed provisions do not include all the provisions under which deductions could be allowed if one were simply computing an amount of taxable income. It is not clear why some provisions are mentioned and others not.

Section 192(5) has therefore been rewritten in section 23(3) of the Act in a way that will allow a person's "overseas earnings" (replacing "foreign emoluments") to be reduced by subtracting *any* deduction that would be allowed to be deducted from those earnings if they were ordinary taxable earnings (see Part 5 of the Act). This approach is also reflected in section 24(3) of the Act, which rewrites paragraph 2(2) and (3) of Schedule 12 to ICTA as applied by section 192(5) of that Act.

If, say, extra deductions of £1,000 can be subtracted as a result of this approach, then the amount of overseas earnings chargeable to tax under section 22 of the Act will be reduced by £1,000 compared to the amount of excepted emoluments chargeable to tax

under Case III. This will mean that the amount of earnings *excepted* from the Case I charge rewritten in section 21 of the Act will fall by £1,000 so that the amount of earnings *within* that charge will increase by that amount. However, since the extra £1,000 corresponds to an amount of allowable deductions, that increase will be balanced out by those deductions when working out the amount chargeable to tax under section 21. So overall the taxpayer will have £1,000 less brought within the charge to tax as a result of the reduced amount chargeable under section 22 of the Act. A worked example appears in the Explanatory Notes dealing with section 23.

This change is in taxpayers' favour in principle and may in practice benefit some although the numbers and amounts are thought to be negligible.

Change 4: Taxable earnings: exception from tax on general earnings from overseas Crown employment subject to United Kingdom tax: sections 28 and 717
This involves the creation of a new statutory exception from income tax based on ESC A25 (Crown service overseas).

This concession operates to remove from the scope of UK income tax locally-engaged, unestablished staff employed overseas by the Crown if the maximum rate of pay for their job is below that of an executive officer in the UK Civil Service working in Inner London. The concession reflects long-standing practice and is in keeping with international treaty obligations.

The use of a salary level and grade in the concession is an attempt to focus its benefits on genuinely temporary or unestablished staff. However, enshrining these existing limits in primary legislation is not thought to be desirable. Instead it is intended to preserve the existing flexibility of the Inland Revenue to adapt the concession to new circumstances by enabling the Board of Inland Revenue to make an order which sets out the limits of the new statutory exception: see section 28(5) and (6) of the Act. Section 28(7) and (8) of the Act, which deal with the factors by reference to which the statutory exception may be expressed, are intended to reflect the scope of this existing flexibility. Section 717(2) of the Act means that an order does not need to be made by statutory instrument.

The new statutory exception will operate on the charges to tax arising by virtue of section 25(2) of the Act (UK-based earnings for year when employee resident, but not ordinarily resident, in UK) or section 27(2) (UK-based earnings for year when employee not resident in UK). It is intended that it should operate at least as widely as the present exception conferred by ESC A25.

This change is in principle in taxpayers' favour but is expected to have no practical effect as it is in line with current practice.

Change 5: Taxable earnings: relief for delayed remittances: remittances in respect of which a claim may be made and conditions for granting relief: section 35(1) and (2)

This enables a claim for relief to be made in respect of some (as opposed to all) of a taxpayer's delayed remittances and it also broadens one condition and removes another condition for a claim for relief.

Section 585 of ICTA provides that relief from tax on Schedule E Case III income may be claimed if the conditions set out in subsection (1)(a) to (c) are met.

- Subsection (1)(a) requires the taxpayer to have been unable to transfer the income to the United Kingdom.

- Subsection (1)(b) requires the inability to transfer to have been due to–

  - the laws of the territory where the income arose,
  - executive action of its government, or
  - the impossibility of obtaining foreign currency in that territory.

- Subsection (1)(c) requires the inability to transfer to have been not due to any want of "reasonable endeavours" on the part of the taxpayer.

(A) Section 585 of ICTA does not expressly refer to the possibility that a claim for relief may be made in respect of some (as opposed to all) of the income which satisfies the conditions in subsection (1)(a) to (c). But in practice the Inland Revenue would allow such a partial claim.

Section 35(1) of the Act gives effect to this practice by providing that a claim may be made "in respect of delayed remittances" without requiring that the claim must be made in respect of all such remittances.

(B) This concerns the condition contained in section 585(1)(b) of ICTA requiring an inability to transfer "due to….the impossibility of obtaining foreign currency" in the territory where the income arose. It could be argued that there cannot be an inability to transfer due to the impossibility of obtaining foreign currency in that territory if foreign currency is in fact obtainable there (regardless of whether it may be transferred to the United Kingdom).

Section 35(2)(c)(iii) of the Act removes the possibility of that narrow interpretation being taken. It requires an inability to transfer due to the impossibility of obtaining in the territory foreign currency "that could be transferred to the United Kingdom".

(C) The condition contained in section 585(1)(c) of ICTA has not been rewritten in the Act. That condition is regarded as adding little to the requirements of section 585(1)(b) of ICTA. If, by reasonable endeavours, the taxpayer could transfer the

income to the United Kingdom it is thought that there would then be no inability to transfer due to local law, government action or the impossibility of obtaining foreign currency as required under section 585(1)(b). The omission of section 585(1)(c) of ICTA also removes a possible area of doubt.

This change is in taxpayers' favour in principle and may in practice benefit some although the numbers and amounts are thought to be negligible.

Change 6: Taxable earnings: relief for delayed remittances: replacement of references to income "arising" with references to income "received": section 35(2) and (4)

This involves replacing references to income "arising" with references to income "received" in the provisions relating to relief for delayed remittances of employment income.

Section 585 of ICTA provides that relief from tax on Schedule E Case III income may be claimed if certain conditions are met. When describing those conditions and the consequences of a successful claim for relief, section 585(1) and (3) refer to income which "arose" before a particular tax year, the territory where the income "arose" and the amount of income "arising" in a tax year.

In 1989 the receipts basis for Schedule E income was introduced but no consequential amendments were made to the references to income "arising" in section 585 of ICTA. Those references therefore do not fit very well with the receipts basis on which Schedule E income is taxed – see section 202A(1) of ICTA rewritten in Chapters 4 and 5 of Part 2 of the Act.

In section 35 of the Act (which rewrites section 585 of ICTA in respect of employment income) the references to income "arising" have therefore been replaced with references to income "received" as the latter appeared more appropriate.

Therefore where, for example, relief is claimed for income for a particular tax year and deducted from the amount of income remitted to the United Kingdom in that year, the income will be reallocated to whichever is the earlier tax year in which the income was "received" rather than the earlier tax year in which it "arose" (see section 35(4) of the Act).

Section 31 of the Act defines what is meant by the "receipt" of money earnings. It derives from section 202B of ICTA (receipts basis: meaning of receipt) which is concerned with tax charged under Case I or II of Schedule E. In rewriting section 202B in section 31 of the Act that section has been expressed to apply for the purposes of the whole of Chapter 5 of Part 2. It will therefore apply to sections 35 and 36 which concern Schedule E Case III income. Having replaced references to income "arising" with references to income "received" it seemed necessary to define what was meant by the receipt of income. The section 31 definition was the obvious choice.

The time when income "arises" may differ from the time when it is "received". This change is therefore in principle adverse to some taxpayers and favourable to others but it is expected to have no practical effect as it is in line with current practice.

Change 7: Taxable earnings: election in respect of delayed remittances: election regarding allocation of income to earlier tax years: section 36
This introduces an election regarding the allocation to earlier tax years of income for which relief for delayed remittances is claimed.

Section 585 of ICTA provides that relief from tax on Schedule E Case III income may be claimed for a particular tax year if certain conditions are met. If they are met, then subsection (3)(a) requires the income to be deducted from the amount of income received in the United Kingdom in that year. It is therefore not charged to tax in that year. But subsection (3)(b) requires the income to be treated as received in the United Kingdom in the earlier tax years in which it "arose". It is therefore charged to tax in those earlier tax years.

As mentioned in the commentary on *Change 6*, the reference in section 585(3)(b) of ICTA to the year in which the income "arose" does not fit very well with the receipts basis on which Schedule E income is taxed. Section 585 therefore gives no guidance as to how the earnings should be allocated to earlier years.

Section 585(3)(b) of ICTA has been rewritten in section 35(4) of the Act in terms of the allocation of income to the previous tax years in which it was "received". But as an alternative, the taxpayer will have the option of making an election under section 36 in respect of all the income.

The election is available where the taxpayer has been able to transfer only some of the income from the employment to the United Kingdom. Some or all of the untransferred income must have been received and untransferable in previous tax years but chargeable to tax if it had been transferred. If that is the case, the taxpayer may specify certain previous tax years to which the income is to be reallocated and in which the income will therefore be charged.

At present the Inland Revenue do not operate an election procedure as set out in section 36 of the Act; but if a taxpayer sought to allocate his delayed remittances on a reasonable basis over previous tax years the Inland Revenue would allow an allocation which would have the same effect as an election under section 36.

This change is in principle in taxpayers' favour but is expected to have no practical effect as it formalises the element of taxpayer choice that the Revenue would currently allow informally.

Change 8: Board to determine disputes as to domicile or ordinary residence: widening of the availability of the procedure: section 42(3)
This widens the availability of the procedure under which the Board of Inland Revenue determines disputes as to domicile or ordinary residence by extending the list of provisions under which such a dispute may arise.

Section 207 of ICTA provides that disputes as to whether a person is or has been domiciled or ordinarily resident in the United Kingdom are to be determined by the Board. The dispute must arise under paragraph 1 of Schedule E to ICTA or under section 192 of ICTA.

Under paragraph 1 of Schedule E to ICTA a person's domicile or ordinary residence is relevant in determining whether tax is charged under Case I, II or III. Section 192 of ICTA makes no reference to a person's ordinary residence. But a person's domicile is relevant to the definition of "foreign emoluments" in section 192(1). That definition applies to Part 5 of ICTA (provisions relating to the Schedule E charge) and is applied elsewhere – see for example section 596(2) of ICTA.

Sections 42 and 43 of the Act rewrite section 207 of ICTA. Section 42(1) and (2) provide that a dispute as to domicile or ordinary residence in connection with any of the provisions listed in subsection (3) is to be decided by the Board. Subsection (3) lists the provisions of the Act which rewrite the relevant provisions of paragraph 1 of Schedule E or the definition of "foreign emoluments" in section 192(1) of ICTA. Schedule 6 to the Act contains amendments of section 645(4A) of ICTA and section 76(6C) of FA 1989 where the references to "foreign emoluments" within the meaning of section 192(1) of ICTA have been consequentially amended and sections 42 and 43 of the Act have been applied.

Three of the provisions listed in subsection (3) of section 42 of the Act, in addition to containing references to domicile which are dependent upon the definition of "foreign emoluments" in section 192(1), also contain references to ordinary residence which are not derived from paragraph 1 of Schedule E or section 192 of ICTA. The three provisions are sections 341, 342 and 376 of the Act (which rewrite section 193(2)-(6) of ICTA). Rather than including disputes as to domicile in connection with those provisions but excluding disputes as to ordinary residence, section 42 of the Act covers both. It therefore has a wider application than section 207 of ICTA.

This change has no implications for the amount of tax paid, who pays it or when. It affects (in principle and in practice) only administrative matters.

Change 9: Appeal against Board's decision on domicile or ordinary residence: introduction of a straightforward appeal procedure: section 43(1)
This introduces a straightforward appeal procedure for an appeal to the Special Commissioners against a decision of the Board of Inland Revenue as to a person's domicile or ordinary residence.

Section 207 of ICTA provides for an appeal to the Special Commissioners from a decision of the Board on domicile or ordinary residence. The procedure for such an appeal is that an application is made for the question to be heard and determined by the Commissioners and "where such an application is so made", the Commissioners then "hear and determine the question in like manner as an appeal".

In section 43(1) of the Act this has been simplified by introducing a straightforward right to appeal - a person "who has been given notice of the Board's decision on a question under section 42 may, if aggrieved by that decision, appeal to the Special Commissioners".

For the purposes of section 207 of ICTA there is no material difference, in law or practice, between a provision that refers to an appeal and one that refers to proceedings to be heard "in like manner as an appeal". Section 48(2) of TMA 1970 provides that various provisions of that Act as regards proceedings before the Commissioners apply to "appeals other than appeals against assessments" and to "proceedings…to be heard and determined in the same way as an appeal". Therefore where there is a disagreement about a decision it seems simpler to use the straightforward appeal approach.

Similar changes have been made in paragraphs 41 and 44 of Schedule 3 (appeal against refusal or withdrawal of approval for SAYE option scheme) and paragraphs 29 and 32 of Schedule 4 (appeal against refusal or withdrawal of approval for CSOP scheme) – see *Change 171*.

Section 207 of ICTA is applied in relation to capital gains tax by section 9(2) of TCGA 1992. Section 9(2) of TCGA 1992 is consequentially amended by Schedule 6 to the Act to refer to sections 42 and 43 of the Act. This change will therefore also apply to capital gains tax. The change will similarly also apply in relation to section 645(4A) of ICTA and section 76(6C) of FA 1989 where the references to "foreign emoluments" within the meaning of section 192(1) of ICTA have been consequentially amended by Schedule 6 to the Act and sections 42 and 43 of the Act have been applied.

This change has no implications for the amount of tax paid, who pays it or when. It affects administrative matters only (and does so only in principle and not in practice).

Change 10: Application of provisions to agency workers: treatment of services under agency contract: section 44(2)
This provides that the remuneration of workers contracted to an agency is treated as if it is employment income.

Section 134(1) of ICTA provides that if certain conditions are satisfied the services which the worker renders or is under an obligation to render are to be treated as if they were the duties of an employment held by the worker.

It is unclear from section 134(1) whether the deemed duties of employment are treated as performed for the agency or the agency's client.

Section 44(2)(a) of the Act provides that the services which the worker provides, or is obliged to provide, to the client under the agency contract are to be treated as duties of an employment held with the agency. It is the agency that will pay remuneration in a normal case.

This change has no implications for the amount of tax paid, who pays it or when. It affects administrative matters only (and does so only in principle and not in practice).

Change 11: Application of provisions to agency workers: arrangements with agencies: section 45
This relates to the case where remuneration is paid by an agency while an agency worker is on their books for a period in which he is not assigned to a particular client.

Section 134(6) of ICTA provides that where an individual enters into arrangements with "another person" with a view to rendering services in a situation where the services will be treated as the duties of an employment under subsection (1) of that section, any remuneration receivable under or in consequence of the arrangements is to be treated as emoluments.

Section 45 of the Act substitutes "a third person ("the agency")" for "another person" to make clear the identity of the party with whom the worker enters arrangements. This is how the provision was intended to apply and has been applied in practice. Any remuneration receivable under or in consequence of the arrangements is to be treated as earnings from an employment held by the worker with the agency.

This change has no implications for the amount of tax paid, who pays it or when. It affects administrative matters only (and does so only in principle and not in practice).

Change 12: Intermediaries: widening of the category of associated companies to which paragraph 3(2) of Schedule 12 to FA 2000 applies: section 51(2).
This involves the widening of the category of associated companies to which paragraph 3(2) of Schedule 12 to FA 2000 applies to include companies that are under the common control of the worker and more than one other person.

The meaning of "associated company" for the purposes of Chapter 8 of Part 2 of the Act is given by section 416 of ICTA (see section 61(1) of the Act). Two companies are associated if one has control of the other, or if they are both controlled by the same person or persons. But paragraph 3(2) of Schedule 12 to FA 2000 provides for common control under a maximum of two persons, the worker and another person. Section 51(2) of the Act, which replaces paragraph 3(2), widens the category of associated companies to which it applies to include companies that are under the common control of the worker and more than one other person.

This change is in taxpayers' favour in principle and may in practice benefit some although the numbers and amounts are thought to be negligible.

Change 13: Intermediaries: treating all relevant engagements as the duties of a continuous employment: section 54(6)
This involves treating all relevant engagements as the duties of a continuous employment with the intermediary for the purpose of working out the travel expenses to be deducted in determining the amount of the deemed employment payment.

The basic assumption in Step 3 in paragraph 7(1) of Schedule 12 to FA 2000 (see section 54(1) of the Act) - that one should look at whether the expenses would be deductible if the worker were employed by the client - does not provide enough information to say what travel expenses should be deducted. This is because entitlement to travel expenses depends on whether or not a workplace is temporary and where the worker is based over the course of the employment.

Section 54(6) of the Act fills the gap by allowing such travel expenses to be deducted under Step 3 as would have been deductible during the combined period of all the relevant engagements if that combined period were a continuous employment with the intermediary.

This change is in principle in taxpayers' favour but is expected to have no practical effect as it is in line with current practice.

Change 14: Intermediaries: normal timing rules to apply for determining when a non-cash benefit is to be treated as received: section 55(5)
This involves applying the normal timing rules for determining when a non-cash benefit is to be treated as received.

Paragraph 10(5)(b) of Schedule 12 to FA 2000 provides that a non-cash benefit is to be treated as received when it is used or enjoyed. But a non-cash benefit might be used or enjoyed over a long period of time or might even (in the case of a car benefit) be calculated by reference to such a period. To cater for such cases, section 55(5) of the Act provides that a non-cash benefit is treated as received–

- if it is calculated by reference to a period within the tax year, at the end of that period,

- if it is not so calculated, when it would have been treated as earnings if the worker had been an employee and the benefit had been provided by reason of the employment.

This change has no implications for the amount of income liable to tax or who is liable for tax on it. It affects only when tax is paid (and does so only in principle and not in practice).

Change 15: Taxable benefits: relationship between earnings and benefits code: section 64

This clarifies the relationship between the charge on emoluments and the charge on taxable benefits.

A benefit obtained by an employee may fall both within the general charge on emoluments under section 131 of ICTA and within the general charge on benefits under section 154 of that Act. The charge on emoluments is on the basis of the money or money's worth obtained by the employee; the charge on taxable benefits is on the basis of the cost of providing the benefit (see section 156 of that Act). Different amounts may therefore be chargeable to tax by virtue of both of those bases of charge applying to the benefit.

Current Inland Revenue practice is not to seek to charge the same benefit twice but to ensure that the total amount charged to tax is equal to whichever is the higher of the two chargeable amounts in respect of the benefit. The Schedule E manual (at SE21640) sets out the practice of charging a benefit–

- initially under section 131 on the basis of its realisable value, and

- then under section 154 on the basis of its cost to the provider, but only to the extent that the cost exceeds the section 131 value.

This practice is given statutory effect in the rules in section 64(1) and (2) of the Act (which, like the rest of the Act, refer to "earnings" rather than "emoluments"). Those rules will apply to benefits caught by any of the provisions of the benefits code contained in Chapters 2 to 11 of Part 3 of the Act, except for the two cases dealt with in section 64(3) to (6). These reflect the special rules in section 146A of ICTA (living accommodation) and section 162(3) and (11) of that Act (employee shareholdings).

This change is in principle in taxpayers' favour but is expected to have no practical effect as it is in line with current practice.

Change 16: Taxable benefits: dispensations: changes in procedure to reflect existing practice: sections 65 and 96

This changes the procedure in relation to dispensations given by the Inland Revenue under section 144(1) or 166(1) of ICTA in order to reflect existing practice.

Section 144(1) of ICTA provides for a dispensation from sections 141, 142 and 143 of ICTA. Under those sections an employee is charged to tax where a voucher or credit-token is provided for the employee or a member of the employee's family by reason of the employment.

Section 166(1) of ICTA provides for a dispensation from the provisions of Chapter 2 of Part 5 of that Act. Under that Chapter employees who are not in lower-paid employment are charged to tax in relation to payments and benefits provided by reason of the employment.

The procedure under sections 144 and 166 of ICTA is the same–

- A person supplies an inspector with a statement of the cases and circumstances in which the payments or benefits in question are provided.

- If the inspector is satisfied that no additional tax is payable, (for example, where any amounts which would be treated as earnings would be balanced by a corresponding deduction), the inspector must "notify" the applicant accordingly.

- The effect of the notification is that sections 141, 142 and 143 of ICTA, or Chapter 2 of Part 5 to that Act do not apply.

- The inspector may revoke the notification "by notice served" on the applicant.

Section 96 of the Act rewrites section 144(1) and (2) of ICTA. Section 65 of the Act rewrites section 166(1) and (2) of ICTA.

In both those sections of the Act–

- References to the "inspector" have been replaced with references to the "Inland Revenue" – see *Change 158.*

- The notification given by the Inland Revenue has been defined as a "dispensation" in order to reflect what it is commonly called.

- The "dispensation" is required to be a "notice". As a result of the application of the definition of "notice" in section 832(1) of ICTA this means that the dispensation must be in writing. This reflects current practice.

- A dispensation may be revoked by "giving" a further notice to the applicant rather than "by notice served" on the applicant. This is consistent with the approach elsewhere in the Act where notice is "given" rather than "served". It is also in line with current practice following the procedure under section 115 of TMA 1970.

This change has no implications for the amount of tax paid, who pays it or when. It affects administrative matters only (and does so only in principle and not in practice).

Change 17: Taxable benefits: expenses payments: section 70
This makes it clear that, in order for the charge to tax on expenses payments to apply to sums put at an employee's disposal and paid away by him, those sums must be in respect of expenses.

Section 153(1) of ICTA charges to tax sums which are paid to an employee in respect of expenses if–

- the employment is employment to which Chapter 2 of Part 5 of ICTA applies (i.e. what is currently referred to as "higher-paid" employment), and

- the sums are paid by reason of the employment.

Section 153(3) of ICTA says that the reference in section 153(1) to sums paid in respect of expenses includes "any sums put at the employee's disposal and paid away by him." If section 153(3) meant that section 153(1) should be read as if the reference to sums paid in respect of expenses were simply replaced by the words in quotes, there would be no reference to anything being paid "in respect of expenses". There would just be a reference to sums put at the employee's disposal and paid away by him.

However, it is thought that such a sweeping proposition cannot have been intended. The whole flavour of section 153(1) and (3) is that these provisions are concerned with sums paid *in respect of expenses*. It is therefore considered that the reference to sums put at the employee's disposal and paid away by him must have been intended to refer to such sums that are *in respect of expenses*. This accords with current Inland Revenue practice.

This has been clarified in rewriting section 153(3) of ICTA in section 70(2) of the Act.

This change is a clarification with no tax effects either in principle or in practice.

Change 18: Taxable benefits: vouchers and credit-tokens: exceptions where voucher or token provided for personal reasons or is of a kind made available to the public generally: sections 73(2), 78, 82(2), 85, 90(2) and 93
This legislates the practice to except vouchers and credit-tokens which are provided in the normal course of an individual employer's domestic, family or personal relationships or which are of a kind made available to the public generally.

Sections 141 to 143 of ICTA charge an employee where a non-cash voucher, cash voucher or credit-token is provided for the employee or a member of the employee's family by reason of the employment.

Section 144(4)(a) of ICTA provides that where a voucher or credit-token is provided by the employer for the employee or a member of the employee's family it is deemed to be provided by reason of the employment.

Provisions similar to section 144(4)(a) of ICTA are found elsewhere in the provisions of that Act which charge benefits – see section 145(7) (living accommodation) and section 168(3), (6)(b) and (6)(d) (expenses and benefits in kind). However those provisions also contain an exception which is not found in section 144(4)(a) of ICTA. The exception applies where the employer is an individual and the provision of the benefit is made in the normal course of the employer's domestic, family or personal relationships. No reason could be found why that exception should not operate in relation to vouchers and credit-tokens. In practice the Inland Revenue do apply it in relation to section 144(4)(a) of ICTA.

Sections 73(2), 82(2) and 90(2) of the Act legislate this practice by providing that a voucher or token provided by the employer is to be regarded as provided by reason of the employment unless the employer is an individual and the provision is made in the normal course of the employer's domestic, family or personal relationships.

In practice the Inland Revenue also except vouchers and credit-tokens which are of a kind made available to the public generally where the employee or member of the employee's family is not given preferential terms. Similar exceptions are provided in relation to living accommodation and loans – see sections 145(7)(b) and 161B of ICTA.

Sections 78, 85 and 93 of the Act legislate this practice.

This change is in principle in taxpayers' favour but is expected to have no practical effect as it is in line with current practice.

Change 19: Taxable benefits: non-cash vouchers: reduction for meal vouchers: section 89
This gives statutory effect to ESC A2 (meal vouchers).

Section 141 of ICTA charges an employee where a non-cash voucher is provided for the employee or a member of the employee's family by reason of the employment. The employee is treated as having received earnings equal to the "chargeable expense" (i.e. the cost of provision of the voucher) less any part of that expense made good by the employee.

Where meal vouchers are issued to employees, ESC A2 exempts from the charge the first 15p of meal vouchers for each working day for which they are provided if the vouchers satisfy certain conditions.

Section 89 of the Act gives statutory effect to the concession.

Subsection (1)(b) of section 89 of the Act provides that the meal voucher must be provided for an employee for use on a working day. This is regarded as implicit from paragraph (c) of the concession which refers to the value of vouchers "issued….for each working day". It reflects the underlying practice that the concession is concerned with the provision of meal vouchers for working days and a 15p exemption for each working day for which the vouchers are provided.

Paragraph (c) of the definition of "meal voucher" in subsection (3) of section 89 of the Act is not mentioned in the concession. It prevents an overlap with the exemption for non-cash vouchers in section 266(3)(e) of the Act (vouchers for subsidised meals).

References in section 141 of ICTA to employees include office-holders (see section 144(5) of ICTA). ESC A2 refers to "employees". No mention is made of office-holders. But in practice the ESC is applied in relation to them.

This practice is given statutory effect in the Act. Section 89 will apply to office-holders because section 5 of the Act means that in that section references to employees will include office-holders.

This change is in principle in taxpayers' favour but is expected to have no practical effect as it is in line with current practice.

Change 20: Taxable benefits: vouchers and credit-tokens: extension of disregard for money, goods or services obtained: section 95

This extends the disregard for money, goods or services obtained by a voucher or credit-token where the benefit of the voucher or token is charged to tax.

Sections 141(1)(a), 142(1)(a) and 143(1)(a) of ICTA provide for an employee to be charged to tax on the benefit of a cash voucher, non-cash voucher or credit-token where the voucher or token is provided for the employee or a member of the employee's family by reason of the employment.

In such a case sections 141(1)(b), 142(1)(b) and 143(1)(b) of ICTA provide that–

- money, goods or services obtained in exchange for the non-cash voucher or by use of the credit-token, and

- money obtained in exchange for the cash voucher,

are to be disregarded for the purposes of the Income Tax Acts.

Section 95(1) of the Act provides that the disregard is also to be available where the benefit of the voucher or credit-token would have been charged to tax but for a dispensation given by the Inland Revenue under section 96. This removes the possibility of the employee being charged to tax under Chapter 10 of Part 3 of the Act (taxable benefits: residual liability to charge) on the money, goods or services obtained.

Section 95(2) of the Act also extends the disregard to cover goods or services obtained in exchange for a cash voucher. Normally a cash voucher is exchanged for a sum of money and tax is charged on that sum. Section 143(1)(b) of ICTA only disregards the money obtained. But if goods or services were provided, in practice tax would not be charged on their value. Section 95(2) of the Act reflects this practice.

This change is in principle in taxpayers' favour but is expected to have no practical effect as it is in line with current practice.

Change 21: Taxable benefits: living accommodation: special rule for calculating cost of providing accommodation: section 107

This allows an employee's contribution to the cost of acquiring living accommodation to reduce the cost of providing the accommodation for the purposes of the special rule that applies where an interest in the accommodation had been held for at least 6 years when the employee first occupied it.

Section 146 of ICTA applies to living accommodation for which the cost of provision exceeds £75,000. An additional amount is to be treated as emoluments in respect of such accommodation by applying the official rate of interest to the amount by which the cost of providing the accommodation exceeds £75,000.

The normal rule for calculating the cost of providing accommodation is in section 146(4), which refers to "the aggregate of-

(a) the amount of any expenditure incurred in acquiring the estate or interest held by the relevant person; and

(b) the amount of any expenditure incurred by a relevant person before the year in question on improvements to the property."

Section 146(5) reduces the aggregate by payments made by the employee in reimbursement of the expenditure in (a) or (b).

A special rule for calculating the cost of providing living accommodation applies where an interest in the accommodation had been held for at least 6 years when the employee first occupied it. In such cases, section 146(6) applies to substitute market value for the amount in (a) and to exclude from (b) any expenditure on improvements before the date the employee occupied the accommodation.

If one then applies section 146(5) to section 146(6) as it has effect with these modifications, it does not appear to allow any reduction on account of any payment made by the employee by way of reimbursement of expenditure incurred in acquiring the property. The difficulty is that, with these modifications, there is no longer a reference to expenditure so incurred but instead a reference to market value; and a payment cannot be a reimbursement of market value as no expenditure is involved. On this basis, any payment made by the employee by way of reimbursement of expenditure incurred in acquiring the accommodation would not be deductible. This would put the employee at a disadvantage compared to someone who made such a payment in respect of accommodation that had not been held for 6 years.

To preserve equity between taxpayers, section 107(3) of the Act allows payments to reimburse expenditure in acquiring the accommodation to reduce the cost of providing it. The deduction is limited to the market value so that if property prices have fallen over the period the property was owned the cost cannot be a negative figure.

It is believed that in practice such a deduction is made in arriving at the additional amount which is payable in respect of accommodation where the cost of provision (in accordance with the normal rule mentioned above) exceeds £75,000.

This change is in taxpayers' favour in principle and may in practice benefit some although the numbers and amounts are thought to be negligible.

Change 22: Taxable benefits: living accommodation: cash equivalent where accommodation provided to more than one employee: section 108
This gives statutory effect to the first part of ESC A91 (living accommodation provided by reason of employment).

Section 145 of ICTA charges any employee for whom accommodation is provided for the whole of the time for which it is available, whether it is used or not. So accommodation provided for a number of employees could result in each employee being charged on the full annual value. The first part of ESC A91 allows the charge on each to be reduced so that the total charged does not exceed the amount which would be chargeable if the accommodation was available to only one employee.

At present the concession says that amount chargeable on each employee will be reduced having regard to all relevant facts. In rewriting the concession in section 108 of the Act apportionment on a "just and reasonable" basis has been substituted as the basis for deciding the extent of any reduction due.

References in section 145 of ICTA to employees include office-holders (see section 168(2) as applied by section 145(8)(b)). On the other hand, although the concession applies to directors as well as employees, it does not apply to other office-holders. However, as rewritten in section 108 it will apply to all office-holders, because section 5 of the Act means that in section 108 references to employees will include office-holders.

This change is in principle in taxpayers' favour but is expected to have no practical effect as it is in line with current practice.

Change 23: Taxable benefits: living accommodation and residual liability to charge: calculation of annual values: sections 110 and 207

This ensures that, in calculating annual values for the purposes of the charge to tax on living accommodation and benefits not otherwise chargeable to tax, amounts that would be payable in respect of certain matters other than the letting of the accommodation or land in question are to be disregarded.

Section 837(1) of ICTA determines what is to be regarded as the annual value of land. It refers to the rent which might reasonably be expected to be obtained under a yearly tenancy if the tenant undertook to pay all usual tenant's rates and taxes and the landlord undertook to bear the cost of maintaining the condition of the property (see also *Change 24*). Section 837(2) provides for section 23 of the General Rate Act 1967 to apply for the purposes of section 837(1).

Section 23 of the General Rate Act 1967 was designed to enable the gross value of a property to be ascertained where the rent that was being used as the benchmark included an amount in respect of services provided by the landlord or was payable in addition to an amount in respect of such services. The section provided for the way in which the gross value was to be adjusted in those circumstances. It was, however, repealed by the Local Government Finance Act 1988 without any replacement provision taking its place.

In view of this repeal, section 837(2) has not been rewritten in the context of the provisions of the Act that rewrite section 837(1), namely sections 110 ("annual value" of living accommodation) and 207 ("annual rental value" of land for purposes of residual liability to charge). But provisions have been included in those sections which are intended to reflect the general thrust of section 23 of the 1967 Act by ensuring that annual values reflect amounts payable in respect of the letting of the properties concerned and not amounts payable in respect of the cost of certain services provided by the landlord: see subsections (2) to (5) of sections 110 and 207.

These provisions will clarify how to find annual values in respect of those properties for which the practice of using gross rateable values or a proxy for them is inapplicable - for example overseas properties. In the case of both these and other properties, all the current practices used in quantifying the cash equivalent of the benefit of living accommodation will continue.

This change accordingly provides a set of rules for valuing property in place of legislation that has been repealed. In practice the existing arrangements for valuing property will continue. The change will be advantageous to some taxpayers as it will clarify the basis of valuation.

Change 24: Taxable benefits: living accommodation and residual liability to charge: meaning of "all usual tenant's rates and taxes": sections 110 and 207
This updates the reference to "all usual tenant's rates and taxes" in the provision under which annual values are assessed for the purposes of the charge to tax on living accommodation and benefits not otherwise chargeable to tax.

As mentioned in *Change 23*, section 837(1) of ICTA determines what is to be regarded as the annual value of land. It refers to the rent which might reasonably be expected to be obtained under a yearly tenancy if the tenant undertook to pay "all usual tenant's rates and taxes". However, there are no longer rates on residential property in the United Kingdom apart from Northern Ireland, and none in respect of overseas properties. The current equivalents to rates in the rest of the United Kingdom are council tax and water and sewerage charges. See also *Change 75.*

Section 837(1) of ICTA is rewritten in section 110(1) of the Act ("annual value" of living accommodation) and in section 207(1) ("annual rental value" of land for purposes of residual liability to charge). In order to update the reference to "all usual tenant's rates and taxes", these sections refer instead to "all taxes, rates and charges usually paid by a tenant". Another change affecting the way in which section 837(1) of ICTA is rewritten in the Act is dealt with in *Change 23*.

This change is in principle in taxpayers' favour but is expected to have no practical effect as it is in line with current practice.

Change 25: Taxable benefits: cars: modification of provisions where car temporarily replaced: section 145(2)
This relaxes one of the conditions for the application of the provisions which modify the calculation of the cash equivalent of the benefit of a car where the car is temporarily replaced.

Section 157 of ICTA charges an employee where a car is made available to the employee or a member of the employee's family or household by reason of the

employment. An amount equal to the cash equivalent of the benefit of the car is treated as emoluments of the employee.

The cash equivalent of the benefit of a car for a year is calculated under Schedule 6 to ICTA by taking a percentage of the price of the car determined under sections 168A to 168G of that Act. Reductions are made under paragraphs 6 and 7 of Schedule 6 to take account of periods of 30 days or more when the car is unavailable and of payments for the private use of the car.

Paragraph 8 of Schedule 6 to ICTA provides that the Treasury may make regulations modifying the effect of Schedule 6 where the car is unavailable to the employee for a period of less than 30 days and it is replaced by another car for the whole or part of that period. In such a case the employee would be charged to tax in relation to both the replaced car and the replacement car and would not be able to claim a reduction in respect of the period when the replaced car is unavailable.

The Income Tax (Replacement Cars) Regulations 1994 (S.I. 1994/778) were made under paragraph 8 of Schedule 6 to ICTA. Those Regulations have been rewritten in section 145 of the Act. Paragraph 8 of Schedule 6 to ICTA is repealed by the Act as it is no longer thought necessary.

The effect of the modifications made by the Regulations is that–

- the cash equivalent of the benefit of the replacement car is nil (because the replacement car is treated as being unavailable during the replacement period), and

- payments made for the private use of the replacement car may be deducted from the cash equivalent of the replaced car (because the replacement car is treated as if it were a continuation of the replaced car).

In order for the Regulations to apply, regulation 4(1) requires that–

- the replacement car is "of similar quality" to the replaced car (condition A), or

- the replacement car is not made available to the employee under an arrangement the main purpose of which is to provide him with a materially better car (condition B).

Regulation 4(2) provides that a replacement car "is of similar quality to the replaced car if it is neither materially better nor materially worse in quality than the replaced car". "Materially better" is defined in Regulation 4(3) as a car which is materially better in quality or has a materially higher price. "Materially worse" is undefined.

In section 145(2) of the Act condition A has been replaced by a requirement that the replacement car is not materially better than the replaced car.

This widens the application of the replacement car provisions insofar as condition A will be satisfied where the replacement car is of lower quality to the replaced car. This reflects the approach which the Inland Revenue have adopted in practice.

This change is in principle in taxpayers' favour but is expected to have no practical effect as it is in line with current practice.

Change 26: Taxable benefits: cars: reduction of cash equivalent where car capable of running on road fuel gas: section 146(2)
This changes the sum which is the basis for a reduction when calculating the cash equivalent of the benefit of a car which is capable of running on road fuel gas.

Section 157 of ICTA charges an employee where a car is made available to the employee or a member of the employee's family or household by reason of the employment. An amount equal to the cash equivalent of the benefit of the car is treated as emoluments of the employee.

The cash equivalent of the benefit of a car for a year is calculated under Schedule 6 to ICTA by taking a percentage of the price of the car. The price of the car is determined under sections 168A to 168G of that Act by taking account of a number of factors, including the price of accessories available when the car was first made available to the employee and of accessories available with the car in the year in question.

Section 168AB(2) of ICTA provides that, where a car is manufactured in such a way as to be capable of running on road fuel gas, the price of the car is to be treated as "the price given by section 168A reduced by so much of that price as it is reasonable to attribute to the car's being manufactured in that way rather than in such a way as to be capable of running only on petrol".

The price of the car "given by section 168A" of ICTA is the list price of the car or its notional price if it has no list price. Under section 168A(4) and (5) the list price will include the price of optional accessories available with the car when it is first made available to the employee if a price for those accessories is published by the car's manufacturer, importer or distributor. If no such price is published for those accessories, the list price of the car will not include the price of those accessories. But the price of the car will be increased under section 168B of ICTA by the list price or notional price of those accessories if they are available with the car in the tax year in question.

In section 121 of the Act a method statement has been used to describe the various steps involved in calculating the cash equivalent. In order to simplify matters the addition of sums in respect of accessories is dealt with at only one stage of the calculation. Thus step 1 is to find the price of the car – i.e. its list price or notional price and step 2 is to add on the price of accessories.

A consequence of this simplified structure is that there is no step which exactly corresponds to "the price given by section 168A" of ICTA. In rewriting section 168AB(2) those words have been replaced in section 146(2) of the Act by "the price of the car found under step 1". That price will not include the price of accessories to which section 168A(4) and (5) of ICTA apply.

But it is thought that the effect of the words "the price of the car found under step 1" will be the same–

- It is difficult to envisage an accessory to which section 168A(4) and (5) of ICTA apply whose contribution to the price of the car would be regarded as reasonably attributable to the manufacture of the car in such a way as to be capable of running on road fuel gas. This is because section 168AB(1) of ICTA excludes "equipment by means of which a car is capable of running on road fuel gas" from being an "accessory". Therefore the amount of the reduction under section 146(2) of the Act should be the same as under section 168AB(2) of ICTA.

- Although the price of the car found under step 1 may be a smaller figure than "the price of the car under section 168A" this should not prejudice the taxpayer. That is because the amount of the reduction (i.e. the amount of the price of the car reasonably attributable to its manufacture in such a way as to be capable of running on road fuel gas) should not exceed the price of the car found under Step 1.

This change has no implications for the amount of tax paid, who pays it or when. It affects (in principle and in practice) only the method of calculation.

Change 27: Taxable benefits: cars & car fuel: concession where car available to family members or car is shared: sections 148, 153 and 169

This gives statutory effect to ESC A71 (company cars: family members and shared use) and the Inland Revenue's practice to make a corresponding concession in respect of the provision of car fuel.

Section 157 of ICTA charges an employee where a car is made available to the employee or a member of the employee's family or household by reason of the employment. An amount equal to the cash equivalent of the benefit of the car is treated as emoluments of the employee.

Section 158 of ICTA charges an employee where car fuel is provided by reason of the employment for a car which is chargeable under section 157 of that Act. An amount equal to the cash equivalent of the benefit of the fuel is treated as emoluments of the employee.

Sections 157 and 158 of ICTA are part of Chapter 2 of Part 5 of ICTA which contains various provisions which charge to tax benefits provided by reason of an employment. That Chapter applies only to employment as a director of a company (subject to certain conditions) or to employment with emoluments of at least £8,500 a year (see section 167 of ICTA).

(A) Paragraphs 1 and 2 of ESC A71 concern the case where a car is made available to a member of the employee's family or household who is also employed by the same employer and either–

- that member is himself charged to tax in respect of the provision of the car, or

- that member is not so charged because he is a lower-paid employee (i.e. not employed in an employment to which section 157 applies) but, broadly speaking, the provision of the car goes with the job and was not by reason of the relationship with the employee.

In such a case the employee is not charged to tax in respect of the car. In practice the Inland Revenue also do not charge the employee under section 158 of ICTA in respect of any fuel provided for the car.

Section 169 of the Act gives statutory effect to paragraphs 1 and 2 of the concession and the Inland Revenue's practice in relation to car fuel.

This change is in principle in taxpayers' favour but is expected to have no practical effect as it is in line with current practice.

(B) Paragraph 3 of ESC A71 concerns the case where two or more employees have shared use of a car which is made available by their employer and in respect of which they are chargeable to tax. Under section 157 of ICTA they would each be charged in respect of the cash equivalent of the benefit of the car. Paragraph 3 of the concession provides that "only a single car benefit charge will be made in respect of the car" which "will be apportioned between them having regard to all the relevant facts".

The difficulty with the wording of the concession is that the reference to a "single car benefit charge" does not accord with the fact that the cash equivalent of the benefit of the car is calculated for each employee separately under sections 168A to 168G of and Schedule 6 to ICTA and may therefore differ depending on the circumstances relevant to each employee – for example, if one of the employees made contributions to expenditure on the provision of the car. The problem is therefore how the "single car benefit charge" (which is to be apportioned) is to be ascertained without enabling each employee to benefit from the circumstances relating to other employees.

In section 148 of the Act this problem has been dealt with by providing that the cash equivalent of the benefit of the car to each of the employees is to be calculated

separately and then reduced on a just and reasonable basis. In making that reduction the availability of the car to any lower-paid employees is disregarded. As far as can be established this reflects how the Inland Revenue have applied paragraph 3 of the concession in practice.

Where the cash equivalent of the benefit of a car is reduced under paragraph 3 of the concession, it is also the Inland Revenue's practice to allow a corresponding reduction in the cash equivalent of the benefit of fuel provided for the car under section 158 of ICTA. This practice is given statutory effect in section 153 of the Act.

This change is in principle in taxpayers' favour but is expected to have no practical effect as it is in line with current practice.

(C) At present it is the practice of the Inland Revenue not to take account of paragraph 3 of ESC A71 and its corresponding concession in relation to car fuel when calculating for the purposes of section 167 of ICTA whether the emoluments from the taxpayer's employment for the year total £8,500 or more. If the emoluments do not equal or exceed that figure, the employment is not an employment to which Chapter 2 of Part 5 of ICTA applies.

As a consequence of giving statutory effect to paragraph 3 of ESC A71 and the practice in relation to car fuel, the taxpayer will have the benefit of those concessions when the emoluments from his employment are calculated under Chapter 11 of Part 3 of the Act (which rewrites section 167 of ICTA) in order to see whether the Chapters of that Part which rewrite the relevant provisions of Chapter 2 of Part 5 of ICTA apply.

This change is in taxpayers' favour in principle and may in practice benefit some although the numbers and amounts are thought to be negligible.

(D) References in sections 157 and 158 of ICTA to employees include office-holders (see section 168(2) ICTA). ESC A71 is expressed to apply to "directors or employees earning at a rate of £8,500 a year or more". No mention is made of other office-holders. But in practice the ESC is applied in relation to them.

This practice is given statutory effect in the Act. Sections 148, 153 and 169 will apply to all office-holders because section 5 of the Act means that in those sections references to employees will include office-holders.

This change is in principle in taxpayers' favour but is expected to have no practical effect as it is in line with current practice.

Change 28: Replacement of references to 365 days with references to the number of days in the year in order to cover leap years: sections 152(4), 158(3), 163(1) and 183(3)

This replaces references to 365 days with references to the number of days in the year in question so that leap years are taken into account when calculating–

- certain reductions when determining the cash equivalent of the benefit of car fuel or of a van, and

- the amount of interest that would have been payable on a loan for a tax year at the official rate of interest.

(A) Taxable benefits: Car fuel and vans

Section 158 of ICTA charges an employee where car fuel is provided by reason of the employment for a car which is chargeable to tax under section 157 of that Act. An amount equal to the cash equivalent of the benefit of the fuel is treated as emoluments of the employee.

Section 158(5) and (6A) of ICTA provide for the cash equivalent to be proportionally reduced if certain conditions are met – for example, where the car for which the fuel is provided is unavailable for any part of the year. Section 158(8) states that the reduced amount is to be given by the formula–

$$CE \times (365-D)/365$$

where "CE" is the amount of the cash equivalent before any reduction and "D" is the total number of days in the year on which the relevant condition is met.

Section 159AA of ICTA charges an employee where a van is made available to the employee or a member of the employee's family or household by reason of the employment. An amount equal to the cash equivalent of the benefit of the van is treated as emoluments of the employee.

Paragraphs 2 and 6 of Schedule 6A to ICTA provide for reductions to be made when calculating the cash equivalent of the benefit of a van in order to reflect any "excluded days" during the tax year in question – i.e. days when the van was unavailable, a shared van or incapable of use. In each case the reduction is based on the proportion that the number of excluded days bears to 365.

Section 152(4) of the Act rewrites section 158(8) of ICTA. Section 158(3) rewrites paragraph 2 of Schedule 6A to ICTA. Section 163(1) rewrites paragraph 6 of that Schedule.

In each case the reduction is calculated by means of a formula where reference is made to "Y" (the number of days in the year) rather than "365". The use of the "Y"

formulation covers the possibility that the year in question is a leap year. Its use is consistent with the approach in paragraph 6 of Schedule 6 to ICTA when calculating the corresponding reduction in the cash equivalent of the benefit of a car for periods when the car is unavailable.

In relation to leap years the use of "366" rather than "365" in the calculations in sections 152(4), 158(3) and 163(1) of the Act will produce a slightly smaller reduction of the cash equivalent than if the figure of "365" had been retained. The change is therefore marginally unfavourable to taxpayers.

(B) Taxable benefits: loans

Section 160(1) of ICTA charges an employee where an interest-free or low-interest loan is made to the employee or a relative of the employee by reason of the employment. An amount equal to the cash equivalent of the benefit of the loan is treated as emoluments of the employee.

Paragraph 3 of Schedule 7 to ICTA provides that the cash equivalent of the benefit of a loan for a tax year is–

- the amount of interest which would have been payable on the loan for that year at the official rate, less

- the amount of interest actually paid on it for that year.

Paragraphs 4 and 5 of that Schedule provide a "normal" and an "alternative" method of calculating the amount of interest which would have been payable at the official rate. The "normal" method is based on the average amount of the loan outstanding during the tax year and the average official rate of interest. The "alternative" method is based on a day by day calculation of the interest at the official rate on the amount outstanding on the loan on each day.

As well as being relevant to the calculation of the cash equivalent, the amount of interest payable on a loan at the official rate is also relevant to sections 160(1) and 161(2) of ICTA. In section 160(1) it is relevant to whether the loan is a low-interest loan and therefore falls within the provision. In section 161(2) it is relevant to whether the loan falls within the exception for fixed rate loans.

Although the methods of calculation in paragraphs 4 and 5 of Schedule 7 to ICTA are not directly applied to the references in sections 160(1) and 161(2) of that Act to the amount of interest payable at the official rate, in practice those methods of calculation are applied. This practice is given statutory effect in sections 182 and 183(1) of the Act – see *Change 31*.

The amount of interest payable at the official rate is therefore relevant to the following provisions of the Act–

- section 175(2)(b) (whether the loan is a low interest loan)
- section 177(2) (whether the loan is an excepted fixed rate loan)
- section 175(3) (the calculation of the cash equivalent of the benefit)

The alternative method of calculation set out in paragraph 5 of Schedule 7 to ICTA refers at sub-paragraph (3)(c) to multiplying the sum of the daily amounts outstanding on the loan by the official rate of interest and then dividing the answer by 365.

In section 183(3) this has been rewritten in terms of division by "the number of days in the tax year". Where the tax year in question is a leap year, division by 366 rather than 365 will result in a reduced figure for the amount of interest payable on the loan for that year at the official rate of interest. This is an equitable result given that the amount of the loan outstanding on each of the 366 days of a leap year is taken into account earlier in the interest calculation.

In relation to each of the provisions to which the interest figure is relevant, a reduced figure in the case of a leap year will be to the taxpayer's advantage.

Paragraph 26 of Schedule 7 to the Act contains a transitional provision which prevents the change applying where section 183 (the alternative method of calculation) applies in relation to section 177 (the fixed rate loan exception) in the case of loans made in a leap year and before 6th April 2003. Only loans made on or after 6th April 2003 and in a leap year will therefore have the benefit of this change.

Section 183(3) of the Act is also applied by section 193(3) (together with other loan provisions) in relation to notional loans in respect of the acquisition of shares. There it will be relevant to the operation of section 175 of the Act (as applied by section 193(3)). Again a reduced figure in the case of a leap year will be to the taxpayer's advantage.

This change is adverse to some taxpayers and favourable to others in principle and in practice. The numbers affected are expected to be few and the amounts involved small as the circumstances will only arise once every four years, if at all.

Change 29: Taxable benefits: loans: exception for advances for necessary expenses: sections 179 and 716(2)(a)

This gives statutory effect to Statement of Practice 7/79 which excepts advances for expenses from the provisions charging to tax the benefit of loans provided by reason of an employment.

Section 160(1) of ICTA charges an employee where an interest-free or low-interest loan is made to the employee or a relative of the employee by reason of the employment.

Advance payments made to an employee by an employer to cover any necessary expenses which the employee will incur in performing the duties of his employment could be charged to tax under section 160(1) of ICTA.

But paragraph 2 of Statement of Practice 7/79 provides that such advances are not in practice to be charged to tax under that provision if the maximum amount advanced at any one time does not exceed £1,000, the advances are spent within 6 months and the employee accounts to the employer at regular intervals for the expenditure of the sum advanced.

Section 179(1), (2) and (5)-(7) of the Act give statutory effect to paragraph 2 of the Statement of Practice. Subsection (2) sets out the conditions which must be met.

Paragraph 3 of the Statement of Practice provides that, while advances which do not meet the conditions in paragraph 2 should be included as beneficial loans by the employer on forms P11D, they will not be charged to tax in practice where there is good reason for exceeding the limits in paragraph 2 – for example, on account of a lengthy overseas trip.

Section 179(4) and (5) of the Act give statutory effect to paragraph 3 of the Statement of Practice. They provide that the Inland Revenue (i.e. any officer of the Board: see section 720(1) of the Act) may, on an application made by the employer, authorise an increase in the sum specified in subsection (2)(a) (currently £1,000), or in the 6 month time limit specified in subsection (2)(b), or in both those limits, if they are satisfied that there is good reason to do so in a particular case. Where such authorisation is given, no entry in the loans section of the form P11D will be necessary in respect of the advance provided that any increased limits and the remainder of the conditions in subsection (2) are met.

Section 716(2)(a) of the Act also provides that the £1,000 limit in section 179(2)(a) may be increased by an order made by the Treasury.

References in section 160 of ICTA to employees include office-holders (see section 168(2) ICTA). Statement of Practice 7/79 refers to advances in respect of expenses incurred by an "employee". No mention is made of office-holders. But in practice the ESC is applied in relation to them.

This practice is given statutory effect in the Act. Section 179 will apply to office-holders because section 5 of the Act means that in that section references to employees will include office-holders.

This change is in principle in taxpayers' favour but is expected to have no practical effect as it is in line with current practice.

Change 30: Taxable benefits: loans: exception for loans totalling not more than £5,000: section 180
This gives statutory effect to the practice to except the amount of certain loans from the total outstanding on loans for the purpose of applying the £5,000 threshold.

Section 160(1) of ICTA charges an employee where an interest-free or low-interest loan is made to the employee or a relative of the employee by reason of the employment. An amount equal to the cash equivalent of the benefit of the loan is treated as emoluments of the employee.

Section 161(1) of ICTA provides an exception from the charge to tax where the amount outstanding on loans "referred to in section 160(1)" does not exceed £5,000. It does not state expressly whether loans excepted from section 160(1) are to be excluded when calculating whether the £5,000 threshold has been exceeded. But in practice the Inland Revenue ignore all excepted loans when making that calculation.

Section 180 of the Act gives statutory effect to this practice by providing that only "taxable cheap loans" are to be counted. A "taxable cheap loan" is defined in section 175(2) of the Act and excludes a loan to which any of the exceptions in sections 176 to 179 apply.

Section 180 is applied by section 193(3) of the Act in relation to notional loans in respect of acquisitions of shares. This change therefore also applies to such notional loans.

This change is in principle in taxpayers' favour but is expected to have no practical effect as it is in line with current practice.

Change 31: Taxable benefits: loans: method of calculating the amount of interest payable at the official rate: sections 182 and 183(1)
This gives statutory effect to the practice, where reference is made in the loan provisions to the amount of interest payable at the official rate, to use the methods of calculating that interest which are provided in the context of determining the cash equivalent of the benefit of the loan.

Section 160(1) of ICTA charges an employee where an interest-free or low-interest loan is made to the employee or a relative of the employee by reason of the employment. An amount equal to the cash equivalent of the benefit of the loan is treated as emoluments of the employee.

Paragraph 3 of Schedule 7 to ICTA provides that the cash equivalent of the benefit of a loan for a tax year is–

- the amount of interest which would have been payable on the loan for that year at the official rate, less

- the amount of interest actually paid on it for that year.

Paragraphs 4 and 5 of that Schedule provide a "normal" and an "alternative" method of calculating the amount of interest which would have been payable at the official rate. The "normal" method is based on the average amount of the loan outstanding during the tax year and the average official rate of interest. The "alternative" method is based on a day by day calculation of the interest at the official rate on the amount outstanding on the loan on each day.

As well as being relevant to the calculation of the cash equivalent, the amount of interest payable on a loan at the official rate is also relevant to sections 160(1) and 161(2) of ICTA. In section 160(1) it is relevant to whether the loan is a low-interest loan and therefore falls within the provision. In section 161(2) it is relevant to whether the loan falls within the exception for fixed rate loans.

Although the methods of calculation in paragraphs 4 and 5 of Schedule 7 to ICTA are not directly applied to the references in sections 160(1) and 161(2) of that Act to the amount of interest payable at the official rate, in practice those methods of calculation are applied.

In the absence of that practice the interest would be calculated using the "alternative" method only. The practice therefore enables the "normal" method also to be used. But both the Inland Revenue and the taxpayer can elect for the "alternative" method to apply where that is more advantageous.

Sections 182 and 183(1) of the Act give statutory effect to this practice by providing that the methods of calculation are "for the purposes of this Chapter" – i.e. Chapter 7 of Part 3 (taxable benefits: loans).

This change has no implications for the amount of tax paid, who pays it or when. It affects the method of calculation only (and does so only in principle and not in practice).

Change 32: Taxable benefits: loans: extension of time limit for giving notice of the application of the alternative method of calculating interest: section 183(2)
This gives statutory effect to the practice to allow notice of the application of the alternative method of calculating the amount of interest payable on a loan at the official rate to be given on the first anniversary of the normal self-assessment filing date.

Section 160(1) of ICTA charges an employee where an interest-free or low-interest loan is made to the employee or a relative of the employee by reason of the employment. An amount equal to the cash equivalent of the benefit of the loan is treated as emoluments of the employee. In order to determine the cash equivalent, paragraphs 4 and 5 of Schedule 7 to ICTA provide a "normal" and an "alternative"

method of calculating the amount of interest which would have been payable on the loan at the official rate.

If the Inland Revenue or the employee want the "alternative" method of calculation to apply for a particular tax year then paragraph 5(2) of Schedule 7 to ICTA requires that notice must be given "before the end of the period of 12 months beginning with the 31st January next following" that year. Therefore notice given on the first anniversary of that 31st January date would be out of time.

But in practice the Inland Revenue allow notice to be given on that date. Section 183(2) of the Act gives statutory effect to this practice by requiring that the notice be given "on or before the first anniversary of the normal self-assessment filing date for the tax year in relation to which the question arises whether the loan is a taxable cheap loan". Section 721(1) of the Act defines "the normal self-assessment filing date", in relation to a tax year, as the 31st January following the tax year.

Section 183 is applied by section 193(3) of the Act in relation to notional loans in respect of acquisitions of shares. This change therefore also applies to such notional loans.

This change is in principle in taxpayers' favour but is expected to have no practical effect as it is in line with current practice.

Change 33: Taxable benefits: loans: method of calculating the cash equivalent of the benefit of a loan which is replaced: section 186(3)
This gives statutory effect to the practice, when determining the cash equivalent of the benefit of a loan which has been replaced, to take account of the amount of interest paid on the original loan and on the replacement loan.

Section 160(1) of ICTA charges an employee where an interest-free or low-interest loan is made to the employee or a relative of the employee by reason of the employment. An amount equal to the cash equivalent of the benefit of the loan is treated as emoluments of the employee.

Paragraph 3 of Schedule 7 to ICTA provides that the cash equivalent of the benefit of a loan for a tax year is–

(a) the amount of interest which would have been payable on the loan for the year at the official rate, less

(b) the amount of interest actually paid on it for that year.

As regards (a), paragraphs 4 and 5 of Schedule 7 to ICTA provide a "normal" and an "alternative" method of calculating the amount of interest which would have been payable at the official rate. The "normal" method of calculation is based on the number of whole months during which the loan was outstanding. Paragraph 4(2) to (4) of Schedule 7 prevent the "normal" method being manipulated where the loan is replaced by another loan part way through a month. It therefore provides that when using the "normal" method of calculation the replacement loan is to be treated as if it were the same loan as the original loan.

As regards (b), Schedule 7 to ICTA is silent as to how the amount of interest paid on the loan is to be calculated where the amount of interest payable at the official rate has been calculated under paragraph 4(2) on the basis that the replacement loan is the same as the original loan. In practice the Inland Revenue take account of the amount of interest paid on the original loan and on the replacement loan. If only the amount of interest paid on the original loan were taken into account, the cash equivalent of the benefit of the loan would be a higher figure.

Section 186(3) of the Act gives statutory effect to this practice.

This change is in principle in taxpayers' favour but is expected to have no practical effect as it is in line with current practice.

Change 34: Taxable benefits: loans: prevention of double charge under section 421 of ICTA where loan released or written off: section 189(1)(b)

This clarifies that there will be no charge under section 160(2) of ICTA in respect of the release or writing off of a loan if the amount released or written off is also charged under section 421 of ICTA (taxation of borrower where loan made by close company is released or written off).

Section 160(2) of ICTA charges an employee where a loan obtained by reason of his employment is released or written off. The amount released or written off is treated as emoluments of the employee.

Section 161(5) of ICTA provides that section 160(2) does not apply where the amount released or written off is "chargeable to income tax as income of the employee apart from that section". It then provides for two exceptions from that rule.

Section 421 of ICTA charges a borrower who is a participator or an associate of a participator in a close company where a loan made to him by the company which is within section 419 of ICTA is released or written off. The amount released or written off is included in the borrower's total income. It is treated as net income received by the borrower after deduction of income tax at the Schedule F ordinary rate.

There could be a double charge under section 160(2) and under section 421 of ICTA. But in practice the Inland Revenue regard a charge under section 421 of ICTA as

having priority and therefore the employee is not also to be charged under section 160(2).

Section 189(1)(b) of the Act legislates this practice by providing that section 188 of the Act (which rewrites section 160(2) of ICTA) does not apply if the amount released or written off "is or is treated as income of the employee (or of the employee as a borrower) which is not employment income and upon which that person is liable to pay income tax".

This change is in principle in taxpayers' favour but is expected to have no practical effect as it is in line with current practice.

Change 35: Taxable benefits: loans: relief where released or written off loan is subsequently repaid: section 191(3)

This introduces relief where an employee is charged on the release or writing off of a loan under section 160(2) of ICTA and the whole or part of the loan is subsequently repaid.

Section 160(1) of ICTA charges an employee where an interest-free or low-interest loan is made to the employee or a relative of the employee by reason of the employment. An amount equal to the cash equivalent of the benefit of the loan is treated as emoluments of the employee.

Section 160(2) of ICTA charges an employee where a loan obtained by reason of his employment is released or written off. The amount released or written off is treated as emoluments of the employee.

Section 160(4A) of ICTA provides relief for the taxpayer where he has been charged under section 160(1) on the basis that the whole or part of the interest payable on the loan has not been paid and the interest is then subsequently paid.

There is no equivalent relief where the employee is charged under section 160(2) of ICTA and the loan is subsequently repaid in whole or in part. The position could be rectified by an error or mistake claim under section 33 of TMA 1970. But the view was taken that it would be better to include express provision in the Act.

Section 191(3) of the Act therefore expressly provides relief in such a case.

This change is in taxpayers' favour in principle and may in practice benefit some although the numbers and amounts are thought to be negligible.

Change 36: Taxable benefits: notional loans in respect of acquisitions of shares: taking account of advance payments for shares: sections 193(1)(a) and (b) and 194(2)(a)
This takes payments for shares made before the time of the acquisition into account in determining whether there is a notional loan and the amount of such a loan.

Under section 162(1) of ICTA there is a notional loan if, among other things, shares are acquired at an under-value. Under section 162(2)(a) of ICTA shares are acquired at an under-value if no payment is made at the time of their acquisition or if the payment then made is less than the market value of fully paid up shares of the same class. This leaves out of account payments made before the time of the acquisition. It is the practice to take account of advance payments. This practice is reflected in section 193(1)(a) and (b) of the Act.

Section 162(3) of ICTA provides that the amount initially outstanding of the notional loan is so much of the under-value on acquisition as is not chargeable to tax as an emolument of the employee. Section 162(2)(b) of ICTA provides that the under-value on acquisition is the market value of fully paid up shares of the same class as the shares less any payment *then* made for the shares. This does not take account of any payments made for the shares before the time of the acquisition. It is the practice to take account of advance payments. Section 194(2)(a) of the Act reflects this.

This change is in principle in taxpayers' favour but is expected to have no practical effect as it is in line with current practice.

Change 37: Taxable benefits: notional loans in respect of acquisitions of shares: listing the provisions of Chapter 7 of Part 3 which apply to notional loans: section 193(4)
This applies to notional loans various provisions about the taxation of employment-related loans.

Section 162(1) of ICTA provides that, "…section 160(1) of and Schedule 7 to ICTA apply as if the employee had the benefit of an interest-free loan obtained by reason of his employment ("the notional loan")". Section 160(1) and Schedule 7 contain some of the provisions about the treatment of employment-related loans. There are other provisions about loans which it is the practice to apply to notional loans. They are section 160(1A) of ICTA, which contains provisions about the interest treated as paid by section 160(1), section 160(1B) and (1BA), which provide for the aggregation of loans, section 161(1) of ICTA, which contains an exception if the aggregate amount outstanding on all loans does not exceed £5,000 and section 161A of ICTA, which contains an exception for qualifying loans.

Section 193(4) of the Act lists the provisions of the Act which are to apply to notional loans. It reflects the practice and applies the provisions of the Act which are based on

sections 160(1A), (1B) and (1BA), 161(1) and 161A of ICTA, as well as those based on section 160(1) of and Schedule 7 to ICTA.

This change is in principle in taxpayers' favour but is expected to have no practical effect as it is in line with current practice.

Change 38: Taxable benefits: notional loans in respect of acquisitions of shares: relationship with liability to tax in respect of exercise of share option: sections 194(2)(c) and 196

This deals with the relationship between the provisions about notional loans and those imposing liability to tax in respect of the exercise of a share option and prevents double taxation where they operate in the same circumstances.

Section 162(3) of ICTA provides that the amount initially outstanding of the notional loan is "so much of the under-value on acquisition as is not chargeable to tax *as an emolument of the employee*". Section 162(11) of ICTA provides that, "This section, in respect of any shares or any interest in shares, operates only to include an amount in emoluments so far as any amount corresponding to it, and representing the same benefit does not otherwise fall to be *so* included under the Tax Acts." Between them, these provisions deal with the relationship between section 162(1) of ICTA and other provisions which operate to include an amount as emoluments. In a case where section 162(1) and the other provision would both operate, it is implicit from section 162(11) of ICTA that the other provision operates, regardless of the position under section 162(1), but in order to avoid double taxation the effect of section 162(3) and (11) of ICTA is that the amount of the notional loan initially outstanding is reduced by the amount that is chargeable to tax as an emolument of the employee. *Note 22* explains how these parts of section 162(3) of ICTA have been rewritten.

Section 162(1) of ICTA may apply to an acquisition resulting from the exercise of a share option. In such a case there could also be a charge to tax under Schedule E under section 135 of ICTA. An amount charged to tax under section 135 is not chargeable to tax *as an emolument of the employee* and so is not deductible from the amount of the notional loan under section 162(3) of ICTA and is not affected by section 162(11) of ICTA. There is therefore the possibility of double taxation.

In practice, the relationship between sections 135 and 162(1) of ICTA is dealt with in the same way as the relationship between section 162(1) and other provisions which operate to include an amount as emoluments. Section 135 of ICTA operates regardless of the position under section 162 and any amount charged to tax under section 135 of ICTA is deducted from the amount of the notional loan initially outstanding.

Section 194(2)(c) of the Act reflects the practice of deducting amounts charged to tax under section 135 of ICTA from the amount of the notional loan initially outstanding. Section 196 makes it clear that liability in respect of the exercise of the share option is not affected by the provisions about notional loans.

This change is in principle in taxpayers' favour but is expected to have no practical effect as it is in line with current practice.

Change 39: Taxable benefits: residual liability to charge: scholarships provided under arrangements entered into by the employer or a connected person if the employer is an individual: section 212

This introduces an exception to the rule that a benefit which is provided to an employee under arrangements entered into by the employer or a connected person is treated as provided by reason of the employment.

Under section 154 of ICTA, if an employee (or a member of the employee's family or household) receives a benefit by reason of the employment, an amount equal to the cash equivalent of the benefit is treated as emoluments of the employment. Sections 165(2) and 168(3) of ICTA both provide that in specified circumstances a benefit is to be treated for the purposes of section 154 as provided by reason of an employment.

Section 168(3) of ICTA says that a benefit is treated as provided by reason of an employment if the employer provides it. However, section 168(3) does not apply if–

- the employer is an individual, and
- the benefit is provided in the normal course of the employer's domestic, family or personal relationships.

Section 165(2) of ICTA only applies where the benefit consists of provision of a scholarship. It says that the scholarship is treated as provided by reason of an employment if it is provided under arrangements entered into by the employer or a person connected with the employer. There is no exception from section 165(2) comparable to the exception from section 168(3) mentioned above.

Section 212 of the Act rewrites section 165(2) of ICTA. Section 212(3) introduces an exception comparable to the exception from section 168(3) of ICTA.

This change is in principle in taxpayers' favour but is expected to have no practical effect as it is in line with current practice.

Change 40: Taxable benefits: residual liability to charge: scholarships: cost of benefit: section 214

This introduces a special rule for determining the cost of the benefit of a scholarship which is provided from a trust fund.

Under section 154 of ICTA, if an employee (or a member of the employee's family or household) receives a benefit by reason of the employment, an amount equal to the cash equivalent of the benefit is treated as emoluments of the employment.

Section 165(1) of ICTA prevents the exemption for scholarships in section 331 of ICTA from applying to certain scholarships and they therefore remain within section 154 of ICTA.

The cash equivalent of a benefit is the cost of provision of the benefit calculated in accordance with section 156 of ICTA. Section 156(2) of ICTA says the cost of the benefit is "the amount of any expense incurred in or in connection with its provision, and…..includes a proper proportion of any expense relating partly to the benefit and partly to other matters".

In the case of a scholarship provided out of a trust fund set up or funded by the employer, section 156(2) could require all the contributions made to the fund, and expenses of running it, to be taken account of in calculating the cash equivalent. This would result in a very difficult calculation to arrive at the cost of a single scholarship paid out of the fund.

Instead, the published practice in the Inland Revenue Schedule E manual at SE30003 is "Where an award is made from an educational trust treat the expense incurred in providing the award as the payments actually made by the trustees. For this purpose do not take into account any tax suffered by the trust on its income."

Section 214 of the Act reproduces this practice. Where that section applies it replaces section 204 (which rewrites section 156(2) of ICTA).

This change is in principle in taxpayers' favour but is expected to have no practical effect as it is in line with current practice.

Change 41: Exemption of modest private use of heavy goods vehicles: widening of exemption: section 238(1)

This widens the exemption for the private use of a heavy goods vehicle so that it applies however the liability to income tax would arise and not only where the charge is under the benefits code.

Section 154 of ICTA provides that where, by reason of a person's employment, a benefit to which that section applies is provided for him or a member of his family or household, the cash equivalent of the benefit is to be treated as emoluments of the employment. The making available of a heavy goods vehicle to an employee for private use is a benefit that would fall within section 154 if the employee were in employment within section 167 of ICTA (higher-paid employments etc.). But section 159AC(2) of ICTA provides that there is no charge under section 154 in respect of the provision of this benefit if the use of the vehicle is not wholly or mainly private use.

It would also be possible for the provision of this benefit to give rise to a charge under section 148 of ICTA if the benefit were received in connection with a change in the duties of, or emoluments from, an employment.

The exemption in section 159AC(2) has been rewritten so that no liability at all arises in respect of the provision of this benefit to an employee, whether as an employment-related benefit within Chapter 10 of Part 3 of the Act or under Chapter 3 of Part 6 of the Act where section 148 is rewritten. See section 238(1) of the Act.

This change is in principle in taxpayers' favour but is expected to have no practical effect as it is in line with current practice.

Change 42: Exemption of expenses payments connected with taxable cars and vans and heavy goods vehicles: widening of exemption: section 239(2)
This widens the exemption for expenses payments in connection with heavy goods vehicles so that it applies however the liability to income tax would arise.

Section 153 of ICTA provides that where, by reason of a person's employment, an expenses payment is made to him which would not otherwise be chargeable, the sums paid are to be treated as emoluments of the employment if the employee is in employment within section 167 of ICTA (higher-paid employments etc.). But section 157(3)(c) of ICTA provides that there is no charge under section 153 on expenses payments made in respect of expenses incurred in connection with a car the benefit of which is taxable under section 157. Sections 159AA(3)(c) and 159AC(3)(c) of ICTA provide similar exemptions for expenses payments made in respect of expenses incurred in connection with a van the benefit of which is taxable under section 159AA or a heavy goods vehicle the benefit of the private use of which is exempted under section 159AC.

It would also be possible for such expenses payments to give rise to a charge under section 19(1)1 of ICTA if they constituted emoluments apart from section 153, or a charge under section 148 of ICTA if they were received in connection with a change in the duties of, or emoluments from, an employment.

These exemptions have been rewritten so that no liability at all arises in respect of these expenses payments however it might otherwise arise. See section 239(2) of the Act.

This change is in principle in taxpayers' favour but is expected to have no practical effect as it is in line with current practice.

Change 43: Exemption where payments and benefits provided to the lower paid in connection with heavy goods vehicles: sections 239(8) and 269(4)(b)
This extends the exemption for payments and other benefits in connection with heavy goods vehicles so that it applies where the payments are made or benefits provided to those who are not in employment within section 167 of ICTA (higher-paid employees etc.).

Section 159AA of ICTA provides that where in any tax year, in the case of a person to whom Chapter 2 of Part 5 of ICTA applies (employees earning more than £8,500 and directors), a van is made available to the person by reason of his employment, the cash equivalent of the benefit is treated as emoluments of the employment. Section 159AC of ICTA applies where a heavy goods vehicle is made available in circumstances where, if the vehicle were a van, the benefit would be chargeable under section 159AA. So it also applies only to employees within Chapter 2 of Part 5.

Section 159AC(2)(a) exempts the benefit of the private use of the vehicle. Section 159AC(3) exempts the employee from–

- any liability in respect of the discharge of any liability of his in connection with the vehicle,

- any liability under section 141 or 142 in respect of a voucher or credit-token used to obtain things in connection with the vehicle, or

- liability in respect of payments of expenses incurred in connection with it.

These kinds of liability may arise in the case of employees who are not within Chapter 2 of Part 5, but the exemptions in section 159AC do not extend to them.

These exemptions have been rewritten so that they apply where the employees are not within Chapter 2 of Part 5, but the benefit of the use of the vehicle would be exempt if they were. See sections 239(8) and 269(4)(b) of the Act.

This change is in taxpayers' favour in principle and may in practice benefit some although the numbers and amounts are thought to be negligible.

Change 44: Exemptions: incidental overnight expenses: deductibility of expenses: section 240

This relates to the substitution of general references to deductibility for the current references to deductibility under specific provisions, for the purposes of the exemption of expenses paid and benefits provided in connection with overnight absences.

Section 200A(1) of ICTA exempts sums paid to or on behalf of employees to the extent that they are paid wholly and exclusively for meeting expenses incidental to the employee being away from home during a qualifying absence where the expenses would not be deductible under section 193, 194, 195, 198 or 332 of ICTA if they had been incurred by the employee. It is considered that all deductions which are really relevant in this context are included in this list.. The only other deduction provision which could theoretically be relevant appears to be section 50 of FA 1989 (security assets and services), which is rewritten within Part 5 at section 377. But its application

here is highly unlikely. Therefore, in rewriting section 200A(1), section 240(1)(c) simply refers to deductions under Part 5.

Section 155(1B) of ICTA provides a similar exemption for benefits provided incidentally to such absences, where the cost of the benefit would not be deductible as mentioned in section 156(8) of ICTA if they had been incurred by the employee. Section 156(8) is the provision that applies to allow a deduction from the amount of the cash equivalent charged under section 154 of ICTA where benefits are provided to an employee that are not otherwise chargeable. It refers to deductibility under section 198, 201, 201AA or 332(3) of ICTA. Although at first sight it appears that this list does not match that in section 200A(1), in view of the provisions in sections 193(7), 194(10) and 195(11) of ICTA requiring references to section 198 and deductions under it to include references to deductions under sections 193, 194 and 195, the reference to section 198 in section 155(1B) brings in those sections. Moreover, the references in section 156(8) to deductions under sections 201 and 201AA do not appear to be relevant in practice to incidental overnight stays. So, although there appear to be differences in the provisions referred to in sections 200A(1) and 155(1B), it is considered that for practical purposes the lists do match. Therefore, in rewriting section 155(1B), section 240(2)(b) also simply refers to deductions under Part 5.

This change is in principle adverse to some taxpayers but is expected to have no practical effect as it is in line with current practice.

Change 45: Exemptions: works transport services: widening of exemption: section 242(1)

This widens the exemption for the provision of a works bus or minibus service for employees so that it applies however the provision would be chargeable and not only where the charge is under the benefits code.

Section 154 of ICTA provides that where, by reason of a person's employment, a benefit to which that section applies is provided for him, the cash equivalent of the benefit is to be treated as emoluments of the employment. The provision for an employee of a works bus service is a benefit that would fall within section 154 if the employee were in employment within section 167 of ICTA (higher-paid employments etc.). But section 197AA(1) of ICTA provides that there is no charge under section 154 in respect of the provision of this benefit.

It would also be possible for the provision of this benefit to give rise to a charge under section 148 of ICTA if the benefit were received in connection with a change in the duties of, or emoluments from, an employment. The exemption in section 197AA(1) has been rewritten so that no liability at all arises in respect of the provision of this benefit to an employee, whether as an employment-related benefit within Chapter 10 of Part 3 of the Act or under Chapter 3 of Part 6 of the Act where section 148 is rewritten. See section 242(1) of the Act.

This change is in principle in taxpayers' favour but is expected to have no practical effect as it is in line with current practice.

Change 46: Exemptions: support for public bus services: widening of exemption: section 243(1)

This widens the exemption in respect of financial or other support for a public transport road service used by employees so that it applies however the provision would be chargeable and not only where the charge is under the benefits code.

Section 154 of ICTA provides that where, by reason of a person's employment, a benefit to which that section applies is provided for him, the cash equivalent of the benefit is to be treated as emoluments of the employment. The provision of financial or other support for a public transport road service used by employees is a benefit that would fall within section 154 if the employee were in employment within section 167 of ICTA (higher-paid employments etc.). But section 197AB(1) of ICTA provides that there is no charge under section 154 in respect of the provision of this benefit.

The nature of this benefit means that it is unlikely that its provision would give rise to any other charge, but in theory a charge under section 148 of ICTA might arise if the benefit were received in connection with a change in the duties of, or emoluments from, an employment. The exemption in section 197AB(1) has been rewritten so that no liability at all arises in respect of the provision of this benefit to an employee, whether as an employment-related benefit within Chapter 10 of Part 3 of the Act or under Chapter 3 of Part 6 of the Act where section 148 is rewritten. See section 243(1) of the Act.

This change is in principle in taxpayers' favour but is expected to have no practical effect as it is in line with current practice.

Change 47: Exemptions: travelling and subsistence during public transport strikes: sections 245, 266 and 267

This gives statutory effect to ESC A58 (travelling and subsistence allowance when public transport disrupted).

Where a strike or other industrial action disrupts the transport used by an employee to get to work and the employee is provided with overnight accommodation at or near the workplace or with transport to get to work, the cash equivalent of the benefit is to be treated as emoluments of the employment under section 154 of ICTA if the employment is within section 167 of ICTA (higher-paid employments etc.). If payments are made to the employee to cover the cost of the accommodation or transport, they may be emoluments or may be treated as emoluments under section 153 of ICTA (payments in respect of expenses), depending on the exact circumstances. In either case they will be taxable.

However, ESC A58 provides that in these circumstances employees will not be assessed in respect of the provision of overnight accommodation at or near an employee's permanent workplace or in respect of payments to an employee in connection with such accommodation if the expenditure is reasonable. It also exempts the provision of transport for ordinary commuting or payments to an employee in respect of expenses incurred on such transport in these circumstances if the expenditure is reasonable.

Section 245 of the Act gives statutory effect to the concession. However, section 245 extends it in two respects–

- it does not reproduce the requirement as to the reasonableness of the expenditure, and

- it covers office-holders as well as employees (see section 5(2)).

Sections 266 and 267 of the Act give statutory effect to the concession, so far as a voucher or credit-token is used.

Section 228 of the Act provides for the exemption to extend to any possible charge to income tax.

This change is in principle in taxpayers' favour but is expected to have no practical effect as it is in line with current practice.

Change 48: Exemptions: transport between work and home for disabled employees: sections 246, 247, 266 and 267

This gives statutory effect to ESC A59 (disabled persons' home to work travel), and current Inland Revenue practices in connection with the provision of home to work travel for disabled employees.

Where an employee is provided with transport for commuting, the cash equivalent of the benefit may be taxable under section 154 of ICTA (general charging provision for benefits) or under sections 157 to 159AC of ICTA (cars and other vehicles available for private use). If payments are made to the employee to cover the cost of the transport, they may be emoluments or may be treated as emoluments under section 153 of ICTA (payments in respect of expenses), depending on the exact circumstances. In either case they will be taxable.

ESC A59 provides an exemption for disabled employees. The original concession covered payments made by the Ministry of Labour to employees of what became Remploy. It benefited severely and permanently disabled people. The revised concession provides a wider exemption where a disabled person is provided with transport to and from the workplace, or to and from work training, or where contributions are made towards the cost of such journeys.

The concession does not exempt the provision of a car which is chargeable under section 157 of ICTA, or, if the vehicle is adapted so that it no longer counts as a car, under section 154 of ICTA. But in practice the provision for a disabled employee of a car or a vehicle that is so adapted is not taxed where it can be used and is used only for "ordinary commuting" or for travel between home and a place where training is provided. Although this extension of the ESC originally applied only to specially adapted cars, it has recently been extended to a car with automatic transmission, if the employee cannot use a geared car because of the disability.

Section 246 of the Act gives statutory effect to the concession and so does not apply to the provision of a car or specially adapted vehicle. Section 247 of the Act gives statutory effect to the Revenue's practice in relation to cars made available to disabled employees. Sections 266 and 267 of the Act give statutory effect to the concession, so far as a voucher or credit-token is used. The sections cover office-holders as well as employees (see section 5(2) of the Act), although the concession does not expressly do so.

This change is in principle in taxpayers' favour but is expected to have no practical effect as it is in line with current practice.

Change 49: Exemptions: transport home, late night working and failure of car-sharing arrangements: sections 248, 266 and 267

This gives statutory effect to ESC A66 (payments for employees' journeys home: late night travel and breakdown in car-sharing arrangements).

Where transport home from work is provided for an employee, the cash equivalent of the benefit usually counts as the employee's emoluments under section 154 of ICTA. If payments are made to the employee to cover the cost of the transport, depending on the exact circumstances they may be emoluments or may be treated as emoluments under section 153 of ICTA (payments in respect of expenses).

However, this Concession exempts an employee from any charge that may arise where an employee is provided with transport home in the following two situations–

- if the employee is occasionally required to work until 9pm or later, by the time he can go home public transport has ceased or it is unreasonable to expect him to use it, and the employer provides or pays for a taxi or similar private transport, or

- if the employee regularly travels to work under car-sharing arrangements with other employees, but cannot use the car on a particular occasion because of unforeseen and exceptional circumstances, and the employer pays for or provides the employee's travel home.

The concession only applies to a maximum of 60 journeys in a tax year.

Sections 248, 266 and 267 of the Act give effect to the concession. They cover office-holders as well as employees, although the concession does not expressly do so. See section 5(2).

Section 228 of the Act provides for the exemption to extend to any possible charge to income tax.

This change is in principle in taxpayers' favour but is expected to have no practical effect as it is in line with current practice.

Change 50: Exemptions: transport, travel and subsistence: definition of qualifying journey: section 249

This applies the definition of "qualifying journey" that applies for the purposes of the exemption of support for public transport bus services to other uses of that expression in exemptions relating to transport.

The definition of "qualifying journey" in section 197AB(2) of ICTA (exemption of support for public bus services), as enacted, matched the definitions in sections 197AA(3) (exemption of works bus services) and 197AC(4) (exemption of provision of cycle or cyclist's safety equipment). The journey was defined as a journey between the employee's home and workplace or between one workplace and another. But the definition in section 197AB was amended by FA 2002 so that the whole or part of such a journey is now a qualifying journey. No corresponding change was made to the definitions in sections 197AB and 197AC.

However, section 248 applies the definition of "qualifying journey" in section 197AB(2), as amended, to the whole of Chapter 3 of Part 4 of the Act. The result is that the exemptions for the provision of works bus services, cycles and cyclist's safety equipment, which are rewritten in sections 242 and 244 respectively, are extended. This is because the requirements that the bus services are provided for conveying employees on qualifying journeys and the cycle or cycle equipment is used by the employee mainly for qualifying journeys will be met where the service conveys employees for only part of the journey between the employee's home or workplace or between one workplace and another or the cycle or equipment is only used for part of such a journey.

This change is in taxpayers' favour in principle and may in practice benefit some although the numbers and amounts are thought to be negligible.

Change 51: Exemptions: work-related training: widening of exemption: section 250(1)

This widens the exemption for the provision of education and training, benefits incidental to that training and payments made in connection with it, so that it applies however the provision, benefits or payments would be chargeable.

Section 154 of ICTA provides that where, by reason of a person's employment, a benefit to which that section applies is provided for him and is not otherwise chargeable, the cash equivalent of the benefit is to be treated as emoluments of the employment. The provision for an employee of work-related training or any related benefit is a benefit that would fall within section 154 if the employee were in employment within section 167 of ICTA (higher-paid employments etc.). An employee would also be taxable under section 19(1)1 of ICTA, for example if he had contracted with a training provider to receive training and the employer paid the bill or if the employer made a payment to him or on his behalf in respect of related costs like travel expenses, as the amount paid would be an emolument.

Section 200B(2) of ICTA provides that the emoluments of an employee shall not be taken to include any amount in respect of expenditure relating to such training or the payment or reimbursement of related costs. So it exempts the employee from both of these charges. And section 148(2A)(b)(i) prevents the benefit of the training being a benefit to which the charge under section 148 of ICTA applies where the benefit is received in connection with the termination of a person's employment.

However, it might be possible for the provision of work-related training to give rise to other charges. For example, a charge might arise under section 148 of ICTA where the training was received in connection with a change in the duties of, or emoluments from, an employment. The exemption in section 200B(2) has been rewritten so that no liability at all arises in respect of the provision of this benefit to an employee or the payment or reimbursement of the related costs, however they would otherwise be chargeable. See section 250(1) of the Act.

This change is in principle in taxpayers' favour but is expected to have no practical effect as it is in line with current practice.

Change 52: Exemptions: work-related training and contributions to individual learning account training provided by third parties: sections 250(1) and 255(1)
This extends the exemptions for the provision of education and training and contributions to individual learning account training, benefits incidental to such training and payments and reimbursements of their costs, so that the exemptions apply where the relevant expenditure is not by the employer, whether or not a benefit is provided.

Section 200B of ICTA provides that the emoluments of an employee shall not be taken to include any amount in respect of expenditure by a person's employer in respect of the provision of work-related training or the payment or reimbursement of related costs. Section 200D of ICTA deals with the case where expenditure in incurred by someone other than the employer. The wording of section 200D requires that (apart from the exemption) an amount would be included in the employee's emoluments in respect of the benefit of the training or a benefit provided in connection with the training, whereas section 200B(2) exempts amounts that would

otherwise be included in the employee's emoluments in respect of the employer's expenditure, as well as amounts in respect of benefits.

In rewriting the exemptions given by sections 200B(2) and 200D in section 250, they have been amalgamated. The rewritten provision exempts both the provision of the training or related benefits and anything on which the employee would otherwise be chargeable by virtue of a relevant payment or reimbursement, without identifying the source of the benefit, payment or reimbursement. It therefore extends the exemption in cases where the source is not the employer or former employer.

Similarly, section 200E of ICTA provides that the emoluments of an employee shall not be taken to include any amount in respect of expenditure by a person's employer or former employer in respect of the provision of individual learning account training or the payment or reimbursement of related costs. In this case section 200J of ICTA deals with the situation where expenditure in incurred by someone other than the employer. The wording of section 200J requires that (apart from the exemption) an amount would be included in the employee's emoluments in respect of the benefit of the training or a benefit provided in connection with the training, whereas section 200E(2) exempts amounts that would otherwise be included in the employee's emoluments in respect of the employer's expenditure, as well as amounts in respect of benefits.

Again, in rewriting the exemptions given by sections 200E(2) and 200J, section 255 amalgamates them. The rewritten provision exempts both the provision of the training or related benefits and anything on which the employee would otherwise be chargeable by virtue of relevant expenditure, without identifying the source of the benefit or expenditure. It therefore extends the exemption in cases where the source is not the employer or former employer.

This change is in principle in taxpayers' favour but is expected to have no practical effect as it is in line with current practice.

Change 53: Exemptions: work-related training and individual learning account training: incidental expenses: sections 250(2)(a) and 255(3)(a)
This removes the requirement that in order to be exempt the payment or reimbursement of an employee's costs that are incidental to undertaking work-related training or individual learning account training must be incurred wholly and exclusively as a result of undertaking it.

Section 200B of ICTA provides that the emoluments of an employee for whom work-related training is provided shall not be taken to include any amount in respect of expenditure in paying or reimbursing related costs. Under section 200B(4)(a) related costs include "any costs which are incidental to the employee's undertaking the training *and are incurred wholly and exclusively as a result of his doing so*".

Similarly, section 200E of ICTA provides that the emoluments of an employee for whom individual learning account training is provided shall not be taken to include any amount in respect of expenditure in paying or reimbursing related costs. Under section 200E(3)(a) related costs include "any costs which are incidental to the employee's undertaking the education or training *and are incurred wholly and exclusively as a result of his doing so*".

The provisions which rewrite sections 200B(4)(a) and 200E(3)(a) do not rewrite the italicised words. See sections 250(2)(a) and 255(3)(a) of the Act.

This change is in principle in taxpayers' favour but is expected to have no practical effect as it is in line with current practice.

Change 54: Exemptions: work-related training and individual learning account training: travelling and subsistence expenses: sections 252(3) and 257(3)
This relates to the substitution of general references to deductibility for the current references to deductibility under section 198 of ICTA, for the purposes of the exemption of travelling or subsistence expenses in connection with work-related training or individual learning account training.

Section 200B(2) of ICTA provides that the emoluments of an employee shall not be taken to include any amount in respect of expenditure on providing such training, including expenditure on paying or reimbursing related costs. Travel and subsistence costs are included if they are incidental to the employee undertaking the training. But under section 200C(2) of ICTA travelling expenses and subsistence expenses are only within this exemption to the extent that–

- mileage allowance relief would be available for them under section 197AF of ICTA if no mileage allowance payments had been made (see section 197AD of ICTA), or

- the expenses would be deductible under section 198 of ICTA.

Similar conditions apply under section 200F(2) of ICTA in respect of the exemption under section 200E of ICTA in relation to travelling and subsistence expenses incurred incidentally to the provision of individual learning account training.

In rewriting the references in sections 200C(2)(b) and 200F(2)(b) to deductibility under section 198 of ICTA, the Act refers instead to deductibility under any of the provisions in Part 5 of the Act. See sections 252(3) and 257(3). The result is that deductibility under a wider range of provisions will count for this purpose. But the reference to section 198 already imports deductions under all the provisions under which travelling and subsistence expenses are deductible as such, because sections 193 to 195 of ICTA (foreign travel expenses) operate through section 198 or are included in references to it by virtue of sections 193(7), 194(10) and 195(11). The

only other deduction provision which could be relevant appears to be section 50 of FA 1989 (security assets and services) which is rewritten within Part 5 at section 377. But its application here is highly unlikely.

This change is in taxpayers' favour in principle and may in practice benefit some although the numbers and amounts are thought to be negligible.

Change 55: Exemptions: contributions to individual learning account training: widening of exemption: section 255(1)
This widens the exemption for the provision of individual learning account training, benefits incidental to that training and payments made in connection with it, so that it applies however the provision, benefits or payments would be chargeable and not only where the charge is in respect of earnings.

Section 154 of ICTA provides that where, by reason of a person's employment, a benefit to which that section applies is provided for him, the cash equivalent of the benefit is to be treated as emoluments of the employment. The provision for an employee of individual learning account training or any related benefit is a benefit that would fall within section 154 if the employee were in employment within section 167 of ICTA (higher-paid employments etc.). An employee might also be taxable under section 19(1)1 of ICTA, for example if the employer made a payment to him or on his behalf in respect of related costs like travel expenses, as the amount paid would be an emolument.

Section 200E(2) of ICTA provides that the emoluments of an employee shall not be taken to include any amount in respect of expenditure in respect of individual learning account training or the payment or reimbursement of related costs. So it exempts the employee from both of these charges. And section 148(2A)(b)(i) prevents the benefit of the education or training being a benefit to which the charge under section 148 of ICTA applies where the benefit is received in connection with the termination of a person's employment.

However, it might be possible for the funding of individual learning account training to give rise to other charges. For example, a charge might arise under section 148 of ICTA where the training was received in connection with a change in the duties of, or emoluments from, an employment. The exemption in section 200E(2) has been rewritten so that no liability at all arises in respect of the provision of this benefit to an employee, or the payment or reimbursement of the related costs, however they would otherwise be chargeable. See section 255(1) of the Act.

This change is in principle in taxpayers' favour but is expected to have no practical effect as it is in line with current practice.

Change 56: Exemptions: annual parties and functions: sections 264, 266 and 716(2)(c)
This gives statutory effect to ESC A70B (staff Christmas parties and similar annual functions).

Section 154 of ICTA provides that where, by reason of a person's employment, a benefit to which that section applies is provided for him or members of his family or household, the cash equivalent of the benefit is to be treated as emoluments of the employment. The provision of a party for employees or their families or households is a benefit that would fall within section 154 if the employees were in employment within section 167 of ICTA (higher-paid employments etc.).

However, ESC A70B exempts the provision of this benefit if the function is open to staff generally and the cost per head to the employer does not exceed £75 per head in a tax year or, where there is more than one function provided, £75 per head in aggregate in a tax year. Where more than one function is provided and the £75 limit is exceeded, the concession covers so many functions as together fall within the limit, and the rest are outside the exemption.

Sections 264 and 266 of the Act give effect to the concession. However, they cover office-holders as well as employees, although the concession does not expressly do so. See section 5(2).

Section 228 of the Act provides for the exemption to extend to any possible charge to income tax.

Section 716(2)(c) of the Act also provides that the limits in section 264(2) and (3) may be increased by an order made by the Treasury.

This change is in principle in taxpayers' favour but is expected to have no practical effect as it is in line with current practice.

Change 57: Exemptions: third party entertainment: widening of exemption: section 265(1)
This widens the exemption in respect of the provision of entertainment for an employee or his family or household so that it applies however the provision would be chargeable and not only where the charge is under the benefits code.

Section 154 of ICTA provides that where, by reason of a person's employment, a benefit to which that section applies is provided for him or a member of his family or household, the cash equivalent of the benefit is to be treated as emoluments of the employment. The provision of entertainment is a benefit that would fall within section 154 if the employee were in employment within section 167 of ICTA (higher-paid employments etc.). But section 155(7) of ICTA provides that section 154 does not apply in respect of the provision of this benefit if certain conditions are met.

As one of those conditions is that neither the employer nor a person connected with the employer has procured the provision of the benefit, it is unlikely that the provision of this benefit would give rise to any other charge, but in theory a charge under section 148 of ICTA might arise if the benefit were received in connection with the termination of a person's employment or a change in the duties of, or emoluments from, an employment. Section 154(7) has been rewritten so that no liability at all arises in respect of the provision of this benefit to an employee, whether as an employment-related benefit within Chapter 10 of Part 3 of the Act (which rewrites section 154) or under Chapter 3 of Part 6 of the Act (which rewrites section 148 and Schedule 11). See section 265(1) of the Act.

This change is in principle in taxpayers' favour but is expected to have no practical effect as it is in line with current practice.

Change 58: Exemptions: non-cash vouchers for free or subsidised meals: section 266

This gives statutory effect to ESC A74 (meals for employees) so far as it applies to the provision of non-cash vouchers for meals.

Section 141 of ICTA provides that where, by reason of a person's employment, a non-cash voucher is provided for him, then the employee is treated as having received as an emolument from the employment an amount equal to the expense incurred by the person providing the voucher and the money, goods or services for which it is capable of being exchanged. The provision of a non-cash voucher for free or subsidised meals for an employee would usually fall within section 141. But ESC A74 (meals provided for employees) provides that income tax is not charged on the benefit where free or subsidised meals are provided on the employer's business premises if all the employer's employees are able to obtain such meals or have vouchers or tokens enabling them to obtain such meals.

Section 266 of the Act gives effect to the concession, so far as it relates to non-cash vouchers. See section 266(3)(e). (So far as the concession relates to the direct provision of meals, it is given statutory effect by section 317. See *Change 77*.) However, it covers office-holders as well as employees, although the concession does not expressly do so. See section 5(2).

This change is in principle in taxpayers' favour but is expected to have no practical effect as it is in line with current practice.

Change 59: Exemptions: small gifts from third parties: sections 270, 324 and 716(2)(g)

This gives statutory effect to ESC A70A (small gifts to employees by third parties).

Under section 154 of ICTA benefits provided for an employee or for a member of his family or household by reason of his employment, if not otherwise chargeable, are to be treated as emoluments of the employment. This applies whether the provision is made by the employer or a third party. Therefore where a gift is provided by a third party it will usually fall into section 154, although it might amount to an emolument that was chargeable under section 19(1)1 of ICTA, and so be chargeable without section 154 applying. Similarly, if the gift is a voucher or a token, it may be amount to an emolument or may be chargeable by virtue of section 141 or section 142 of ICTA. Again these provisions apply equally where the provider is a third party, rather than the employer.

However, ESC A70A provides that tax will not be charged on gifts by third parties where certain conditions are met. Most importantly, the gift must be goods or a voucher or token, the donor must not be or be connected with the employer and the employer must not have procured it, and the total cost to the donor of gifts to the same employee in the tax year must not exceed £150.

Section 270 of the Act gives statutory effect to the concession in so far as it relates to vouchers and tokens, and section 324 of the Act gives statutory effect to the concession in so far as it relates to gifts of goods. Because the overall limit of £150 relates to all gifts, whether goods, vouchers or tokens, these sections have to refer to each other. In fact, to avoid repetition, the conditions which are common to gifts of all kinds, including the condition about the total cost to the donor, are set out in section 324 and referred to in section 270.

Section 228 of the Act provides for the exemption to extend to any possible charge to income tax.

Section 716(2)(g) of the Act also provides that the limit in section 324(6) may be increased by an order made by the Treasury.

This change is in principle in taxpayers' favour but is expected to have no practical effect as it is in line with current practice.

Change 60: Exemption of removal benefits and expenses: vouchers and credit-tokens: sections 272 and 287

This extends the exemption for removal benefits to include the provision of a voucher or credit-token that is used to obtain something, the direct provision of which would itself be within the exemption, and adjusts the limit on the exemption to take into account amounts so exempted.

Paragraph 1 of Schedule 11A to ICTA provides for an exemption where eligible removal expenses are paid or reimbursed or qualifying removal benefits are provided in connection with a change of residence by an employee as a result of certain changes affecting employment. The benefits that are qualifying benefits are listed in

Part 3 of the Schedule and the expenses that are eligible expenses are listed in Part 4 of the Schedule. But the lists do not clearly cover the provision of the benefits or the payment of the expenses using a voucher or token.

Section 272(2) of the Act specifically includes as a qualifying removal benefit the provision of a voucher or credit-token that is used to obtain a benefit that is itself such a benefit or to obtain money that is used for that purpose.

As a consequence a further change has been made in rewriting paragraph 24 of Schedule 11A. That limits the exemption by providing that it only applies to the extent that the total value to the employee in respect of any particular change of residence does not exceed £8,000. Paragraph 24(2) defines "the total value to the employee" as the total of–

- the aggregate of the amounts paid to or on behalf of the employee in respect of qualifying removal expenses, and

- the aggregate of any amounts represented by qualifying removal benefits provided in connection with the change.

Under paragraph 24(3) "the amount represented by a benefit" is the amount that would be the cash equivalent of the benefit under Chapter 2 of Part 5 of ICTA if the benefit were chargeable under the appropriate provision of that Chapter. Paragraph 24(3) does not take account of the possibility that items might have been funded by the use of vouchers or credit-tokens, where the charge would be under section 141, 142 or 143 of ICTA (which are part of Chapter 1 of Part 5, not Chapter 2).

As a result of the inclusion of vouchers and tokens in section 272(2), the value to the employee of the exemption has increased, and accordingly the rewritten paragraph 24 includes any amounts exempted in respect of vouchers and tokens in the calculation of the value of the exemption. They will fall within "the benefits code earnings" mentioned in section 287(2)(b) of the Act.

This change is in taxpayers' favour in principle and may in practice benefit some although the numbers and amounts are thought to be negligible.

Change 61: Exemption of removal benefits: benefits and expenses relating to loans on disposal of residences: sections 279(5) and 284(2)(b)
This widens the exemptions for benefits and expenses relating to the disposal of a residence so that loan benefits and expenses are included where the whole loan does not meet either of the applicable conditions, but each part meets one of them.

Paragraph 1 of Schedule 11A to ICTA exempts–

- sums paid to, or on behalf of, an employee in respect of qualifying removal expenses, and

- qualifying removal benefits provided for an employee or a member of the employee's family of household.

"Qualifying removal expenses" are defined in paragraph 3 of the Schedule as eligible removal expenses that meet specified conditions. Paragraph 7 lists the kinds of expenses that may be eligible expenses. They include expenses of disposal of a residence and bridging loan expenses. Under paragraph 8(2)(b) the expenses of redeeming a loan relating to a residence for the purpose of its disposal are expenses of disposal of a residence. Paragraph 8(4) provides that a loan relates to a residence "if the loan was raised to obtain an interest in the residence, or an interest in the residence forms security for the loan, or both".

This test has been rewritten in section 279(5) so that a loan satisfies it if part of the loan was raised to obtain an interest in the residence and the rest of the loan is secured on an interest in the residence.

"Qualifying removal benefits" are defined in paragraph 4 of the Schedule as eligible removal benefits that meet specified conditions. Paragraph 16 lists the kinds of benefits that may be eligible benefits. They include benefits in respect of the disposal of a residence. Under paragraph 17(2)(b) the waiving of a penalty for redeeming "any loan relating to residence" for the purpose of its disposal is included. Paragraph 17(3) applies paragraph 8(4) for the interpretation of that phrase, and so the same point arises as is described above.

Section 279 describes disposal benefits as well as disposal expenses and so 279(5) applies for both purposes.

"Bridging loan expenses" are defined in paragraph 13 of the Schedule. Such expenses consist of interest in respect of a loan which is either used for redeeming a loan relating to the employee's former residence or acquiring an interest in a new residence. Under paragraph 13(5) the test for whether the loan relates to the former residence is the same as in paragraph 8(4). This test has been rewritten in section 284(2)(b) in the same way as the test in paragraph 8(4) has been rewritten in section 279(5).

This change is in principle in taxpayers' favour but is expected to have no practical effect as it is in line with current practice.

Change 62: Exemption of removal benefits: travelling and subsistence costs of relevant children where employee in temporary accommodation: section 281
This widens the exemptions for expenses and benefits relating to travelling and subsistence of relevant children making journeys to or from temporary accommodation of an employee moving residence.

Paragraph 1 of Schedule 11A to ICTA exempts–

- sums paid to, or on behalf of, an employee in respect of qualifying removal expenses, and

- qualifying removal benefits provided for an employee or a member of the employee's family of household.

"Qualifying removal expenses" are defined in paragraph 3 of the Schedule as eligible removal expenses that meet specified conditions. Paragraph 7 lists the kinds of expenses that may be eligible expenses. They include travelling and subsistence expenses. Similarly, "qualifying removal benefits" are defined in paragraph 4 of the Schedule as eligible removal benefits that meet specified conditions. Paragraph 16 lists the kinds of benefits that may be eligible benefits. They include travelling and subsistence benefits.

Under paragraph 12(1)(h) and (j) subsistence expenses of a relevant child are covered where for educational reasons the child moves earlier or later than the employee, and under paragraph 12(1)(i) and (k) such a child's travelling expenses are covered where he travels–

- between accommodation in the old area and the employee's new residence, or

- between living accommodation in the new area and the employee's former residence.

In the same way the benefit of the provision of travelling and subsistence is covered under paragraph 21(1)(h) to (k).

Although paragraphs 12(1)(e) and (f) and 21(1)(e) and (f) contemplate the employee staying in temporary accommodation in the old or new area, subsistence expenses of a relevant child who for educational reasons lives apart from the employee in those circumstances and his travelling to visit the employee in that accommodation are not covered.

Section 281, which rewrites both paragraphs 12 and 21, fills this lacuna: see section 281(1)(f) and (g), (2) and (3).

This change is in taxpayers' favour in principle and may in practice benefit some although the numbers and amounts are thought to be negligible.

Change 63: Exemption of removal benefits: exclusion where car and van benefits otherwise taxable: section 283

This restricts the exception from the exemption for car or van facilities provided in connection with house moves where the car or van is available for other private use by the employee, so that the exception only applies if it is so available in the tax year in which the car or van is provided in connection with a house move.

Paragraph 1 of Schedule 11A to ICTA exempts qualifying removal benefits provided for an employee or a member of the employee's family of household. "Qualifying removal benefits" are defined in paragraph 4 of the Schedule as eligible removal benefits that meet specified conditions. Paragraph 16 lists the kinds of benefits that may be eligible benefits. They include the travelling benefits for the employee and his family and household described in paragraph 21(1), which brings in a number of cases where the employee or his family or household need to travel between areas because of two or more residences or other accommodation being used by them. But under paragraph 21(2) the provision of a car or van is excluded from the exemption if it is also available "at any relevant time" to the employee or members of his family or household and is so available by reason of the employment and without any transfer of property. (If it is so available, it will usually be taxable under section 157 or 159AA of ICTA.) Paragraph 21(6) provides that a relevant time is any time falling on or before the relevant day (that is, the last day of the tax year following the one in which the employment change in question occurs: see paragraph 6 of Schedule 11A). The exemption is not available for anything provided after that time (see paragraph 4(3)).

Section 283 rewrites the restriction in paragraph 21(2). Instead of applying the restriction by reference to "any relevant time", it refers instead to the car or van being available "in the tax year in which it is provided [for the house move]". Therefore the exemption will not apply to the benefit of having a car or van made available if it is available for other private use in the same tax year and so taxable under section 157 or 159AA, apart from the move. But under section 283 the availability of the car or van for private use in earlier tax years than that in which the car or van is provided for the move is disregarded, whereas under the current provisions the fact that a car supplied for a move happens to be one that was the employee's company car in a previous tax year would prevent the exemption from applying. Similarly, where a vehicle is provided in connection with a move in the same tax year as that in which the employment change occurs, the fact that the same vehicle happens to be provided for ordinary private use, unconnected with the move, in the next tax year will be irrelevant for the exemption, whereas under the current provisions it would prevent the exemption from applying.

This change is in principle in taxpayers' favour but is expected to have no practical effect as it is in line with current practice.

Change 64: Exemption of removal benefits: bridging loan expenses: interest partially exempt: section 284(4) and (5)
This provides a method for determining the amount of loan interest within the exemption for bridging loan expenses where two requirements relating to the interest are each only partly met.

Paragraph 1 of Schedule 11A to ICTA exempts sums paid to, or on behalf of, an employee in respect of qualifying removal expenses. "Qualifying removal expenses" are defined in paragraph 3 of the Schedule as eligible removal expenses that meet specified conditions. Paragraph 7 lists the kinds of expenses that may be eligible expenses. They include bridging loan expenses. Under paragraph 13(3) where the interest on a bridging loan exceeds the market value of the employee's old residence at the time when the new residence is acquired, the excess is not exempt. Under paragraph 13(4) interest on so much of a loan as is not used for one of the purposes specified there is not exempt. The legislation does not state how to determine how much interest is and is not exempt where both paragraph 13(3) and (4) apply.

Paragraph 13(3) and (4) are rewritten in section 284(2) and (3). Section 284(4) and (5) contain a description of the method to be used to work out the amount of the interest that is exempt.

This change is in principle in taxpayers' favour but is expected to have no practical effect as it is in line with current practice.

Change 65: Exemption of removal benefits: replacement of domestic goods: deduction of sale proceeds: section 285
This removes the requirement that where expenses in respect of the replacement of domestic goods are exempt and the replaced goods are sold, the sale proceeds must be deducted from the amount that would otherwise be exempt.

Paragraph 1 of Schedule 11A to ICTA exempts sums paid to, or on behalf of, an employee in respect of qualifying removal expenses and the provision of any qualifying removal benefit.

"Qualifying removal expenses" are defined in paragraph 3 of the Schedule as eligible removal expenses that meet specified conditions. Paragraph 7 lists the kinds of expenses that may be eligible expenses. They include duplicate expenses. "Duplicate expenses" are defined in paragraph 14 of the Schedule. They include expenses incurred on the purchase of domestic goods intended to replace goods used at the employee's former residence, but not suitable for the new one. Under paragraph 14(2) and (3) of the Schedule where the replaced goods are sold, an amount equal to the proceeds of their sale is to be deducted from the amount of the expenses that would otherwise be the amount exempted as duplicate expenses.

A parallel exemption applies for the benefit of the provision of domestic goods for such replacement. (See paragraphs 4, 16(f) and 22(1)(e) of Schedule 11A.) But there is no equivalent of paragraph 14(2) and (3) that applies where the exemption for the provision of domestic goods for such replacement applies under paragraph 22.

Section 285 rewrites the exemptions in both paragraph 14(1) and 22(1), but the requirement for the deduction of an amount equal to the sale proceeds of any replaced goods that have been sold has not been rewritten.

This change is in taxpayers' favour in principle and may in practice benefit some although the numbers and amounts are thought to be negligible.

Change 66: Exemption of removal benefits and expenses: limit on exemption: section 287

This changes the way in which the limit on the amount of the exemption for removal benefits and expenses is expressed so as to prevent the double counting of amounts where there is a charge on emoluments apart from the benefits code, as well as a benefit that could have a cash equivalent under it.

Schedule 11A to ICTA provides for an exemption where certain expenses are paid or reimbursed or certain benefits are provided in connection with a change of residence by an employee as a result of certain changes affecting employment. Paragraph 24 of the Schedule limits the exemption by providing that the exemption only applies to the extent that the total value of the exemption to the employee in respect of any particular change of residence does not exceed £8,000. Paragraph 24(2) defines "the total value to the employee" as the total of–

- the aggregate of the amounts paid to or on behalf of the employee in respect of qualifying removal expenses, and

- the aggregate of any amounts represented by qualifying removal benefits provided in connection with the change.

Under paragraph 24(3) "the amount represented by a benefit" is the amount that would be the cash equivalent of the benefit under Chapter 2 of Part 5 of ICTA if the benefit were chargeable under the appropriate provision of that Chapter. Chapter 2 of Part 5 of ICTA relates to the charging of benefits where employees earn at least £8,500. The principal provision is section 154, under which, where the cost of providing an employment benefit is not otherwise chargeable, an amount equal to the cash equivalent of the benefit is to be treated as emoluments of the employment.

Where an employer incurs expense providing an employee with a benefit in respect of which there is a money's worth charge, it is the Inland Revenue's practice only to charge any excess amount under section 154, and this is reflected in section 64(2). (See *Change 15*.) Paragraph 24(2) may involve double counting in such a case where

what is provided is a removal benefit, since both the expense incurred by the employer and the cash equivalent have to be included in the total value to the employee.

Section 287(2)(b) and (4) of the Act prevents such double counting by referring to the amount that would be chargeable under the benefits code if the exemption did not apply, so taking into account the deduction that is made under section 64(2)(b) to prevent double charging.

This change is in taxpayers' favour in principle and may in practice benefit some although the numbers and amounts are thought to be negligible.

Change 67: Exemptions: daily subsistence allowances paid to experts seconded to the European Commission: section 304
This gives statutory effect to ESC A84 (allowances paid to detached national experts).

Where an allowance is paid to an employee to cover subsistence expenses, depending on the exact circumstances it may be an emolument or may be treated as an emolument under section 153 of ICTA (payments in respect of expenses). In either case it will be taxable.

However, ESC A84 provides that income tax will not be charged on daily subsistence allowances paid by the European Commission to detached national experts seconded to the Commission. Such secondments are effected under a scheme introduced on 26th July 1988 which provides for secondments for periods of between 3 months and three years.

Section 304 of the Act gives statutory effect to the concession. It is drafted by reference to "the detached national experts scheme" and that is defined as the 1988 scheme as it has effect for the time being or any scheme having effect for the time being which replaces that scheme. The section covers office-holders as well as employees. See section 5(2).

Section 228 of the Act provides for the exemption to extend to any possible charge to income tax.

This change is in principle in taxpayers' favour but is expected to have no practical effect as it is in line with current practice.

Change 68: Exemptions: offshore oil and gas workers: mainland transfers: section 305
This gives statutory effect to ESC A65 (workers on offshore oil and gas rigs or platforms: free transfers from or to mainland).

Where an employer pays the cost of, or provides transport for, the employee to get to or from work, the cash equivalent of the benefit is to be treated as emoluments of the employment under section 154 of ICTA if the employment is within section 167 of ICTA (higher-paid employments etc.). The situation is the same if accommodation is provided before the journey because the timing of the transport makes it necessary. If payments are made to the employee to cover the cost of the transport or accommodation, they may be emoluments or may be treated as emoluments under section 153 of ICTA (payments in respect of expenses), depending on the exact circumstances. In either case they will be taxable. No deduction is allowable under section 156(8) for the expenses of the employee's journey from home to his normal place of work.

However, ESC A65 provides that income tax will not be charged where, as is usual, workers on offshore oil and gas rigs or platforms are transferred between the mainland and the rig, or supplied with accommodation because of the timing of the transfer, or paid or reimbursed reasonable accommodation costs.

Section 305 of the Act gives statutory effect to the concession. It imposes two conditions for the availability of the exemption–

- that the place of arrival or departure on the mainland is one from which transport to the offshore installation is provided for employees generally. (This reflects how the concession is operated in practice.)

- that the cost of the transport would not be deductible if paid by the employee. (This reflects the rationale of the concession, since the exemption would be unnecessary if a deduction for the amount were available.)

The section covers office-holders as well as employees, although the concession does not expressly do so. See section 5(2).

Section 228 of the Act provides for the exemption to extend to any possible charge to income tax.

This change is in principle in taxpayers' favour but is expected to have no practical effect as it is in line with current practice.

Change 69: Exemptions: miners' and former miners' coal and allowances in lieu of coal: sections 306 and 646

This gives statutory effect to ESC A6 (miners: free coal and allowances in lieu), and to current Inland Revenue practice in connection with the provision of fuel and payments in lieu to miners and retired miners and their widows and widowers.

If an employee is provided with free coal by his employer, the cash equivalent of the benefit is to be treated as emoluments of the employment under section 154 of ICTA

(general charging provision for benefits) if the person's employment is within section 167 of ICTA (higher-paid employments etc.). If payments are made to him in lieu of the coal, they will count as emoluments and be taxable as such.

If a former employee is provided with free coal by his former employer, or with a payment in lieu of coal, the provision of the coal or the payment would be taxed as a pension. The widow or widower of such a person would also be taxed in the same way if provided with coal or a payment in lieu.

ESC A6 provides an exemption for free coal given to miners and for payments made to them in lieu of such coal. It is current Inland Revenue practice to extend this concession in the following ways.

- It is extended to other colliery workers apart from miners.
- It is extended to smokeless fuel if the recipient lives in an area where there is a smoke control order in force.
- It is extended to former miners and colliery workers, and their widows and widowers.

Sections 306 and 646 of the Act give statutory effect to the concession and to the extensions mentioned above. Section 306 relates to current employees and section 646 to former employees and their widows and widowers. The exemptions in both sections are subject to the condition that the amount of fuel provided, or in lieu of which the payment is made, does not substantially exceed the amount reasonably required for personal use. But that condition is assumed to be met unless the contrary is shown.

Section 228 of the Act provides for the exemption in section 306 to extend to any possible charge to income tax.

This change is in principle in taxpayers' favour but is expected to have no practical effect as it is in line with current practice.

Change 70: Exemptions: death or retirement benefits provision: section 307
This gives statutory effect to ESC A72 (pension schemes and accident insurance policies).

Under section 154 of ICTA benefits provided for an employee *or for a member of his family or household* by reason of his employment, if they are not otherwise chargeable, are to be treated as emoluments of the employment. Section 155(4) of ICTA provides that section 154 does not apply to the provision for an employee *or the spouse, children or dependants of the employee* of any pension, annuity, lump sum or gratuity to be given on the employee's death or retirement. The expression "member

of an employee's family or household" is defined in section 168(4) of ICTA so as to cover a wider range of persons than spouse, children and dependants. For example, the employee's parents and his children's spouses are included. So the exception in section 155(4) does not cover the cases where provision is made for pensions etc. to be given on the employee's death or retirement to beneficiaries who fall within the more widely-defined expression in section 154.

However, ESC A72 widens the exception by providing that tax will not be charged by virtue of section 154 when the provision involves such beneficiaries.

Section 307 of the Act gives statutory effect to the concession by rewriting section 155(4), using the expression "member of the employee's family or household". The definitions in section 721(4) and (5) of the Act which reflect section 168(5) then apply.

The section covers office-holders as well as employees, although the concession does not expressly do so. See section 5(2).

This change is in principle in taxpayers' favour but is expected to have no practical effect as it is in line with current practice.

Change 71: Exemptions: counselling and other outplacement services and retraining courses: sections 310 and 311 and paragraphs 67 and 69 of Schedule 6
This relaxes the requirements in sections 589(2)(b) and 589B(2)(c) of ICTA that the employee or ex-employee for whom retraining or counselling services are provided must have been employed by the employer for two years in the employment that is ceasing for those benefits to be exempt from tax, and is reflected in the consequential amendment relating to the corresponding deductions for employer's expenses.

(A) Section 588 of ICTA provides that an employee or former employee is not to be regarded as receiving any emolument that forms part of his income for the purposes of Schedule E where the employer or former employer pays or reimburses relevant expenses in connection with a "qualifying course of training". The requirements for a qualifying course of training are set out in section 589(1) and (2). Section 589(2)(b) requires that the employee is employed by the employer full-time throughout the period of 2 years ending with the time he begins to undertake the course or, if earlier, the time he ceases to be employed by the employer.

The exemption given by section 588 is rewritten in section 311. Section 311(4)(c) rewrites section 589(2)(b) so that the employment does not need to have been with the same employer throughout that period of two years. This change is also reflected in the amendment of section 588 in paragraph 67 of Schedule 6, as it applies as respects the deduction of expenses incurred by the employer.

(B) Section 589A(4) of ICTA provides no charge to tax under Schedule E is to arise in respect of the provision of "qualifying counselling services" to an employee or former employee or the payment or reimbursement of fees or travelling expenses in connection with such services. The requirements for qualifying counselling services are set out in section 589B(2). Section 589B(2)(c) requires that the employee is employed by the employer full-time throughout the period of 2 years ending with the time the services are provided or, if earlier, the time he ceases to be employed by the employer.

The exemption given by section 589A is rewritten in section 310. Section 310(4) rewrites section 589B(2)(c), so that the employment does not need to have been with the same employer throughout that period of two years. This change is also reflected in the amendment of section 589A in paragraph 69 of Schedule 6, as it applies as respects the deduction of expenses incurred by the employer.

This change is in principle in taxpayers' favour but is expected to have no practical effect as it is in line with current practice.

Change 72: Exemptions: counselling and other outplacement services and retraining courses: sections 310 and 311 and paragraphs 67 and 69 of Schedule 6
This removes the requirements in sections 589(1)(d) and 589B(2)(e) of ICTA that retraining courses and counselling services for employees and ex-employees must take place in the United Kingdom for their provision and the payment or reimbursement of connected expenses to be exempt from tax, and is reflected in the consequential amendment relating to the corresponding deductions for employer's expenses.

(A) Section 588 of ICTA provides that an employee or former employee is not to be regarded as receiving any emolument that forms part of his income for the purposes of Schedule E where the employer or former employer pays or reimburses relevant expenses in connection with a "qualifying course of training". The requirements for a qualifying course of training are set out in section 589(1) and (2). Section 589(1)(d) requires that all teaching and practical application forming part of the course must take place in the United Kingdom.

The exemption given by section 588 is rewritten in section 311. Section 311(3) sets out "the course conditions", omitting the requirement in section 589(1)(d), so that the payment and reimbursement of course expenses may be exempt wherever the course is held. This change is also reflected in the amendment of section 588 in paragraph 67 of Schedule 6, as it applies as respects the deduction of expenses incurred by the employer.

(B) Section 589A(4) of ICTA provides that no charge to tax under Schedule E is to arise in respect of the provision of "qualifying counselling services" to an employee or former employee or the payment or reimbursement of fees or travelling expenses in

connection with such services. The requirements for qualifying counselling services are set out in section 589B(2). Section 589B(2)(e) requires that the services must be provided in the United Kingdom and section 589B(3) provides that, if services are provided partly in and partly outside the United Kingdom, the extent to which the services are provided in the United Kingdom is to be decided on a just and reasonable basis.

The exemption given by section 589A is rewritten in section 310. The requirement for the counselling services to be provided in the United Kingdom has not been rewritten, and so the provision for the extent to which the services are so provided to be decided on a just and reasonable basis has also been omitted. Therefore the provision of such services and the payment and reimbursement of fees and connected travelling expenses may be exempt wherever the services are provided. This change is also reflected in the amendment of section 589A in paragraph 69 of Schedule 6, as it applies as respects the deduction of expenses incurred by the employer.

This change is in principle in taxpayers' favour but is expected to have no practical effect as it is in line with current practice.

Change 73: Exemptions: counselling and other outplacement services and retraining courses: deductibility of travel expenses: sections 310 and 311
This relates to the substitution of general references to deductibility for the current references to deductibility under specific provisions, for the purposes of the exemption of travelling expenses paid in connection with retraining courses and counselling services.

Section 589 of ICTA exempts travelling expenses for people whose employment has ceased or is expected to cease and who are provided with retraining courses. The expenses must be expenses that would be deductible under section 198 of ICTA if attending the course were an employment duty (see section 589(5)(d) to (6A)). A similar condition applies under section 589B(4) and (4A) to the exemption given by section 589A for the travelling expenses of those to whom counselling services are provided in connection with the termination of employment. (For tax year 2002-03 onwards these provisions have been amended so that the expenses are allowable also if mileage allowance relief would be available if no mileage allowance payments had been made in respect of the expenses.)

In rewriting these references to deductibility under section 198 of ICTA, the Act refers instead to deductibility under any of the provisions in Part 5 of the Act. See sections 310(6)(b) and 311(5)(b). The result is that deductibility under a wider range of provisions will count for this purpose. But the reference to section 198 already imports deductions under all the provisions under which travelling expenses are deductible as such, because sections 193 to 195 of ICTA (foreign travel expenses) operate through section 198 or are included in references to it by virtue of sections 193(7), 194(10) and 195(11). The only other deduction provision which could be

relevant appears to be section 50 of FA 1989 (security assets and services) which is rewritten within Part 5 at section 377. But its application here is highly unlikely.

This change is in taxpayers' favour in principle and may in practice benefit some although the numbers and amounts are thought to be negligible.

Change 74: Exemptions: retraining courses: undertaking courses with a view to retraining: section 311 and paragraph 67 of Schedule 6
This removes the requirement in section 588(1)(b) of ICTA that, for the payment or reimbursement of retraining course expenses to be exempt from tax, the course must be undertaken with a view to retraining the employee, and is reflected in the consequential amendment relating to the corresponding deduction for employer's expenses.

Section 588(1) of ICTA provides that an employee or former employee is not to be regarded as receiving any emolument that forms part of his income for the purposes of Schedule E where the employer or former employer pays or reimburses relevant expenses in connection with a qualifying course of training and the course "is undertaken with a view to retraining the employee". Under section 589(3) and (4) several further conditions are set out which must be met before the course can be regarded as undertaken with a view to retraining the employee. But in practice, so long as those further conditions are met, the Inland Revenue do not otherwise inquire about the motive for undertaking the training.

The exemption given by section 588 is rewritten in section 311. The requirement in section 588(1)(b) that the course be undertaken with a view to retraining the employee has been omitted. This change is also reflected in the amendment of section 588 in paragraph 67 of Schedule 6, as it applies as respects the deduction of expenses incurred by the employer.

This change is in principle in taxpayers' favour but is expected to have no practical effect as it is in line with current practice.

Change 75: Exemptions: living accommodation: exemption where rates etc. discharged for employee: section 314
This updates the reference to "rates" in the current exemption for payments by an employer in respect of rates.

The final part of section 145(4) of ICTA applies to employees who are excepted from the charge to tax on living accommodation under section 145, for example because they need to live there in order to perform their duties properly. It provides an exemption from tax where the employer pays the "rates" on the living accommodation or reimburses the employee for paying them.

The system of rates for residential property now only exists in Northern Ireland. But the existing practice is to extend the exemption to the current equivalents in the rest of the United Kingdom, namely council tax and water and sewerage charges. This extension is reflected in section 314 of the Act.

This change is in taxpayers' favour in principle but is expected to have no practical effect as it is in line with current practice.

Change 76: Exemptions: living accommodation: limit on charge to tax on connected expenses: section 315

This extends to all employees the limit on amounts chargeable to tax in respect of certain expenditure (or the reimbursement of expenditure) in connection with living accommodation.

Section 163 of ICTA applies to employees who are excepted from the main charge to tax on living accommodation under section 145, for example because they need to live there in order to perform their duties properly. Such an employee may nevertheless be chargeable to tax in respect of expenditure (or the reimbursement of expenditure) incurred on various matters connected with the living accommodation, such as heating, lighting, repairing or furnishing it. This may be because it is to be regarded as emoluments of the employee or as a benefit that is to be treated as emoluments.

Section 163 of ICTA sets a limit on the amount chargeable to tax in respect of such expenditure (or reimbursement of expenditure). However, since section 163 only applies to employments to which Chapter 2 of Part 5 of ICTA applies, the section only applies to employees who are directors or are earning more than £8,500 per year (see section 167).

Section 315 of the Act is drafted in such a way that all employees will benefit from this limit.

This change is in taxpayers' favour in principle and may in practice benefit some although the numbers and amounts are thought to be negligible.

Change 77: Exemptions: free or subsidised meals: section 317

This widens the exemption for meals provided in a staff canteen and gives statutory effect to ESC A74 (free or subsidised meals) so far as it applies to the direct provision of meals.

Section 154 of ICTA provides that where, by reason of a person's employment, a benefit to which that section applies is provided for him, the cash equivalent of the benefit is to be treated as emoluments of the employment. The provision of free or subsidised meals for an employee is a benefit that would usually fall within section

154 if the employee were in employment within section 167 of ICTA (higher-paid employments etc.). But section 155(5) of ICTA provides that section 154 does not apply to the provision of meals in a staff canteen and ESC A74 (meals provided for employees) provides that income tax is not charged on the benefit where free or subsidised meals are provided on the employer's business premises if all the employer's employees are able to obtain such meals or have vouchers or tokens enabling them to obtain such meals, regardless of where on the premises those meals are obtained.

Although it is improbable because of the terms of section 155(5), it would also be possible for the provision of a benefit that falls within that section and so is outside the charge under section 154 still to give rise to a charge under section 148 of ICTA. This could happen if the benefit were received in connection with a change in the duties of, or emoluments from, an employment.

Section 317 of the Act gives effect to the concession and extends the effect of section155(5) and the concession in two respects–

- it covers cases where the employer's employees are at several locations and the meals are provided to all the staff at the location where the employee in question is employed, and

- it provides that no liability to tax at all is to arise in respect of the provision of this benefit to an employee, whether by virtue of section 154 or otherwise.

Although the concession does not expressly do so, the section covers office-holders as well as employees. See section 5(2).

The concession also applies to the provision of non-cash vouchers enabling employees to obtain meals, but that part of the concession is given effect to in section 266(3) of the Act. See C*hange 58*.

This change is in principle in taxpayers' favour but is expected to have no practical effect as it is in line with current practice.

Change 78: Exemptions: suggestion awards: sections 321, 322 and 716(2)(e)
This gives statutory effect to ESC A57 (suggestion schemes).

Where a payment is made to an employee who makes a suggestion under a suggestion scheme run by the employer, it will usually form part of the employee's emoluments and so will be chargeable under Schedule E. (If the suggestion involves an invention or know-how devised by the employee, there may be income tax liability under Schedule D in respect of the disposal of the employee's rights in the invention or know-how.)

However, ESC A57 provides that income tax will not be charged under Schedule E if certain conditions are met. In particular, the amounts of the awards are limited and the limit differs according to whether the award is made for a suggestion that will be implemented or one that will not but has intrinsic merit or reflects meritorious effort.

Section 321 of the Act gives statutory effect to the exemption provided by the concession, except that it allows suggestion schemes to be open only to particular descriptions of employees, as well as to all employees. This accords with Inland Revenue practice.

Section 321 merely refers to "the permitted maximum" for any award, leaving section 322 of the Act to set out the financial limits in detail. The limits in section 322 follow ESC A57, but it has been necessary to elaborate on how the exempt amount is to be divided up where more than one award is made in respect of the same suggestion on the same or different occasions, because the concession does not deal fully with that. The sections also covers office-holders as well as employees, although the concession does not expressly do so. See section 5(2).

Section 228(1) of the Act confines the effect of the exemption to liability in respect of employment income chargeable under Schedule E. So liability in respect of the disposal of rights connected with inventions or know-how is not affected.

Section 716(2)(e) of the Act also provides that the limits in section 322(1) and (4) may be increased by an order made by the Treasury.

This change is in principle in taxpayers' favour but is expected to have no practical effect as it is in line with current practice.

Change 79: Exemptions: long service awards: sections 323 and 716(2)(f)
This gives statutory effect to ESC A22 (long service awards).

Where a non-cash award is made to an employee to mark a period of service, the cash equivalent of the benefit will usually be treated as emoluments of the employment under section 154 of ICTA if the employment is within section 167 of ICTA (higher-paid employments etc.).

However, ESC A22 provides that income tax will not be charged in respect of the award if certain conditions are met. In particular–

- the amount that would be chargeable apart from the concession must not exceed £20 for each year's service marked by the award,

- the period of service marked by the award must be a period of at least 20 years with the same employer,

- the award must take the form of a tangible article or shares in the employer company (or another company in the same group), and

- no similar award may have been made within the previous 10 years.

Section 323 of the Act gives statutory effect to the exemption provided by the concession, except that it relaxes the requirements of the concession in two respects–

- it allows the award to take the form of other benefits so long as they do not fall within the list in subsection (3)(c), and

- following the practice of the Inland Revenue, it allows service to be treated as being with the same employer where it has in fact been with two or more employers who are successors or predecessors of each other or belong to the same group.

The section extends to all office-holders, although the concession only refers to directors. See section 5(2).

Section 228 of the Act provides for the exemption to extend to any possible charge to income tax.

Section 716(2)(f) of the Act also provides that the limit in section 264(2) may be increased by an order made by the Treasury.

This change is in principle in taxpayers' favour but is expected to have no practical effect as it is in line with current practice.

Change 80: Exemptions: expenses incidental to a transfer of a kind not normally met by the transferor: section 326
This involves the creation of a new statutory exemption from income tax based on ESC A85 (transfers of assets by employees and directors to employers and others).

The purpose of ESC A85 is to prevent an employee who transfers an asset, such as a house, to the employer or a nominee of the employer being charged to tax in respect of the employer or nominee's costs relating to the purchase of the house.

The concession is based on the premise that the only relevant charge to tax is under section 154 of ICTA (general charging provision). It provides that for the purposes of section 156 of ICTA the cash equivalent of the benefit charged under section 154 is the total of the price paid for the asset, any other valuable consideration given for it and any costs which would normally be met by a vendor but are borne by someone other than the employee. This leaves out costs incurred by someone other than the vendor of a kind not normally met by the vendor. The effect of the concession is therefore to exempt those costs.

Section 326 of the Act achieves the same result as the concession, but does so by providing for an exemption from tax in respect of the costs left out by the concession in the calculation of the cash equivalent of the benefit charged under section 154 of ICTA. This is a more direct way of achieving the same aim.

The concession applies to directors as well as employees, but not to other office-holders. However, as rewritten in section 326 it will apply to all office-holders, because of section 5 of the Act.

This change is in principle in taxpayers' favour but is expected to have no practical effect as it is in line with current practice.

Change 81: Deductions for employee's expenses: requirement for payment out of the emoluments of the employment: section 329 and Chapters 2 to 6 of Part 5 generally

This involves the omission of the requirement that for an employee's expenses to be deductible they must have been paid out of the emoluments of the employment, its replacement by the general proposition that deductions from earnings are not to exceed earnings and consequential changes to provisions referring to deductibility.

Under section 198(1) of ICTA and other deductions provisions (see sections 193(4)(b), 198(3), 201(1), 201AA(1) and 201A(2)(e) and (2A)(c) of ICTA and section 50(3) of FA 1989) a deduction is only allowed where an expense has been incurred and defrayed out of the emoluments of the employment. (There are differences in the detail of the wording of the various provisions mentioned.) But in practice in these cases the Inland Revenue do not require the employee to show that an expense has in fact been paid out of those particular emoluments, rather than from other money. It is sufficient that the emoluments charged to tax in the tax year equal or exceed the deductions to be made from them.

Accordingly, a general rule that deductions from earnings are not to exceed earnings has been stated in section 329(1) of the Act, and the requirement that the expenses must have been paid out of emoluments from the employment has been omitted in sections 336 and 337, which rewrite section 198(1), and sections 338 and 340 to 342, which all rewrite provisions that operate through section 198(1), and in rewriting the other deductions provisions in the case of which the requirement is not in practice enforced. A reference to payment out of earnings has been retained in section 353(2)(a)(ii) of the Act since the requirement is still enforced in practice in the case of deductions under section 198(3) of ICTA which section 353 of the Act rewrites. (The words are also retained in section 355(4) of the Act, which rewrites section 192(3) of ICTA, but that is not currently a deduction provision (see *Change 93*), and the requirement is still enforced in relation to it.)

A number of provisions refer to amounts or expenses the deduction of which would be allowed if the employee incurred and paid them out of the emoluments of the

employment (or in some cases just incurred or just paid them, although the intention appears to have been the same). (See ICTA ss.141(3), 142(3), 145(3), 156(8), 168(5), (5A), 200A(1), (3), 200C(2A), 200F(2A).) And sections 589(6)(b) and 589B(4)(b) of ICTA just refer to expenses that would be deductible under section 198. The provisions of the Act that rewrite these sections are listed in section 332, where they are defined as "the deductibility provisions". Since in most cases the requirement that amounts or expenses be incurred and paid out of emoluments of the employment is not being rewritten, the deductibility provisions do not rewrite the words "out of the emoluments" Instead, they refer to amounts or expenses that would be allowed as a deduction if the employee had incurred and paid them. In the case of the deduction under section 353, where the requirement for payment out of earnings has survived, it is provided that, for the purposes of the deductibility provisions, the expenses are to be assumed to have been paid out of the earnings. (See section 353(4).)

Since the general requirement in section 329(1) that deductions from earnings are not to exceed earnings is currently assumed to be met in the deductibility provisions because of the references in them to the employee being assumed to have paid the amounts or expenses out of emoluments, section 329(5) provides that section 329 is to be disregarded for the purposes of the deductibility provisions.

This change is in principle in taxpayers' favour but is expected to have no practical effect as it is in line with current practice.

Change 82: Fixed sum deductions: prevention of double deductions: section 330 and Chapter 4 of Part 5

This enables the employee to choose whether to claim a fixed sum deduction or a deduction for an amount actually paid where both kinds of deductions are available, whether or not the choice results in the deduction of the larger amount.

Under section 199(1) of ICTA where an employee's emoluments are payable out of the public Revenue and the Treasury are satisfied that the employee falls into a class of persons who are obliged to meet expenses in the performance of their duties, deductions are to be made from the employee's emoluments for such sums as the Treasury fix for employees of that class. Under section 199(2) if, but for section 199(1), a person would be entitled to deduct a larger amount than the amount fixed under section 199(1) that amount may be deducted instead. However, some taxpayers prefer to claim a deduction for the actual amount incurred and to disregard the fixed sum deduction, even where the actual amount incurred is less than the fixed sum.

Accordingly, in rewriting section 199 in section 367, nothing has been included to reflect section 199(2), so far as that implies that the deduction for the actual amount expended is only available where that is greater than the fixed sum. Instead, section 330(2) of the Act (prevention of double deductions) provides that where both a fixed sum deduction and a deduction for actual expenditure in respect of the same kind of expenses would be allowable, only one of the deductions is allowed. Therefore the

employee may choose which of the deductions to claim, regardless of the amount deductible under each.

This change is a clarification with no tax effects either in principle or in practice.

Change 83: Deductions for employee's expenses: deductions operating through section 198(1) of ICTA: sections 340 to 342

This involves the rewriting of certain provisions about the deduction of travel expenses that currently operate through section 198(1) of ICTA independently of that section, and the omission of certain requirements and hypotheses linked to the application of that section.

Under section 198(1)(a) of ICTA if the holder of an office or employment is obliged to incur and defray qualifying travel expenses, the amount so incurred and defrayed is deductible. "Qualifying travel expenses" are defined in section 198(1A), and include amounts necessarily expended on travelling in the performance of duties of the employment.

Section 193(3) and (6) and 198(1B) of ICTA operate by deeming certain travel expenses to have been necessarily incurred or expended in the performance of duties of the employment. The intention is clearly to enable these expenses to be qualifying travel expenses and so to be deductible under section 198(1). But section 193(3) and (6) and 198(1B) do not mention anything more about the requirements that apply under section 198(1) and so it seems that those requirements continue to apply. This means that the employee must be obliged to incur and defray the expenses as holder of the employment in question. In practice, however, deductions are allowed where the requirements under section 198(1) are not all met.

Section 340 of the Act rewrites section 198(1B) largely independently of the deduction for expenses necessarily expended on travelling in the performance of duties of the employment, which is rewritten at section 337. The requirement from section 198(1) that the employee was obliged to incur and pay the expenses is retained, but not the requirement that he was obliged to do so as holder of the employment. In this case the hypothesis that the expenses were expended in the performance of duties of the employment *to be performed at the destination* has been retained for the limited purposes of sections 353 and 354 of the Act, because the place of performance of duties is relevant for those provisions.

Section 341 of the Act rewrites the deduction at section 193(2) and (3) of ICTA without referring to the deduction in section 337 of the Act or deeming the expenses in question to have been expended on travelling in the performance of duties of the employment. It omits the requirement that the employee must be obliged to incur and defray the expenses as holder of the employment in question. The same applies to section 342 of the Act, which rewrites section 193(5) and (6) of ICTA.

This change is in principle in taxpayers' favour but is expected to have no practical effect as it is in line with current practice.

Change 84: Deduction for professional membership fees: meaning of "professional fee": section 343(2)
This section provides for a deduction from earnings in respect of fees paid by employees to enable them, lawfully, to pursue their professions or occupations.

Section 201(2) of ICTA sets out a list of the fees and contributions allowable, subject to the condition in subsection (5)(a). This list was not updated by means of primary legislation. The names of bodies which receive fees deductible under section 201(2) of ICTA and those that the Board approves under section 201(3) are published in a booklet called "Fees and subscriptions paid to Professional Bodies and Learned Societies" which is known as "List 3".

Section 343(2) of the Act incorporates new cases which fulfil the requirements of the original section 201(5)(a) but which do not appear in section 201(2).

This updating reflects fees which appear in List 3 as qualifying for deduction under section 201(2), and a few cases where fees have been approved under section 201(3) when they actually fall within section 201(2).

The opportunity has also been taken to include further cases which satisfy the requirement in section 201(5)(a) but which are not currently published in List 3.

As a consequence of adding to the list in subsection (2) it has been necessary to add a reference to "licensing or other matter" in section 343(1)(b).

In the course of updating the list of fees which qualify for deduction as explained above, it became apparent that certain of the new fees relate to the issue or grant of certificates or licences, as well as to retention or renewal of an existing status. In order to achieve a consistent approach for all professional fees, subsection (2) makes clear that fees payable for initial registration, entry on a particular register or on the issue of a certificate or licence are covered by the relief in all cases.

This change is in taxpayers' favour in principle and may in practice benefit some although the numbers and amounts are thought to be negligible.

Change 85: Deduction for professional membership fees: new power for Board to extend "professional fee": sections 343(3) and (4) and 717
This section provides for a deduction from earnings in respect of fees paid by employees to enable them, lawfully, to pursue their professions or occupations.

Section 201(2) of ICTA sets out a list of the fees and contributions allowable, subject to the condition in subsection (5)(a). This list was not updated by means of primary legislation. The names of bodies which receive fees deductible under section 201(2) of ICTA and those that the Board approves under section 201(3) are published in a booklet called "Fees and subscriptions paid to Professional Bodies and Learned Societies" which is known as "List 3".

Section 343(2) of the Act has updated the position so as to include fees which have appeared as entries in List 3 since the original provision was enacted and certain others which are considered to fulfil the requirements of section 201(5)(a), see *Change 84*.

Section 343(3) provides a new power for the Board of Inland Revenue. The Board may add a new fee to the list if they are satisfied that the fee meets the condition in subsection (4). This condition ensures that fees are eligible for inclusion only if they satisfy the same criteria as those cases already within subsection (2).

This new power will ensure that subsection (2) reflects all fees allowable under this section.

This change has no implications for the amount of tax paid, who pays it or when. It affects (in principle and in practice) only administrative matters.

Change 86: Deduction for annual subscriptions: approval of bodies for purpose of receiving subscriptions: notice of decision by Inland Revenue: section 344(4)
This section provides for a deduction for annual subscriptions to bodies having certain specified characteristics, established for particular qualifying objects and whose activities fulfil certain conditions. A deduction is allowed if it is paid to such a body approved by the Inland Revenue under this section.

Section 344(3) of the Act sets out the requirements to be satisfied by a body before it can be granted approval.

Section 344(4) requires the Inland Revenue to notify the body of its decision on the application. This requirement is new.

This change is in principle in taxpayers' favour but is expected to have no practical effect as it is in line with current practice.

Change 87: Deduction for annual subscriptions: approval of bodies for purpose of receiving subscriptions: timing of deduction: section 344(7)
This section provides for a deduction for annual subscriptions to bodies having certain specified characteristics, established for particular qualifying objects and whose

activities fulfil certain conditions. A deduction is allowed if it is paid to such a body approved by the Inland Revenue under this section.

Under section 201(6) of ICTA, where a body is approved and the application was made before the end of a particular year of assessment, a deduction is allowed for a subscription paid to the body in that year "whether the approval is given before or after the end of the year".

Section 344(7) of the Act makes clear that a subscription paid in any year between that in which the body seeks approval and that in which approval is granted is also allowable as a deduction in the year in which it is paid.

This change is in principle in taxpayers' favour but is expected to have no practical effect as it is in line with current practice.

Change 88: Decisions of the Inland Revenue in relation to approval of bodies: section 345(1)
This section provides powers for the Inland Revenue to withdraw or vary any approval given to or any determination made in respect of a body and provides a right of appeal.

Section 201(6) of ICTA gives power to withdraw or vary decisions so as to take account of any change in circumstances.

Section 345(1) of the Act rewrites this provision. The Revenue is required to notify the body of its decision. This requirement is new.

This change has no implications for the amount of tax paid, who pays it or when. It affects (in principle and in practice) only administrative matters.

Change 89: Decisions of the Inland Revenue in relation to approval of bodies: appeals to the Special Commissioners: section 345(2)
This section provides powers for the Inland Revenue to withdraw or vary any approval given to or any determination made in respect of a body and provides a right of appeal.

Section 201(7) of ICTA provides that a body may in certain circumstances require a matter to be determined by the Special Commissioners. The Special Commissioners are to "hear and determine the manner in like manner as an appeal".

In section 345(2) of the Act this has been simplified by introducing a straightforward right of appeal. A body aggrieved by a decision "may appeal to the Special Commissioners". This change is similar to *Change 9* and *Change 171*.

This change has no implications for the amount of tax paid, who pays it or when. It affects (in principle and in practice) only administrative matters.

Change 90: Deduction of expenses of ministers of religion: section 351 and paragraph 47 of Schedule 6

This prevents expenses of ministers of religion incurred in connection with appointments within Schedule D being allowed as a deduction from emoluments, and expenses incurred in connection with employment as a minister being deducted from Schedule D income.

Section 332(3) of ICTA provides that expenses incurred in connection with duties as a minister of religion are deductible from Schedule D profits as such a minister or Schedule E emoluments earned as such a minister. This is anomalous because it is the only provision allowing expenses relating to an employment to be deducted in calculating profits from a trade or profession, or expenses relating to a trade or profession to be deducted from employment income. Moreover, very few ministers are chargeable under Schedule D on their income as such and even fewer are both so chargeable and chargeable under Schedule E on emoluments received as a minister.

Section 351 of the Act rewrites section 332(3) of ICTA so far as it relates to deductions from emoluments, but only enables expenses to be deducted from emoluments if the expenses relate to employment as a minister. Paragraph 47 of Schedule 6 to the Act amends section 332(3) of ICTA so that it will permit expenses to be deducted in calculating Schedule D profits as a minister only if the expenses relate to an appointment as a minister that is taxable under Schedule D. However, any potential adverse effect from this change is expected to be counteracted by section 380 of ICTA (set-off against general income). That section has the effect that, if the deductions under section 351 of the Act exceed the earnings remaining after other deductions, the excess may be set off against income taxable under Schedule D, and, if the deductions that a minister is allowed under section 332(3) of ICTA, as amended by Schedule 6 to the Act, exceed his Schedule D income, the excess may be set off against income from employment as a minister.

This change is adverse to some taxpayers in principle and in practice but the numbers affected are expected to be few if any and the amounts involved are likely to be small, because claims under section 380 of ICTA (set-off against general income) may be made.

Change 91: Deduction of expenses of ministers of religion: determination of deduction for rent by inspectors: section 351(2)

This changes the way in which the amount deductible by a minister of religion in respect of rent for accommodation used partly for professional purposes is determined, so that just and reasonable apportionment applies instead of an inspector determining the amount.

Section 332(3)(b) of ICTA provides that where rent is paid by a minister of religion in respect of a dwelling-house, any part of which is used mainly and substantially for the purposes of his duty as a minister, a deduction may be made for "such part of the rent (not exceeding one quarter) as the inspector by whom the assessment is made may allow". The inspector's decision is subject to appeal to the General or Special Commissioners.

Section 351(2) rewrites this part of section 332(3), but, in order to make self-assessment easier for the employee, reference to the inspector is not to be required and instead the amount allowable is to be–

- one quarter of the rent, or

- if less, the part of the rent that, on a just and reasonable apportionment, is attributable to the part of the dwelling house used mainly and substantially for the purposes of the employee's duties as a minister.

This change has no implications for the amount of tax paid, who pays it or when. It affects (in principle and in practice) only administrative matters.

Change 92: Deductions: agency fees paid by entertainers: application of limit of 17.5% of earnings: section 352

This consequence of *Change 81* makes it possible for amounts which would not be deductible at all at present (because they are only eligible for deduction in a single tax year and exceed the limit on the amounts so deductible in that tax year) to be carried forward and deducted instead in a subsequent tax year.

Section 201A of ICTA allows a deduction in calculating the emoluments of an employment which fall to be charged to tax for a year of assessment for certain agency fees paid by entertainers but only–

- if the fees are defrayed out of the emoluments of the employment falling to be charged to tax for that tax year; and

- to the extent that the fees do not exceed 17.5% of those emoluments.

The only sensible reading of the reference to the emoluments of an employment falling to be charged to tax *for* a particular tax year is a reference to the emoluments of the employment which are received in the tax year. To read the expression as a reference to the emoluments which, by virtue of the contract of the employment, relate to the tax year, places a rather strained interpretation on it; if that is what the expression was intended to mean, it could more naturally have been expressed as "the emoluments of the employment for the year concerned which fall to be charged to tax (whether or not in that tax year)". The better interpretation is reflected in section 352(2) of the Act.

Accordingly, if fees are paid out of the emoluments for a particular tax year ("tax year X"), a deduction in respect of them can only be made for tax year X.

To the extent that the amount of the fees paid out of the emoluments of the employment for tax year X exceed 17.5% of those emoluments for tax year X, they cannot be deducted, for that or any other year.

However, to the extent that the fees are paid out of the emoluments of the employment for the next tax year ("tax year Y") (whether because the emoluments in tax year X are insufficient to cover the fees or merely because they are paid late), they can be deducted from the earnings from the employment for tax year Y, subject to the limit of 17.5% of the emoluments of the employment for tax year Y.

Change 81 effectively removes the restriction that makes fees eligible for a deduction only in a single tax year (namely, the tax year out of whose emoluments they were paid).

As a result, if the fees paid in a particular tax year exceed 17.5% of the taxable earnings from the employment in question in the tax year, the excess can be carried forward in all cases (and not only where the fees are paid out of a subsequent year's earnings – see above) and deducted in calculating the net taxable earnings from the employment in a subsequent tax year (subject to the 17.5% limit for that tax year).

This change is in taxpayers' favour in principle and may in practice benefit some although the numbers and amounts are thought to be negligible.

Change 93: Deductions for corresponding payments by non-domiciled employees with foreign employers: section 355

This involves replacing the current relief for payments made out of foreign emoluments that correspond to payments which would reduce the employee's liability to income tax with deductions for those payments.

Section 192(3) of ICTA allows relief for payments made out of foreign emoluments, as defined in section 192(1). The relief may be claimed if the employee makes payments out of the foreign emoluments in circumstances corresponding to those in which the payments would have reduced the employee's liability to income tax. The relief is used for payments that are usually deductible from total income, as well as ones usually deductible from emoluments. Examples of such payments are payments under foreign court orders and contributions made to a foreign pension scheme which would be allowable as deductions if the scheme were an approved scheme in the United Kingdom.

The relief under section 192(3) is given "as a deduction in computing the amount of the emoluments". Therefore the relief operates by reducing the amount that is taken into account as emoluments, before any deductions are given.

Section 355, which rewrites section 192(3), provides for the relief for these payments to be allowed as a deduction after computing the amount of the emoluments, rather than as a deduction in computing them.

A consequence of this change is that the payments to which section 192(3) applies are not deducted in computing the emoluments of an employee to determine if he is a higher-paid employee for the purposes of section 167 of ICTA. Therefore section 218 of the Act, which rewrites section 167, includes deductions under section 355 in the deductions that count as "authorised deductions" for the purposes of section 218.

This change has no implications for the amount of tax paid, who pays it or when. It affects (in principle and in practice) only administrative matters.

Change 94: Deduction of business entertainment and gifts expenses: restriction of disallowance to expenses connected with employer's trade: section 356(1)
This restricts the disallowance of the deduction of business entertainment gifts and expenses so that it applies only to expenses in connection with *the employer's* trade, business, profession or vocation and not *the employee's*.

Section 577(1)(a) of ICTA provides that no deduction is to be made in computing profits chargeable to tax under Schedule D *for expenses incurred in providing business entertainment*, and section 577(1)(b) provides that no deduction for *expenses so incurred* is to be made from emoluments charged to tax under Schedule E. Under section 577(8) the provision of a gift is treated largely the same as the provision of entertainment. Section 577(5) defines "business entertainment" as entertainment provided by a person or his staff in connection with *a trade* carried on by that person. The usual meaning of "trade" is extended by section 577(7)(b) as including any business, *profession or vocation.* So where an employee's job can be described as a profession or vocation, section 577(1)(b) could operate to deny a deduction to him.

Section 356 rewrites the part of section 577 that prohibits deductions from emoluments. Section 356(1) provides that no deduction is allowed for expenses incurred in providing entertainment or a gift in connection with *the employer's* trade, profession or vocation. So it does not prevent the deduction of expenses incurred in connection with the employee's profession or vocation, if they are otherwise allowable.

This change is in principle in taxpayers' favour but is expected to have no practical effect as it is in line with current practice.

Change 95: Deduction of business entertainment and gifts expenses: exception where employer's expenses disallowed: tonnage tax companies: section 357(4)
This extends the exception from the disallowance of the deduction of business entertainment gifts and expenses where the employer's expenses are disallowed to

cases where the employer's expenses would be disallowed if it were not a tonnage tax company.

Section 577(1)(a) of ICTA provides that no deduction is to be made in computing profits chargeable to tax under Schedule D for expenses incurred in providing business entertainment and such expenses are not to be included in computing any expenses of management in respect of which relief may be given under the Tax Acts. (This is directed at investment companies, insurance companies etc.) Section 577(1)(b) provides that no deduction for expenses so incurred is to be made from emoluments charged to tax under Schedule E.

The main exception to the prohibition in section 577(1)(b) is provided by section 577(3). This applies where–

- the employee's earnings include an amount in respect of the expenses, for example an allowance, and

- the employer is prevented by section 577(1)(a)–

  - from getting a deduction for the expense involved in putting the employee in funds for this purpose in computing his profits for Schedule D, or
  - from having the expenses included in his expenses of management.

Therefore this exception is only available to employees whose employer has profits chargeable to tax under Schedule D or expenses of management. However, neither of these conditions will be met by an employer which is a shipping company and elects to have its relevant shipping profits taxed under the tonnage tax provisions in Schedule 22 to FA 2000, because under that Schedule corporation tax is charged on notional rather than actual profits and so actual expenses are not deducted in computing the chargeable profits.

Section 357 of the Act rewrites the exception in section 577(3). Under subsection (4) of section 357 the exception is available to employees whose employer is not prevented by section 577(1)(a) from getting a deduction against its relevant shipping profits for the expense involved in putting the employee in funds for providing business entertaining if the employer would have been prevented from doing so apart from electing under Schedule 22 to FA 2000 to come within the tonnage tax regime. (Subsection (5) defines "tonnage tax company", "tonnage tax election" and "relevant shipping profits".)

This change is in principle in taxpayers' favour but is expected to have no practical effect as it is in line with current practice.

Change 96: Deduction of business gifts expenses: exception for advertisements of the donor: other companies in employer's group: sections 358(3) and (4) and 716(2)(h)

This extends the exception from the rule disallowing the deduction of business gifts expenses where the gift incorporates a conspicuous advertisement for the donor, so that it applies to allow a deduction for an employee's expenses where the advertisement is for the employer or a member of the same group of companies and provides for the limit on the cost to the donor to be increased by Treasury order.

(A) Section 577(1)(a) of ICTA provides that no deduction is to be made in computing profits chargeable to tax under Schedule D for expenses incurred in providing business entertainment, and section 577(1)(b) provides that no deduction for expenses so incurred is to be made from emoluments charged to tax under Schedule E. The main exception to the prohibition in section 577(1)(b) is provided by section 577(3) (which is rewritten at section 357). This applies where–

- the employee's earnings include an amount in respect of the expenses, for example an allowance, and

- the employer is prevented by section 577(1)(a) from getting a deduction for the expense involved in putting the employee in funds for this purpose.

Under section 577(8) the provision of a gift is treated the same as the provision of entertainment, except where the gift consists of an article incorporating a conspicuous advertisement for *the donor*, which is not of a prohibited type (food, drink etc.) and the cost of which to *the donor*, when aggregated with other gifts to the same donee, does not exceed £50. This exception is aimed at the employer rather than the employee and so the donor is expected to be the employer. However, if the employer puts the employee in funds to buy such a gift, a deduction for the employer's expenses will be allowed, and that will mean that the amount spent by the employee will not be allowed under the exception in section 577(3). So there is a lacuna if section 577(8) does not apply to employee's expenses in these circumstances.

Section 358(3) and (4) of the Act rewrite this exception in terms that enable an employee's expenses to fall into the exception, so that the fact that the employer's expenses are allowable, and hence the exception in section 577(3) does not apply, does not matter. The advertisement is described as one for the employer or, if the employer is a company, another company which belongs to the same group as the employer.

(B) Section 577(8) of ICTA fixes the £50 limit that applies so as to restrict the cost to the donor of gifts to the same donee in the tax year that incorporate an advertisement to which that section applies. There is no provision for that limit to be increased otherwise than by Finance Acts. However, section 716(2)(h) of the Act provides that the £50 limit in section 358(3)(b) of the Act, which rewrites section 577(8)(b), may be increased by an order made by the Treasury.

This change is in principle in taxpayers' favour but is expected to have no practical effect since it reflects current practice, except as respects the Treasury's power to make an order. As respects such an order, the change is in principle in taxpayers' favour, although the numbers and amounts are likely to be negligible.

Change 97: Deductions: disallowance of certain accommodation expenses of MPs and other representatives: section 360

This involves substituting a reference to Chapter 2 of Part 5 of the Act for references to the individual provisions that rewrite section 198 of ICTA.

Section 198(4) of ICTA provides that MPs and other representatives may not obtain a deduction from emoluments under section 198 for expenditure incurred by them in or in connection with the provision of residential or overnight accommodation to enable them to perform their duties in or about the place where the body sits or the constituency or region they represent. This is directed at the deduction available under section 198(1) for expenses incurred wholly, exclusively and necessarily in the performance of the duties of an employment. But the reference to overnight accommodation might bring in accommodation and subsistence expenses incurred as part of the cost of travelling to perform duties where the body sits or in the constituency, which would be allowable under section 198(1)(a) and (1A), or under one of the provisions that operate through or are construed as one with section 198.

Section 360(1) rewrites section 198(4) by providing that no deduction from earnings is allowed "under this Chapter or section 373", rather than under all the specific provisions which rewrite, operate through, or are construed as one with section 198. In so far as Chapter 2 of Part 5 of the Act includes material that has no connection with section 198, in theory this section may operate to disallow a deduction that ought not to be disallowed. But it is not thought that in practice this section would operate to disallow any deduction that is currently allowable. On the other hand, material that operates through or is to be construed with section 198 has been rewritten elsewhere than in Chapter 2 of Part 5, so this section does not disallow deductions that currently are covered by the reference in section 198(4). However, because of the circumstances in which those deductions are available, in practice it is most improbable that any of them could apply.

This change is in principle adverse to some taxpayers and favourable to others but it is expected to have no practical effect as it is in line with current practice.

Change 98: Deductions from benefits code emoluments: limit on amount of deductions: sections 362 to 365

This enables benefits code deductions to be allowed from all emoluments and not only from the relevant benefits code emoluments, but limits the deductions to the amount of the benefits code emoluments or an appropriate proportion of that amount.

Sections 141(3), 142(2), 145(3) and 156(8) of ICTA all make similar provision allowing deductions under certain sections *from the amount treated as emoluments under the benefits code by virtue of the provision in question* of such amounts, if any, as would have been so deductible if the cost of the goods, services or other benefits had been incurred by the employee out of his emoluments. So, for example, under section 141(3) a deduction is allowable from the amount chargeable under section 141(1), that is, an amount equal to the expense incurred by the person at whose cost the non-cash voucher and the money, goods or services for which it is capable of being exchanged are provided, and not from other emoluments of the employment.

Sections 362 to 365 rewrite sections 141(3), 142(2), 145(3) and 156(8). Instead of providing that the deductions are allowed from the emoluments that are treated as having been received under section 141(1) or, as the case may be, section 142(1), 145(1) or 156(1), these sections provide that the deductions may be made from any earnings from the employment.

However, these sections also limit the amount of the deduction. In the case of sections 362 and 363, which rewrite sections 141(3) and 142(2), the amount of the deduction is expressly limited so that it cannot exceed the amount treated as earnings under the provision in question. In the case of section 364, which rewrites section 145(3), the amount of the deduction is to be the amount that would be deductible if the employee paid an amount for the accommodation equal to the amount treated as earnings. Therefore the deduction cannot exceed the amount chargeable. Similarly, in the case of section 365, which rewrites section 156(8), the amount of the deduction is to be the amount that would be deductible if the employee paid the cost of benefit. As the cost of the benefit is the measure of charge under section 154, the effect is again to impose a limit equal to the amount chargeable.

In all these cases, however, if, had an actual expense been incurred, only a proportion of the amount spent would have been allowable because only that proportion was attributable to business, the amount referred to in sections 362 to 365 as the amount that would have been deductible under Chapter 2 or 5 of Part 5 is reduced to a proportion of the amount assumed to have been spent. In the case of the deduction under section 364, the deduction is calculated on the assumption that the employee paid an amount equal to the amount treated as earnings, rather than, as section 145(3) provides, that he paid for the accommodation. Therefore, if the amount that would be paid for the accommodation differs from the amount chargeable, which it may in rare cases, then in a case where only a proportion of the amount assumed to be paid would be allowed under Chapter 2 or 5 of Part 5, the amount that is allowed under section 364(1)(b) will differ from the amount that would be allowed under section 145(3). If the amount that would be paid for the accommodation is greater than the amount chargeable for it, the deduction under section 364 will be lower than the amount that would be allowed under section 145(3).

So the overall effect of enabling the deduction to be made from any emoluments from the employment and imposing a limit on the amount deductible produces a similar

result to that under the current legislation and practice, except in the case of amounts allowed for accommodation used partly for business purposes where the amount chargeable for the accommodation differs from the amount that the employee would have paid for it.

This change is in principle adverse to some taxpayers but it is expected to have no practical effect as it is in line with current practice.

Change 99: Deductions from benefits code emoluments: references to deductibility under specific provisions: sections 362 to 365

This relates to the substitution of general references to deductibility for the current references to deductibility under specific provisions, for the purposes of the deduction of expenses from benefits code earnings.

Sections 141(3), 142(2), 145(3) and 156(8) of ICTA all make similar provision allowing deductions under specified sections from the amount treated as emoluments under the benefits code by virtue of section 141, 142, 145 or 154 of such amounts, if any, as would have been so deductible if the cost of the goods, services or other benefits had been incurred by the employee out of his emoluments. Sections 141(3), 142(2) and 156(8) refer to deductions under section 198, 201, 201AA or 332(3) of ICTA, and section 145(3), which only relates to accommodation benefits, refers to deductions under section 198 or 332(3) of ICTA. In rewriting sections 141(3), 142(2), 145(3) and 156(8), sections 362 to 365 refer not to deductions under the sections rewriting the specified provisions but to deductions under Chapter 2 or 5 of Part 5. These Chapters include all the deductions provisions referred to in sections 141(3), 142(2), 145(3) and 156(8), but also some others.

This change is in principle in taxpayers' favour but is expected to have no practical effect as it is in line with current practice.

Change 100: Fixed sum deductions for repairing and maintaining work equipment: section 367

This gives statutory effect to ESC A1 (flat rate allowances for costs of tools and special clothing).

Under section 198(1) of ICTA deductions are available for the cost of the upkeep of tools or special clothing if they are borne wholly exclusively and necessarily in the performance of the duties of the employment. It is traditional in many trades that the employees themselves provide and maintain tools and equipment or clothing or maintain clothing even where it is provided by the employer. To avoid the Inland Revenue having to examine and agree a large number of small claims, it negotiates the amount of the average annual expenditure on these things with the trade unions involved. ESC A1 provides that the agreed sums are to be allowed as a deduction in arriving at the emoluments of employees in the trade in question, regardless of the

actual expenditure incurred by them on the things in question, if the employees bear the cost themselves and the employer would not bear it if requested to do so. Where the employee only meets part of these costs, the fixed sum is reduced accordingly.

If an employee to whom ESC A1 applies incurs actual expenditure that exceeds the fixed sum deduction then he may claim a deduction under section 198(1) of ICTA for the actual sums incurred.

Section 367 of the Act gives statutory effect to the concession. It covers office-holders as well as employees, although the concession does not expressly do so. See section 5(2).

This change is in principle in taxpayers' favour but is expected to have no practical effect as it is in line with current practice.

Change 101: Deductions for emoluments representing benefits or reimbursed expenses: sections 369 and 370 and Chapter 5 of Part 5 generally

This relates to the extension of the circumstances in which a deduction is available where amounts are included in an employee's emoluments in respect of the provision of certain benefits or the reimbursement of certain expenses to cases where the provision or payment was not made by or on behalf of the employer, and secondly to the omission of rules about the place of performance of certain duties of employment.

(A) Under sections 193 to 195 of ICTA and section 50 of FA 1989 where–

- certain benefits are provided for an employee (or in some cases for his family or household) and the cost is borne *by or on behalf of the employer,* or

- the employee incurs certain expenses that are reimbursed *by or on behalf of his employer*,

so that the employee's emoluments include an amount in respect of the cost of the benefit or the expenses reimbursed, deductions are allowed for amounts equal to so much of those costs or expenses as falls to be included in the emoluments. (See, for instance, section 193(4).) However, an amount may be included in a person's emoluments where a benefit is provided or employment expenses are reimbursed otherwise than by or on behalf of the employer if the provision or payment is by reason of the employment. No deduction is currently available under these provisions in those circumstances.

These provisions are rewritten in Chapter 5 of Part 5. Section 369 sets out the circumstances in which the Chapter applies without limiting them to cases where the provision or payment is by or on behalf of the employer, and none of the individual deductions rewritten in Chapter 5 imposes that limitation.

(B) Section 132(2) and (4) of ICTA contain rules relating to the place of performance of duties of employment in particular cases where they are performed outside the United Kingdom. In these cases the duties are treated as performed in the United Kingdom. Section 132(2) and (4) have been rewritten in sections 39 and 40 for the purposes of Chapter 5 of Part 2 of the Act (taxable earnings: rules applying to employee resident, ordinarily resident or domiciled outside the United Kingdom). They have also been rewritten in Part 5 in the places where they are needed to preserve the availability of a deduction (see sections 341(6) and (7) and 376(4) and (5) of the Act) or the current scope of the foreign earnings deduction for seafarers under section 192A of ICTA (see sections 382(2) and 384 of the Act).

However, the rules in section 132(2) and (4) are not currently applied in some cases where their application would reduce the availability of certain deductions relating to travel expenses and they have not been rewritten for those cases. For example, section 132(2) provides that if an employment is one where in substance the duties are performed outside the United Kingdom, then for the purposes of Cases I and II of Schedule E incidental duties performed in the United Kingdom are treated as performed outside the United Kingdom. If this were applied in the case of the deduction available under section 194(3) of ICTA for foreign travel where the duties of the employment are performed partly inside and partly outside the United Kingdom, the deduction would not be available for expenses incurred on a journey to or from the United Kingdom in order to perform incidental duties there. But as a matter of practice deductions for such travel expenses are allowed. Consequently, section 132(2) has not been rewritten so as to apply to section 370(4) and (5) of the Act which rewrite section 194(3) of ICTA.

This change is in taxpayers' favour in principle and may in practice benefit some although the numbers and amounts are thought to be negligible.

Change 102: Deductions for travel benefits and expenses of non-domiciled employees where duties performed in UK: 5 year limit: sections 373(3) and 374(3)

This changes the way in which the condition limiting the period within which the deduction under section 195 of ICTA applies is expressed, so that the journey in question must be undertaken within the 5 year period rather than the expenditure having to be incurred within that period.

Under section 195 of ICTA deductions are available in respect of a non-domiciled employee's travel costs and expenses for journeys undertaken by the employee to perform duties of the employment in the United Kingdom, and journeys by accompanying spouses and children. Section 195(2) provides that section 195 only applies if the conditions in section 195(3) are met in respect of a date on which the employee arrives in the United Kingdom to perform the duties of the employment, and even then section 195 only "applies" for the period of 5 years beginning with that date. It is unclear whether the expenditure for which the deduction might be available

must have been incurred within that period of 5 years or whether the journey must be undertaken during that period. For example, the employee might make a journey 4 years and 11 months after the relevant arrival date, but the costs might not be paid by the employer until more than 5 years after that date.

Sections 373(3) and 374(3) rewrite the part of section 195(2) about section 195 applying for 5 years. They provide that the journey in question must end on that date (which is referred to in the rewritten provision as "the qualifying arrival date"), or during the 5 year period. So the expenditure may be incurred after that date.

This change is in principle in taxpayers' favour but is expected to have no practical effect as it is in line with current practice.

Change 103: Deductions from seafarers' earnings: taking account of other deductions: section 381

This relates to the substitution of general references to deductibility for the current references to deductibility under specific provisions, for the purposes of the deduction of expenses from a seafarer's earnings to determine the amount in respect of which the foreign earnings deduction for seafarers is allowed.

Section 192A of and Schedule 12 to ICTA provide for a special deduction for seafarers (the foreign earnings deduction or "the FED") against earnings for a year in which the seafarer is resident and ordinarily resident in the United Kingdom. The amount of the deduction is equal to the amount of the earnings attributable to the period for which the deduction is available.

Paragraph 1A of Schedule 12 provides that for this purpose the amount of the emoluments for a year of assessment from any employment shall be taken to be the amount remaining after any capital allowance and after any deductions under section 192(3), 193(4), 194(1) 195(7), 197AG, 198, 199, 201, 332, 592 or 594 of ICTA. This is directed at cases where only part of a seafarer's earnings for a year are eligible for the FED. It is intended to ensure that, where that is so, other deductions relating to the full year are not all set off against the earnings which are not eligible for the FED. So those other deductions are required to be deducted before the earnings for the whole year are apportioned between the periods for which the FED is or is not available.

However, the list in paragraph 1A is incomplete. For example, it does not refer to deductions under section 201AA of ICTA or sections 50 to 52 of FA 1989.

In rewriting paragraph 1A, section 381 refers to the whole of Chapters 2, 3, 4 and 5 of Part 5 of the Act. Since section 201AA of ICTA is rewritten in Chapter 2 of Part 5 and sections 50 to 52 of FA 1989 are rewritten in Chapter 5 of Part 5, this means that those deductions will be taken into account.

This change is in principle adverse to some taxpayers but it is expected to have no practical effect as it is in line with current practice.

Change 104: Payments to non-approved pension schemes: relief where no benefits paid or payable: sections 386(6) and 392(1) and (3)
This extends the circumstances in which applications for relief may be made where, following a charge on a payment to a non-approved pension scheme, no relevant benefits have been paid or will be payable.

Under section 595(1)(a) of ICTA where an employer pays a sum pursuant to a retirement benefits scheme with a view to the provision of relevant benefits for the employee, the sum paid is deemed to be Schedule E income of the employee. Under section 595(5) any reference *in section 595* to provision for an employee of such benefits includes a reference to the provision of benefits payable to the employee's wife, husband, widow, widower, children, dependants or personal representatives.

However, under section 596(3) where "in respect of the provision for an employee of such benefits" a sum has been deemed to be income of the employee's under section 595(1), the employee may make an application for relief from the charge. The relief is only available if the employee proves to the Board of Inland Revenue that–

- no payment in respect of, or in substitution for, the benefits has been made, and
- some event has occurred by reason of which no such payment will be made.

As section 595(5) only applies to references in section 595, the relief in section 596(3) is not available where the charge under section 595 has applied in a case where the provision of relevant benefits is for the employee's family, rather than the employee. Moreover, some benefits may not be due until after the employee's death.

Section 386(6) rewrites section 595(5) so that the extension to the provision of benefits for the employee's family applies to the whole of Chapter 1 of Part 6 of the Act and therefore to section 392 which rewrites section 596(3). So the relief may be claimed where the provision was for the employee's wife, husband, widow, widower, children, dependants or personal representatives rather than for the employee.

Under section 392(3) if the employee has died the application for relief may be made by the employee's personal representatives.

This change is in principle in taxpayers' favour but is expected to have no practical effect as it is in line with current practice.

Change 105: Payments to non-approved pension schemes: exception for seafarers with overseas earnings: section 391
This excepts from the charge on payments pursuant to non-approved retirement benefits schemes any payment to a seafarer whose earnings from the employment for the period when it is made are subject to the foreign earnings deduction for seafarers.

Under section 595(1)(a) of ICTA where an employer pays a sum pursuant to a retirement benefits scheme with a view to the provision of relevant benefits for the employee, the sum paid is deemed to be Schedule E income of the employee. It does not count as emoluments. Section 192A of and Schedule 12 to ICTA provide a special deduction for seafarers from emoluments chargeable under Case 1 of Schedule E. This deduction amounts to a total exemption for those emoluments, since the amount deductible from the emoluments is equal to the amount of the emoluments. But the deduction is not available against income deemed to be paid to a seafarer under section 595 because of such a payment not counting as emoluments, only as income.

Section 391 gives statutory effect to the Inland Revenue's practice of excepting a payment from the charge under section 595 (rewritten as section 386) if it is made in a period for which the seafarer is allowed the foreign earnings deduction against his emoluments from the employment. (See Chapter 6 of Part 5.)

This change is in principle in taxpayers' favour but is expected to have no practical effect as it is in line with current practice.

Change 106: Benefits from non-approved pension schemes: certain lump sums: reduction of amount which counts as employment income: section 397
This removes one of the conditions which has to be met before a deduction is allowed from the amount taxed when a lump sum is provided from certain non-approved retirement benefits schemes.

Under section 596A(1) of ICTA, a benefit received from a retirement benefits scheme is taxed unless the scheme is of a kind mentioned in section 596(1) of ICTA. (Section 596(1) concerns approved schemes, certain schemes established under statute and foreign government schemes.)

Section 596A(8) exempts lump sums from this charge completely if the following conditions are met (see section 596A(8)(a) to (c)).

- The first condition is that the employer has paid a sum or sums towards the provision of benefits under the scheme.

- The second condition is that an employee has been assessed to tax (under section 595(1) of ICTA) in respect of those sums.

- The third condition is that the lump sum is provided to the employee or certain other people related to or connected with the employee.

But the complete exemption in section 596A(8) does not apply if any of the income or gains accruing to the scheme are not brought into charge to tax (see section 596A(9)). Instead of the complete exemption, section 596A(9) allows certain deductions to be made from the amount which is taxed.

For these deductions to be made, the three conditions mentioned above must still be met. Although section 596A(9) does not expressly mention the conditions, it refers to "the lump sum". This reads back to the lump sum mentioned in section 596A(8) and therefore brings in the conditions. In practice, however, the Inland Revenue has allowed deductions to be made under section 596A(8) even if the third condition has not been met.

Section 397 of the Act rewrites section 596A(9) of ICTA. The rewritten provision does not make the availability of the reductions dependent on the third condition being met.

This change is in principle in taxpayers' favour but is expected to have no practical effect as it is in line with current practice.

Change 107: Payments and benefits on termination of employment etc: meaning of benefit: section 402(4)

This excludes the right to receive a payment or benefit from being a benefit for the purposes of the charge to tax on payments and benefits received in connection with the termination of, or a change in the duties of, or earnings from, a person's employment.

Under section 148(1) of ICTA payments and other benefits received in connection with the termination, or a change in the duties of, or earnings from, a person's employment are chargeable to tax if and to the extent that they exceed £30,000 and if they are not otherwise chargeable. Under section 148(3) an amount so chargeable is income chargeable under Schedule E for the tax year in which the payment or benefit is received. But the right to receive the payment or other benefit is not itself regarded as a benefit "for this purpose". The purpose in question is clearly meant to be the purpose of determining the year for which the amount is income and the reason for this provision appears to be that without it a conflict might arise where the right to receive the payment or benefit was conferred in one tax year, but the payment or benefit itself was received in a later year.

However, it might be thought that the right to receive something was itself a benefit that would fall within the charge under section 148 if the benefit or payment itself were never received, for example because the right was assigned before that receipt occurred.

In rewriting this provision in section 402(4), it has been generalised so that a right to a payment or benefit is not itself a benefit for any purpose of Chapter 3 of Part 6 of the Act.

This change is in principle in taxpayers' favour but is expected to have no practical effect as it is in line with current practice.

Change 108: Payments and benefits on termination of employment etc.: exception for contributions to tax-exempt pension schemes: section 408
This excepts contributions made to a tax exempt pension scheme as part of an arrangement relating to the termination of an employee's employment from the charge on payments and other benefits received in connection with the termination of employment.

Under section 148 of ICTA payments and other benefits received in connection with the termination of a person's employment are chargeable to tax if and to the extent that they exceed £30,000 and if they are not otherwise chargeable. Payments to employees under tax-exempt occupational pension schemes on the termination of their employment are excepted from the charge under section 148 by paragraph 4 of Schedule 11 to ICTA. But this exception does not apply to the special contributions that are frequently made to the employees' pension arrangements, for example, to ensure that a pension which will be paid earlier than was previously anticipated is properly funded. So such payments fall within the terms of section 148.

Section 408 gives statutory effect to the Inland Revenue's practice of excepting such special contributions from the charge under section 148 (rewritten as section 403) if they are made–

- as part of an arrangement relating to the termination of a person's employment, and

- to a tax-exempt occupational pension scheme or approved personal pension arrangement.

This change is in principle in taxpayers' favour but is expected to have no practical effect as it is in line with current practice.

Change 109: Payments and benefits on termination of employment etc: reduction in cases of foreign service: section 414
This relates to the reduction available from the amount chargeable on payments and other benefits received in connection with the termination of employment, where some of the employee's service was foreign service, but the exception under paragraph 10 of Schedule 11 of ICTA is not available.

Under section 148 of ICTA payments and other benefits received in connection with the termination of a person's employment are chargeable to tax if and to the extent that they exceed £30,000 and are not otherwise chargeable. Payments are excepted from the charge under section 148 by paragraph 10 of Schedule 11 to ICTA where there has been lengthy foreign service before the termination. Where the conditions for paragraph 10 to apply are not met because the foreign service is too short, paragraph 11 of Schedule 11 provides for a reduction in the amount charged to tax related to the proportion of the employee's total service that is foreign service. Under paragraph 11(3) the reduction is limited. A person is not entitled to relief under paragraph 11–

> "in so far as the relief, together with any personal relief allowed to him, would reduce *the amount of income* on which he is chargeable below *the amount of the income tax* which he is entitled–
>
> (a) to charge against any other person, or
>
> (b) to deduct, retain or satisfy out of any payment which he is liable to make".

This limit is defectively drafted. The intention appears to have been to ensure that after the reduction enough tax will remain in charge to satisfy the tax to be charged, deducted, retained or satisfied by the employee, for example if he makes a payment under a charitable covenant.

The limit has been rewritten in section 414(4) and (5) of the Act, so as to give effect to that intention. Therefore the section provides that the relief must not reduce *the amount of income tax for which the person is liable* below the amount the person is entitled to deduct, retain, satisfy or charge.

This change simply corrects a technical defect. It is expected to have no practical effect as it is in line with current practice.

Change 110: Payments and benefits on termination of employment etc: valuation of benefits: application of benefits code rules: section 415

This involves the application, for the purposes of the charge on benefits received in connection with the termination of employment, of the valuation rules that apply for the benefits code, instead of those that apply for the charge on benefits under non-approved retirement benefits schemes.

Under section 148 of ICTA benefits received in connection with the termination of a person's employment are chargeable to tax if and to the extent that they exceed £30,000 and are not otherwise chargeable. Under paragraph 12 of Schedule 11 to ICTA the amount of a non-cash benefit is the cash equivalent of the benefit, and that is the greater of–

- the amount that would be chargeable under section 19(1) of ICTA if the benefit were an emolument chargeable under Case 1 of Schedule E, and

- the cash equivalent of the benefit determined in accordance with section 596B of ICTA (cash equivalent of benefits in kind for the purposes of the charge to tax on benefits under non-approved retirement benefits schemes).

Section 415 rewrites paragraph 12 of Schedule 11. However, instead of applying the rules in section 596B, section 415(2) provides that the value of a non-cash benefit is the greater of–

- the amount of earnings (as defined in Chapter 1 of Part 3) that the benefit would give rise to if it were received by an employee for duties of the employment (money's worth), and

- *the cash equivalent of the benefit under the benefits code* if it were so received and the code applied. ("The benefits code" is defined in section 63(1) as Chapters 2 to 11 of Part 3.)

So the section applies the benefits code valuation rules, rather than those in section 596B.

For this purpose, the benefits code rules are slightly modified by subsections (4), (6) and (7). Most significantly, section 415(4) provides that references in the benefits code to the employee are to be taken as referring to the taxable person (who may be a former employee, rather than a current one) and any other person by whom the benefit is received. As the provisions about the calculation of the cash equivalent provide for the deduction of amounts made good by the employee, this allows the deduction of such amounts where recipients other than the employee have made good.

This change is in taxpayers' favour in principle and may in practice benefit some although the numbers and amounts are thought to be negligible.

Change 111: Share-related income: extending the time limits for the supply of particulars: sections 432(3), 433(3), 445(3) and 466(3)

This extends the time limit for the supply of information relating to conditional interests in shares, convertible shares and post-acquisition benefits so that the time limits for the supply of the information are either the same as, or more in line with, those for other requirements to supply information relating to shares.

(A) Conditional interests in shares and convertible shares

Section 140G of ICTA requires information to be supplied for the purposes of sections 140A to 140F of ICTA (conditional interests in shares and convertible shares). Section 140G(5) of ICTA requires particulars to be delivered no later than 30 days after the end of the year of assessment in which the interest is provided, the event occurs or the conversion takes place.

But more generous time limits apply in relation to other requirements to supply information relating to shares. Section 136(6) of ICTA requires certain particulars relating to share options to be delivered to the Inland Revenue "not later than 92 days after the end of that year". Section 85(1) of FA 1988 requires particulars to be given to an inspector where a person acquires shares, or an interest in shares, in a company in the circumstances described in section 77(1) of that Act. Those particulars are to be given "within 92 days of the end of the year". It is possible that the same information could be required under section 140G of ICTA no later than 30 days after the end of the year of assessment and under section 136(6) of ICTA or section 85(1) of FA not later than 92 days after the end of the year.

It is thought to be in the interests of taxpayers that the time limits for the provision of information relating to shares should be the same, where that is possible. Accordingly, the time limits in sections 432(3), 433(3) and 445(3), which are otherwise based on section 140G(5) of ICTA, have been extended from 30 days after the end of the tax year to 92 days after the end of the tax year. This new time limit has been rewritten as "before 7th July in the tax year following that in which" the interest is provided or the event or conversion takes place so that taxpayers do not have to work out which day is 92 days after the end of the tax year.

(B) Post-acquisition benefits from shares

Section 85(2) of FA 1988 requires particulars to be given of an event that is a chargeable event for the purposes of section 78 of that Act and of the receipt of special benefits (within the meaning given for the purposes of section 80 of that Act). The particulars must be given within 60 days of the event occurring or the receipt. It is thought that this time limit should be extended to 92 days to bring it more into line with the other time limits mentioned above. Accordingly section 466(3) of the Act does so.

This change has no implications for the amount of tax paid, who pays it or when. It affects (in principle and in practice) only administrative matters.

Change 112: Share-related income: convertible shares: amount of charge: "event" to include the expiry of a period: section 439(7)

This ensures that an amount that counts as employment income under Chapter 4 of Part 7 of the Act as a result of the expiry of a period, in a case where the shares are convertible shares, is deducted in calculating the amount that counts as employment income on the conversion of the shares.

Section 140A(5) to (7) of ICTA set out the amount of the charge to tax where an interest in shares which is only conditional ceases to be only conditional or the employee disposes of the shares. The amount of the charge is the difference between the market value of the employee's interest and any deductible amounts. Under section 140A(7)(c) of ICTA one of the deductible amounts is "any amounts on which

the employee has, by reference to an event occurring not later than the time of the event by virtue of which a charge arises under this section, become chargeable to tax in respect of the shares under section 78 or 79 of FA 1988 (unapproved employee share schemes)". Section 140A(7)(c) of ICTA refers to two events, namely, an event by virtue of which a charge arises under section 140A and an event by reference to which the employee has become chargeable to tax in respect of the shares under section 78 or 79 of FA 1988. Section 140A(9) of ICTA provides that the references in section 140A(7)(c) to an event include references to the expiry of a period. It is thought that this was intended to deal with the argument that where an interest in shares had ceased to be conditional because of the passage of time, there had been no *event* for the purposes of section 140A(7)(c).

Section 140D(5) to (7) of ICTA provide for the amount of the charge on the conversion of convertible shares. The provisions are similar to those in section 140A(5) to (7) of ICTA. In particular, under section 140D(6)(d) one of the deductible amounts is "any amounts on which the employee has, by reference to an event occurring not later than the time of the conversion, become chargeable to tax in respect of the shares under section 78 or 79 of FA 1988 (unapproved employee share schemes)". Section 140D(6)(d) of ICTA only refers to one event, namely, an event by reference to which the employee has become chargeable to tax in respect of the shares under section 78 or 79 of FA 1988. There is no provision to the effect that an event includes the expiry of a period for the purposes of section 140D(6)(d).

Under section 79(1) of FA 1988 a person is chargeable to tax if there is a chargeable increase in the value of the shares. Under section 79(2) if the shares are shares in a company which was a dependent subsidiary at the time of the acquisition, there is a chargeable increase in the value of shares if the value of the shares at the earlier of the expiration of 7 years from the time of the acquisition and the time when the person making the acquisition ceases to have a beneficial interest in the shares exceeds their value at the time of the acquisition. The event by reference to which a person becomes chargeable to tax under section 79 of FA 1988 could therefore be the expiry of the period of 7 years from the time of the acquisition. Similarly in the case where the shares are shares in a company which has become a dependent subsidiary, by virtue of section 79(3)(a) of FA 1988 a person may become chargeable to tax under section 79 at the expiry of the period of 7 years from the time when the company became a dependent subsidiary.

It is therefore possible that the event by reference to which a person becomes chargeable to tax under section 79(1) of FA 1988 could be the expiry of a period. If the expiry of this period does not count as an event for the purposes of section 140D(6)(d) of ICTA, the amount of the charge under section 79 of FA 1988 would not be a deductible amount for the purposes of section 140D. There would be the possibility of double taxation. As section 140A(9) of ICTA makes it clear that an event includes the expiry of a period for the purposes of section 140A(7)(c) of ICTA, it is considered that similar provision should also be made in relation to the provision based on section 140D(6)(d) of ICTA.

Section 439 of the Act is based on section 140D(5) to (7) of ICTA and subsection (3) is based on section 140D(6)(d) of ICTA. Section 439(7) makes it clear for the purposes of subsection (3) that an event includes the expiry of a period.

This change is in principle in taxpayers' favour but is expected to have no practical effect as it is in line with current practice.

Change 113: Share-related income: post-acquisition benefits from shares: amount of charge where increase in value of shares of dependent subsidiaries: section 455

This corrects a defect in the mechanism for quantifying the amount charged to tax where there has been an increase in value of shares of a company that is a dependent subsidiary.

Section 79 of FA 1988 (charge for shares in dependent subsidiaries) applies in two cases where there has been an acquisition of shares (or an interest in shares) by a director or an employee–

- the first case is where the company whose shares they are was a dependent subsidiary at the time of the acquisition;

- the second case is where that company has become a dependent subsidiary after the time of the acquisition but while the director or employee retains a beneficial interest in the shares.

A "dependent subsidiary" is broadly speaking a subsidiary company that does not have the degree of independence from the other members of the group required by section 86 of the Act.

Section 79(2) and (3) impose charges to tax on increases in the value of the shares as compared with–

- (in the first case) their value at the time of the acquisition, or

- (in the second case) their value at the time when the company became a dependent subsidiary.

Section 79(6) is designed to reduce the amount chargeable if, in accordance with the terms on which the acquisition was made, the director or employee disposes of his interest in the shares but does so for less than market value. In these circumstances the amount chargeable is stated to be the excess of the proceeds of the disposal over the value of the shares or the interest *at the time of the acquisition.*

This reference to the value at the time of acquisition is appropriate where the charge to tax operates in the first case mentioned above. But it is not appropriate where the

charge to tax operates in the second case, because in that case the reference point for the increase in value is the time when the company became a dependent subsidiary. In such a case section 79(6) ought to have referred to that time and not the time of acquisition.

Section 77(6) has been rewritten in a way that corrects this defect: see section 455(3)(b) of the Act.

This change is in principle adverse to some taxpayers and favourable to others but it is expected to have no practical effect as it is in line with current practice.

Change 114: Shares: post-acquisition benefits from shares: deemed acquisitions by director or employee: sections 457 and 463

This clarifies the effect of the provisions deeming shares (or interests in shares) to be acquired or retained by directors or employees for the purposes of the provisions charging post-acquisition benefits from shares.

Section 83 of FA 1988 is designed to extend the scope of operation of Chapter 2 of Part 3 of that Act, which imposes charges to tax in respect of shares (or an interest in shares) acquired by a director or employee of a company by reason of that person's office or employment.

In broad terms, section 83(1) provides for shares (or an interest in shares) acquired by a person as a result of being a person connected with a director or employee of a company to be treated for the purposes of the Chapter as acquired by the director or employee. *Note 46* refers to the fact that section 447(5) of the Act spells out–

- that in such a case the beneficial interest in the shares is to be regarded as held by the director or employee so long as it is held by the connected person, and

- that the acquisition is to be treated as an acquisition by that person *as a director or employee of the company concerned.*

(A) Section 83(2) of FA 1988 then provides that where a person who acquires shares (or an interest in shares) disposes of the shares (or interest) otherwise than by a bargain at arm's length with a person who is not connected with him, he is deemed to continue to have a beneficial interest in the shares until there is a disposal by such a bargain. (This rule does not apply where the disposal is in accordance with the terms on which the acquisition was made: see section 83(3).)

It is reasonably plain what section 83(2) of FA 1988 is trying to do, namely to ignore disposals which are not at arm's length or are to a connected party with the result that the director or employee is deemed to retain the beneficial interest. But it is not clear whether the current wording achieves that result where the shares were in fact acquired by a person connected with the director or employee and so have already

been subject to the deeming provision in section 83(1) (see above). The Inland Revenue have, however, always regarded the rule in section 83(2) as applying to shares acquired by connected persons. The rule has been rewritten in section 463 of the Act in a way that ensures that it will so apply for the purposes of Chapter 4 of Part 7 of the Act.

(B) Finally, section 83(4) of FA 1988 sets out to ensure that the provisions in section 83(1) and (2) dovetail with the provisions of section 80 of the Act which charge certain benefits acquired by virtue of the ownership of shares (or an interest in shares). The *first* limb of section 83(4) provides, in effect, that where a director or employee is deemed by section 83(1) to have made an acquisition of shares (or an interest in shares) by virtue of an acquisition by a connected person, a benefit received by the connected person in circumstances within section 80 is deemed to have been received by the director or employee for the purposes of that section. The *second* limb provides that where, at a time when a person ("A") is deemed to continue to have a beneficial interest in shares by virtue of section 83(2), another person receives a benefit in circumstances within section 80 then the benefit is to be treated as received by A for the purposes of that section.

Again it is reasonably plain what section 83(4) is trying to achieve, namely to ensure that directors or employees can be regarded for the purposes of section 80 as having received benefits in fact received by other persons. But it is not clear that the current wording successfully deals with a case where–

- shares were acquired by a connected person (so that section 83(1) applies),

- the shares were disposed of by the connected person otherwise than by a bargain at arm's length (so that section 83(2) applies), and

- during the period when the connected person is deemed to continue to have beneficial interest in the shares another person receives a section 80 benefit (so that the *second* limb of section 83(4) applies).

The difficulty is that the *first* limb of section 83(4) does not seem apt to ensure that the benefit treated as received by the connected person is deemed to have been received by the director or employee. It only applies where a benefit is received by the connected person in circumstances within section 80. Chief among those circumstances are receipt of the benefit "by reason of his ownership of or interest in the shares" (see section 80(1)). However, in the scenario mentioned above the connected person would be receiving the benefit not by virtue of his ownership of or interest in the shares, but by virtue of the deeming provision in the *second* limb in section 83(4).

Despite the deficiencies in the wording of section 83(4) which this analysis reveals, the Inland Revenue have proceeded on the basis that that provision must have been intended to cover the scenario mentioned above. In rewriting the opening provisions

of section 80 of FA 1988 in section 457 of the Act, subsection (2) of section 457 (which deals with the recipients of benefits for the purposes of the section) contains a paragraph (c) that is drafted in such a way as to ensure that that scenario is covered in the Act.

This change is in principle adverse to some taxpayers but it is expected to have no practical effect as it is in line with current practice.

Change 115: Share-related income: post-acquisition benefits from shares: restriction of liability to tax on special benefits from shares: section 460
This corrects a defect in the provisions restricting liability to tax on special benefits from shares.

Section 80(1) of FA 1988 (charge on special benefits from shares) imposes a charge to tax on a director or employee receiving a special benefit from shares by virtue of his ownership of or interest in the shares. Section 80(1A) to (3A) explain what are "special benefits" for the purposes of the section.

Section 80(5) restricts the operation of the charge to tax: it is only to apply if *the person receiving the benefit has been a director or employee of the company referred to in section 80(1)* or another company mentioned in section 80(5).

The difficulty with this wording is that no company is actually mentioned in section 80(1). But it is thought that section 80(5) must have been intended to refer to the company *whose shares are* mentioned in section 80(1). Section 80(5) has therefore been rewritten in a way that corrects this defect: see section 460 of the Act.

This change simply corrects a technical defect. It is expected to have no practical effect as it is in line with current practice.

Change 116: Share-related income: post-acquisition benefits from shares: duty to provide information: section 465
This modifies the requirements to provide information about share acquisitions for the purposes of the provisions which charge to tax post-acquisition benefits from shares.

These requirements are modified in two different ways–

- by expressly applying them to acquisitions of additional shares and the issue of new shares in a reorganisation (see *(A)* below);

- by excluding them in a case where an acquisition of shares has already been notified to the Inland Revenue under another provision (see *(B)* below).

(A) Section 85(1) of FA 1988 requires a director or employee who acquires shares (or an interest in shares) by reason of his office or employment to give particulars of the acquisition to the inspector within 92 days of the end of the tax year in which it occurs.

It seems clear that, in order for all acquisitions of shares relevant for the purposes of Chapter 2 of Part 3 of FA 1988 to be notified to the Inland Revenue, this requirement should apply not only to an original acquisition of shares but also to an acquisition of additional shares under section 82(1) of FA 1988 and to the issue of new shares in a reorganisation under section 82(3) of that Act.

Indeed, section 82(2)(a) of that Act has this result in relation to additional shares by virtue of requiring such shares to be treated for the purposes of the Chapter (which include the information requirements of section 85(1)) as having been acquired by the director or employee by reason of his office or requirement. There is a difficulty however, in that the acquisition of additional shares is deemed by section 82(2)(a) to take place at the same time as the acquisition of the original shares. This might suggest that the time limit for providing the information about the additional shares is 92 days from the end of the tax year in which the *original* shares were acquired. This would be inappropriate and it could be argued that section 85(1) simply does not work in relation to additional shares. However, the accepted view is that the intended time limit is intended to run by reference to the tax year in which the *additional* shares are acquired.

A similar view is taken as regards the operation of the requirement in connection with the issue of new shares in a reorganisation.

Sections 82(2) and 85(1) of FA 1988 have been rewritten in such a way as to ensure–

- that the information requirements will apply to additional shares and new shares: see section 465(2) of the Act;

- that the time limit will run from the end of the tax year in which the additional shares are acquired: see section 461(2)(b) of the Act (under which the deeming provision as to the time of acquisition of the shares does not apply in relation to section 465 of the Act).

(B) There is currently an element of duplication between section 85(1) of FA 1988 (see above) and sections 136(6) and 140G(1) of ICTA in that a particular acquisition of shares may be required to be notified to the Inland Revenue under both section 85(1) and one of the other provisions. The Inland Revenue do not currently insist on multiple notifications.

Section 85(1) has been rewritten in section 465 of the Act; and subsection (5) of section 465 excludes the requirement to notify an acquisition under that section if it

has already been notified under the provisions rewriting section 136(6) or 140G (i.e. under section 432 or 486 of the Act).

(C) In addition it should be mentioned that, in rewriting section 85(1) in section 465, the reference to "the inspector" has been replaced by a reference to "the Inland Revenue" (and a similar change has been made in rewriting section 85(2) in section 466). This is dealt with in *Change 158*.

This change has no implications for the amount of tax paid, who pays it or when. It affects administrative matters only (and does so only in principle and not in practice).

Change 117: Share-related income: post-acquisition benefits from shares: meaning of "interest in shares": section 470
This excludes share options from the meaning of "interest in shares" in the provisions charging post-acquisition benefits from shares.

Chapter 2 of Part 3 of FA 1988 imposes various charges to tax where a person has acquired shares or *an interest in shares*. Technically, a share option, which is a right to acquire shares, could be regarded as an interest in shares. However, it is not thought that Chapter 2 was intended to apply where a share option is acquired, and the Inland Revenue have never sought to apply the Chapter in such cases.

Section 470(1) (which defines various expressions for the purposes of the provisions rewriting Chapter 2) therefore contains a definition of "interest in shares" that expressly excludes share options.

This change is in principle in taxpayers' favour but is expected to have no practical effect as it is in line with current practice.

Change 118: Share-related income: share options: application of rule about the employment by reason of which a share option was granted to the charge in section 477: section 473(1)
This introduces a rule that the charge under section 477 of the Act (charge on employee where option exercised, assigned or released by another person) does not apply to a share option if any earnings from the office or employment by reason of which it was granted were not general earnings to which section 15 or 21 of the Act applies.

There are two charges to tax in section 135 of ICTA. One is in subsection (1) and it arises "where a person realises a gain by the exercise, or by the assignment or release, of a right to acquire shares in a body corporate *obtained by that person as a director or employee of that or any other body corporate*". Section 140(1) of ICTA gives the meaning of the phrase "obtained by a person as a director or employee". Under

section 140(1) of ICTA one of the requirements is that the right to acquire shares has been granted by reason of the person's office or employment as a director or employee of a body corporate who is chargeable to tax in respect of that office or employment under Case I of Schedule E. Section 140(1) of ICTA therefore prevents there being a charge to tax under section 135(1) of ICTA if the employee or director by reason of whose office or employment the share option was granted was not chargeable to tax in respect of the office or employment under Case I.

The second charge to tax in section 135 of ICTA is in subsection (6). It provides that, if the conditions in paragraph (a) or (b) of the subsection are met, "…a person shall, in the case of a right granted by reason of his office or employment, be chargeable to tax under this section in respect of a gain realised by another person". The phrase "*obtained by that person as a director or employee*" is not used in that subsection, so section 140(1) of ICTA does not apply. There is nothing in section 135(6) of ICTA or elsewhere to limit the offices and employments to those in respect of which the employee or director is chargeable to tax under Case I. Accordingly, there is nothing to restrict the charge under section 135(6) of ICTA to share options granted to directors and employees who are chargeable to tax under Case I in respect of their offices and employments.

In practice, charges to tax under section 135(6) of ICTA are not imposed unless the director or employee concerned is so chargeable to tax. Otherwise an employee who is chargeable to tax in respect of his office or employment under Case II or III of Schedule E and who exercised a share option would not be liable to tax under section 135(1) of ICTA because of section 140(1) of ICTA but if the share option had been granted to his wife and she had exercised it, he would be liable under section 135(6) of ICTA.

Section 473(1) of the Act reflects the practice by including section 477 (based on section 135(6) of ICTA) in the sections which do not apply to a share option granted by reason of a person's office or employment if any earnings from the office or employment were not general earnings to which section 15 or 21 applies.

This change is in principle in taxpayers' favour but is expected to have no practical effect as it is in line with current practice.

Change 119: Share-related income: share options: value of longer-term option for purposes of liability to tax in respect of receipt: section 475(2)
This limits the value of a share option for the purposes of liability to tax in respect of its receipt.

Section 135(5)(b) of ICTA provides for the value of a share option for the purposes of a charge to tax in respect of its receipt. It provides that the value is "*not less than*" the market value of certain shares. In practice, there have been very few occasions on which the Inland Revenue have argued for a figure higher than market value.

Section 475(2) of the Act is based on section 135(5)(b) of ICTA. The words "not less than" have been left out so that the value of the share option can no longer be greater than the market value of the shares.

This change is in principle in taxpayers' favour but is expected to have no practical effect as it is in line with current practice.

Change 120: Share-related income: share options: value of longer-term option to acquire convertible shares: section 475(2)
This removes one of the alternatives in the rule for valuing an option to acquire convertible shares for the purposes of liability to tax in respect of the receipt of the option.

Section 135(5)(b) of ICTA provides for the value of a share option for the purposes of liability to tax in respect of its receipt. It provides that the value is not less than the market value of certain shares. These shares are either the shares which may be acquired by the exercise of the share option or shares for which those shares may be exchanged.

The second option will only be available if the shares which are acquired by the exercise of the share option may be exchanged for other shares, that is if they are convertible shares. In such a case, section 135(5)(b) of ICTA contains no guidance as to which value should be used, that of the shares that may be acquired by the exercise of the option or that of the shares for which those shares may be exchanged.

In practice the value of the shares which may be obtained on exchange is used where it is higher than the value of the shares which may be acquired by the exercise of the share option. Section 475(2) of the Act reflects this practice by specifying that "MV is the higher of" the two values set out in paragraphs (a) and (b) of the definition of MV.

This change is adverse to some taxpayers in principle but is expected to have no practical effect as it is in line with current practice.

Change 121: Share-related income: share options: exception where share option exercised, assigned or released by certain people after the death of the person to whom it was granted: section 477(4)
This involves the creation of a new statutory exception from the charge to tax in section 477 of the Act (charge on employee where option exercised, assigned or released by another person).

Section 135(6) of ICTA imposes a charge to tax under Schedule E on a person in certain circumstances where a share option granted by reason of that person's office as a director or employment is exercised, assigned or released by another person. Generally, the Inland Revenue do not enforce this charge if the share option is

exercised by the personal representatives of the person to whom it was granted. In some circumstances, this concession is also extended to a person who inherits the share option under a will. These practices are described in the booklet IR16 and in para.3.19 of the Share Schemes Manual.

Section 477(4) of the Act reflects these practices but also extends the exception to any person on whom the option devolves under a testamentary disposition or on an intestacy or partial intestacy.

The effects of this change are also referred to in part (C) of *Change 129*.

This change is in taxpayers' favour in principle and may in practice benefit some although the numbers and amounts are thought to be negligible.

Change 122: Share-related income: share options: amount of charge to tax under Case VI of Schedule D: section 477(6)
This reduces the amount of the charge to tax under Case VI of Schedule D which arises when a share option is exercised, assigned or released by a person who acquired the option when the person by reason of whose office as a director or employment it was granted was divested of it by operation of law.

Section 135(6) of ICTA imposes a charge to tax under Schedule E on a person in certain circumstances where a share option granted by reason of that person's office as a director or employment is exercised, assigned or released by another person. The circumstances are set out in paragraphs (a) and (b) of section 135(6) of ICTA. The circumstances in section 135(6)(b) of ICTA are where the other person acquired the right otherwise than by or under an assignment made by way of a bargain at arm's length and where the two are connected persons.

Section 135(7) of ICTA provides that, "A person shall not be chargeable to tax by virtue of subsection (6)(b) above in respect of any gain realised by another person if the first-mentioned person was divested of the right by operation of law …but the other person shall be chargeable to tax *in respect of the gain* under Case VI of Schedule D."

Where a person is chargeable to tax under section 135(6) of ICTA in the circumstances in paragraph (b) of that subsection, the effect of the full-out words at the end of that subsection is that the amount of the gain is treated as reduced by the amount of any gain realised by a previous holder on an assignment of the right. It is not clear whether their effect is also to reduce the amount of the gain for the purposes of the charge to tax under Case VI of Schedule D. It is the practice to reduce the amount of the gain for this purpose.

Section 477(6) of the Act reflects this practice and provides that the amount of the charge under Case VI of Schedule D is the amount of the gain in a case within the provisions of the Act that are based on section 135(6)(b) of ICTA.

This change is in principle in taxpayers' favour but is expected to have no practical effect as it is in line with current practice.

Change 123: Share-related income: share options: deductions for the amount of the liability to tax in respect of the receipt of the share option: section 478(2) and (3)

This prevents double taxation where there was liability to tax in respect of the receipt of a share option and an amount counts as employment income under section 477 of the Act in respect of the exercise, assignment or release of the share option by a person other than the person by reason of whose office or employment the option was granted.

Section 135(5) of ICTA provides:

> "Where such a right as is mentioned in subsection (1) above is obtained as mentioned therein and is capable of being exercised later than ten years after it is obtained, and the receipt of the right is chargeable to tax under any other provision of the Tax Acts, then–
>
> (a) the amount so charged shall be deducted from any amount which is chargeable under subsection (1) above by reference to the gain realised by the exercise, assignment or release of that right; and …".

Section 135(5)(a) of ICTA does not provide for a deduction where the charge is under section 135(6) of ICTA (charge on a person where share option granted by reason of the person's office as a director or employment is exercised, assigned or released by another person). If the charge is under section 135(6) of ICTA, there is no provision permitting the deduction of any liability to tax in respect of the receipt of the share option.

In order to prevent double taxation in such a case, section 478(2) of the Act provides for deductions in respect of such a liability where the charge is under section 477 of the Act (based on section 135(6) of ICTA), as well as where it is under section 476 (based on section 135(1) of ICTA). Section 478(3) of the Act prevents an amount being deducted if section 476 or 477 of the Act has already applied to the share option by virtue of an earlier event and the amount was deducted on that occasion. This exception is to prevent double deductions.

This change is in principle in taxpayers' favour but is expected to have no practical effect as it is in line with the practice since the amendment of section 135(5)(a) of ICTA by FA 2002.

Change 124: Share-related income: share options: requiring an apportionment of consideration to be reasonable as well as just: section 484(2)
This alters the rule for the apportionment of consideration so that the apportionment has to be reasonable, as well as just.

The full-out words at the end of section 135(3) of ICTA require a just apportionment to be made of any entire consideration given for the grant of the share option and other share options or for the grant of the share option and for something else. It is now the practice in new tax legislation to require an apportionment to be just *and reasonable*. For example, section 140B of ICTA, which contains a similar rule in relation to interests in shares which are only conditional, requires the apportionment of consideration to be just and reasonable. There is no reason why some apportionments required by the Act should be made on a just basis and others on a just and reasonable basis. It is desirable that they should all be done on the same basis.

Accordingly, section 484(2) of the Act (based on the full-out words at the end of section 135(3) of ICTA) reflects the practice in newer tax legislation and requires an apportionment of consideration to be reasonable, as well as just.

This change makes a minor amendment to an existing rule, but is expected to have no practical effect as it is in line with current practice.

Change 125: Share-related income: share options: correcting consolidation error in section 136(2)(b) of ICTA: section 485(5)(b) and corresponding provisions
This corrects a consolidation error in section 136(2)(b) of ICTA.

Section 136(2) of ICTA deals with cases where one share option is exchanged for another. It requires transactions to be treated as a single transaction whereby a share option is assigned for a consideration which consists of or comprises the other share option, where the conditions in paragraphs (a) and (b) of the subsection are met. The condition in section 136(2)(b) is that "any of those transactions was effected under arrangements to which two or more persons holding rights in respect of which *tax may be chargeable under this section* were parties".

In fact, no tax is chargeable under section 136 of ICTA so no such rights exist. The provision should refer to "persons holding rights in respect of which tax may be chargeable under section 135". The problem results from consolidation. Before consolidation the provision from which section 136(2) of ICTA was derived and the provisions from which section 135 of ICTA were derived were all part of section 186 of the Income and Corporation Taxes Act 1970. When that section was split into two on consolidation, the need to change "this section" to "section 135" was overlooked. This has not been a problem in practice.

Section 485(5)(b) of the Act is based on section 136(2)(b) of ICTA, but as if the consolidation error had not been made. Accordingly, section 485(5)(b) refers to "persons holding share options, in respect of which there may be liability to tax under this Chapter".

Section 136(2) of ICTA is applied in relation to conditional interests in shares and convertible shares by sections 140B(7) and 140E(7) of ICTA. Accordingly, there are similar changes in sections 430(4) and 443(4) of the Act, which are respectively based on sections 140B(7) and 140E(7).

This change simply corrects a technical defect. It is expected to have no practical effect as it is in line with current practice.

Change 126: Share-related income: share incentive plans: no charge on increase in value of shares of dependent subsidiary: section 495

This clarifies the operation of the exemption from tax that is available to a participant in a share incentive plan in respect of an increase in value of shares of a dependent subsidiary.

Paragraph 80(3) of Schedule 8 to FA 2000 provides that a participant in a share incentive plan (a "SIP") is not chargeable to tax under section 79 of FA 1988 (charge on increase in value of shares of dependent subsidiaries) in respect of any shares that are subject to the SIP at the time when the chargeable increase is determined under section 79. That time ("the appropriate time") may be the time when the shares are sold or some other time specified in section 79(2) or (3).

There is a difficulty with the current wording of paragraph 80(3). If the appropriate time is the time when the shares are sold, it is debatable whether they are still subject to the SIP *at that time*: paragraph 122(1) and (3) of Schedule 8 to FA 2000 have the effect that shares *cease* to be subject to a SIP at the time when they are sold. Nevertheless, it seems clear that the exemption under paragraph 80(3) must have been intended to cover these circumstances, and the Inland Revenue have always accepted that it does.

In rewriting paragraph 80(3) in section 495 of the Act the words "or immediately before" have been inserted in subsection (1) of that section. The result is that the exemption will be available in respect of shares that are subject to a SIP "at *or immediately before* the appropriate time".

This change is in principle in taxpayers' favour but is expected to have no practical effect as it is in line with current practice.

Change 127: Share-related income: share incentive plans: no charge in respect of incidental expenditure: section 499

This extends the exemption from tax that is available to employees in respect of incidental expenditure incurred in operating a share incentive plan.

Paragraph 78(3) of Schedule 8 to FA 2000 provides that incidental expenditure of the trustees or the employer in operating a share incentive plan (a "SIP") is not treated as giving rise to any charge to income tax on employees. There is a difficulty with this wording because "the employer" may or may not be the company that established the SIP, depending on the circumstances. If "the employer" is *not* the company that established the SIP, then the exemption conferred by paragraph 78(3) of Schedule 8 will not cover incidental expenditure incurred by that company in operating the plan.

In rewriting paragraph 78(3) in section 499 of the Act this omission has been corrected by referring to incidental expenditure of the trustees and of *the company which established the plan or (if different)* the employer.

This change is in taxpayers' favour in principle and may in practice benefit some although the numbers and amounts are thought to be negligible.

Change 128: Share-related income: share incentive plans: identification of shares ceasing to be subject to plan: section 508

This extends to dividend shares the rules for deciding the order in which a participant's shares are to be regarded as ceasing to be subject to a share incentive plan.

Paragraph 122(6) of Schedule 8 to FA 2000 contains rules for deciding the order in which a participant's shares are to be regarded as ceasing to be subject to a share incentive plan (a "SIP"). The primary rule is that shares are to be taken as ceasing to be subject to a SIP in the order in which they were awarded to the participant. There is a further rule, which is also drafted in terms of shares being "awarded".

The difficulty with these references to shares being "awarded" is that, while (as a result of paragraph 3 of Schedule 8) it is appropriate to refer to an award of free, matching or partnership shares, this terminology is not used in the Schedule in relation to dividend shares. (Paragraph 56 of the Schedule contemplates that dividend shares will be acquired on behalf of, or appropriated to, a participant.)

Nevertheless it seems clear that the intention behind paragraph 122(6) is that <u>all</u> of a participant's shares should be pooled, and that those shares should be regarded as ceasing to be subject to the SIP on a "first in/first out" basis. This accords with the Inland Revenue's practice.

In rewriting paragraph 122(6) in section 508 of the Act, a special gloss explaining the meaning of "awarded" in relation to dividend shares has therefore been included in subsection (2) of that section.

This change is a clarification with no tax effects either in principle or in practice.

Change 129: Share-related income: SAYE option schemes and CSOP schemes: no charge in respect of exercise of options: sections 519 and 524; Schedule 6, paragraph 221

This clarifies the time limits that apply to tax-exempt exercises of options obtained under approved share option schemes.

(A) Section 185(3) and (4) of ICTA apply to a savings-related share option scheme (a "SAYE option scheme"). They have the effect that income tax is not chargeable in respect of the exercise of a share option obtained by an employee under a SAYE option scheme if–

- it is not exercised within 3 years of its being obtained; or
- it is exercised within 3 years of its being obtained but it is not so exercised by virtue of a provision included in the scheme pursuant to paragraph 21 of Schedule 9 to ICTA (which allows for exercises to take place following changes in the status of the employer company).

Section 185(3) and (4) of ICTA have been rewritten in a way that ensures that the 3-year period during which an exercise of an option obtained under a SAYE option scheme may not be tax-exempt begins with the day on which the option was obtained rather than with the following day. See section 519(2) and (3) and section 520(1) of the Act.

Section 519(2) and (3) are also applied in paragraph 10 of Schedule 7D to TCGA 1992 (inserted by paragraph 221 of Schedule 6 to the Act) which deals with capital gains tax consequences of the exercise of an option under an approved SAYE option scheme.

(B) Section 185(3) and (5) of ICTA apply to share option schemes other than a savings-related one (a "CSOP scheme"). They have the effect that income tax is not chargeable in respect of the exercise of a share option obtained by an employee under a CSOP scheme if–

- the period beginning with his obtaining the option and ending with the exercise is not less than 3, nor greater than 10, years; and
- it is not exercised within 3 years of the date of a previous tax-exempt exercise of an option obtained under a CSOP scheme.

Section 185(3) and (5) of ICTA have been rewritten in section 524(2) and (3) in a way that ensures that, as regards the period of not less than 3 nor more than 10 years during which an exercise of an option obtained under a CSOP scheme may be tax-exempt–

- the 3 years begins with the day on which the option was obtained rather than with the following day; and

- the 10 years in effect begins with the following day.

In addition, section 524(2)(b) of the Act makes it clear that the three-year period during which there must not have been a previous tax-exempt exercise of an option is a period of 3 years ending with the date on which the current option is exercised.

The extension of the 10-year period will be consistent with the 10-year period within which a tax-exempt exercise of an option acquired in accordance with Schedule 14 to FA 2000 (enterprise management incentives) may occur.

Section 524(2) of the Act is also applied in paragraph 13 of Schedule 7D to TCGA 1992 (inserted by paragraph 221 of Schedule 6 to the Act) which deals with capital gains tax consequences of the exercise of an option under an approved CSOP scheme.

(C) It may be mentioned that section 185(3) of, and paragraph 27(3) of Schedule 9 to, ICTA currently make provision for tax-exempt exercises of options obtained under a CSOP scheme where they are exercised after the death of the option holder and within 10 years of his obtaining them. This has not been rewritten because the Act contains a general exemption from tax on the exercise of an option by the holder's personal representatives etc: see *Change 121*.

Nothing in section 185 of, or Schedule 9 to, ICTA expressly deals with the tax position where options obtained under an SAYE scheme are exercised after the death of the option holder. But it may be inferred that any exercise of such an option that is made in accordance with the scheme (see paragraph 18 of Schedule 9) will be tax-exempt. This will remain the case: as mentioned above, the Act contains a general exemption from tax on the exercise of an option by the holder's personal representatives etc: see *Change 121*.

This change is in principle in taxpayers' favour but is expected to have no practical effect as it is in line with current practice.

Change 130: Share-related income: the EMI code: disqualifying events relating to employee: section 535

This simplifies the "working time" rule that may operate to modify the tax advantages available to an employee on the exercise of a share option obtained under the provisions relating to enterprise management incentives.

Part 6 of Schedule 14 to FA 2000 (enterprise management incentives) confers tax advantages in respect of the grant and exercise of share options obtained in accordance with the Schedule. The tax advantages in respect of the exercise of an option may be affected by the occurrence of one of the "disqualifying events" mentioned in paragraph 47 of the Schedule.

Paragraph 47(3) says that a disqualifying event is to be treated as occurring if in any tax year the employee's relevant working time amounts to less than 25 hours a week or, if less, 75% of his working time. This rule is supplemented by the detailed provisions of paragraph 52 of the Schedule, which require month-by-month calculations of the amount of the employee's working time over the tax year to date. If that amount falls below the threshold, a disqualifying event is treated as occurring.

Those provisions are thought to produce unfair results for employees who work flexi-time: the hours worked by such employees may in some weeks fall below 25 hours, even though on average they would equal or exceed this threshold (see also *Change 176*). Further, they do not appear to deal satisfactorily with the circumstances where a disqualifying event has been treated as having occurred during a tax year but the result of a subsequent calculation is that no disqualifying event should be treated as occurring during the year.

(A) In rewriting paragraphs 47(3) and 52 in section 535 of the Act a much simpler mechanism has been devised. The effect of subsections (2) to (6) of section 535 is that a disqualifying event is to be treated as occurring at the end of a tax year if, during that year, the average amount per week of the employee's reckonable time in relevant employment was less than the statutory threshold of 25 hours or (if less) 75% of the employee's working time. A special rule for the tax year in which the option was granted will result in any part of that year which preceded the grant of the option being disregarded in calculating this average amount (see subsection (5) of the section).

(B) In subsection (3) of the section, the definition of an employee's "reckonable time in relevant employment" follows the definition of "relevant working time" in paragraph 52 of Schedule 14 to FA 2000 by referring to time in fact spent on the business of the relevant company or the group. In addition it corrects an omission in paragraph 52 by referring also to time that would have been so spent but for any of the reasons set out in paragraph 26(3)(a) to (d) of Schedule 5 to the Act (which refer to injury, ill-health, maternity leave etc.).

This change is in taxpayers' favour in principle and may in practice benefit some although the numbers and amounts are thought to be negligible.

Change 131: Share-related income: the EMI code: no charge on acquisition of shares as a taxable benefit: section 540
This clarifies the scope of the relief available to the holder of a qualifying option from the charge to tax on acquisitions of shares at an undervalue.

Paragraphs 42 to 55 of Schedule 14 to FA 2000 contain provisions relating to the income tax effects of the grant or exercise of a qualifying option under the provisions relating to enterprise management incentives.

Paragraph 54 of the Schedule provides that section 162 (1) of ICTA (which imposes a charge to tax where an employee acquires shares at an undervalue), as it applies in relation to an employee chargeable under Case 1 of Schedule E, does not apply in relation to the acquisition of shares by the exercise of a qualifying option.

This suggests that the residence test (required to determine whether the employee would be chargeable under Case 1) applies at the time the option is exercised. However, such a construction could result in a charge under section 135 of ICTA being removed by the EMI relief in paragraphs 44 to 46 of the Schedule, only to be replaced by a charge under section 162(1) of ICTA. In practice, therefore, the Inland Revenue has applied the test at the time of the grant of the option.

In rewriting paragraph 54 of the Schedule in section 540, it has been made clear that the residence test (now expressed in terms of whether there are general earnings from the employment to which section 15 or 21 of the Act apply) can be applied at the time of the grant, or at the time of the exercise, of a qualifying option.

This change is in taxpayers' favour in principle and may in practice benefit some although the numbers and amounts are thought to be negligible.

Change 132: Share-related exemptions: priority share allocations: definitions of "director" and "shares": section 548
This introduces definitions of "director" and "shares".

Section 68 of FA 1988 is unusual in that it does not contain a definition of "director" or "shares", apart from subsection (5), which includes prospective and former directors and employees.

The definition of "director" must have the same meaning as is applicable in relation to the charges to tax which are excluded by section 68 of FA 1988. Any narrower definition would narrow the scope of the exemption and any wider definition would be unnecessary. The charges to tax in relation to which the exemption in section 68 of FA 1988 applies are the charge to tax as emoluments and possibly the charge to tax in respect of a notional loan under section 162 of ICTA (employee shareholdings). The definition of "director" which applies for the purposes of section 162 of ICTA is in section 168(8) and (9) of ICTA and includes shadow directors. Elsewhere in ICTA the

same definition of "director" is used without the full-out words which bring in shadow directors; see ICTA s.136(5)(b). Accordingly, part of the definition in section 548(1) and (2) is based on section 68(5) of FA 1988 but part is new. The new part is based on section 168(8) and (9) of ICTA, because this is the widest definition of director that could be relevant.

Section 68 of FA 1988 was enacted to deal with issues arising in connection with large-scale offers to public and employees of shares in companies taking over the role of nationalised industries. The purpose was to remove a possible tax disadvantage that might discourage wider share-ownership. It is therefore thought that "shares" should include "stock", as in Chapters 2, 3, 4 and 5 of Part 7 of the Act. But it is thought that in this context "shares" should not include securities because the purpose behind section 68 of FA 1988 was to encourage employees and the public to become shareholders, rather than the holders of securities. It is thought that if the intention had been to include securities, it would have been necessary to include a definition of shares that did so.

The addition of these definitions to clarify the legislation was approved in consultation.

This change is a clarification with no tax effects either in principle or in practice.

Change 133: Share-related income: employee benefit trusts: "qualifying disposals": section 551

This extends the types of disposals which may be made by a trust without infringing its status as an employee benefit trust.

Paragraph 7 of Schedule 8 to ICTA contains the conditions which must be satisfied by a trust if it is to be an employee benefit trust. Paragraph 7 has been repealed for most purposes by FA 1997. But it still applies for the purposes of the "no material interest" requirements that must be satisfied by an individual wishing to participate in one of the share schemes or other arrangements established under–

- Schedule 9 to ICTA (savings-related and other share option schemes),
- Schedule 8 to FA 2000 (employee share ownership plans), and
- Schedule 14 to FA 2000 (enterprise management incentives).

Paragraph 7(5) of Schedule 8 to ICTA contains the conditions that a trust must satisfy if it is to be an employee benefit trust in relation to a company:

- all or most of the employees of the company must be eligible to benefit, and

- apart from certain permitted disposals, there must have been no disposals of property subject to the trust since 13th March 1989.

The permitted disposals include disposals of property applied for the benefit of "individual employees or former employees of the company" or certain other people connected with such employees, such as their spouses or dependants (see paragraph 7(6)(a) of Schedule 8).

Although paragraph 7(6)(a) refers to employees "of the company", it has been the practice of the Inland Revenue to extend the benefit of this provision to employees of a subsidiary of the company and those connected with them. For this purpose a "subsidiary" is understood as being a company controlled by another company ("control" having the meaning given by section 840 of ICTA).

Paragraph 7(6)(a) is rewritten in section 551(2) of the Act, and subsection (3) of section 551 accordingly provides that each reference to "the company" in section 551(2) includes a reference to a company controlled by the company. ("Control" will have the meaning given by section 840 of ICTA as a result of section 719 of the Act.)

This change is in principle in taxpayers' favour but is expected to have no practical effect as it is in line with current practice.

Change 134: Former employees: deductions for liabilities: start of period during which payment must be made to be deductible from total income: section 556(1)
This makes clear that the period during which a former employee or office holder may deduct from total income the amount of certain employment-related liabilities and insurance premiums begins with the day following the last day of employment.

Under section 92 of FA 1995, a person who has ceased to hold an office or employment is entitled to make certain deductions when calculating his total income for a year of assessment. The former employee may deduct–

- the amount of any liability incurred in connection with acts or omissions relating to the office or employment; and

- the premium of any insurance policy taken out to meet liabilities of that kind.

The period during which a deduction is allowed under section 92 of FA 1995 is set out in subsection (2)(a). The period begins "when [the taxpayer] ceased to hold the relevant office or employment". This wording leaves scope for doubt about whether the period begins on the last day of employment or on the following day.

Section 92 of FA 1995 is rewritten in Part 8 of the Act. Section 556 sets out the period during which the deduction may be made. Subsection (1)(a) makes clear that the period begins with the day following the last day of employment.

This change has no implications for the amount of tax paid, who pays it or when. It affects (in principle and in practice) only administrative matters.

Change 135: Pension income and social security income: person chargeable: sections 572, 579, 582, 592, 597, 600, 618, 622, 636 and 662
This makes clear that the person who receives or is entitled to certain kinds of pension and social security income is the person liable to pay the tax charged on the income.

These sections of the Act concern the following kinds of pension and social security income–

- section 572: pensions payable by or on behalf of a person who is in the United Kingdom (except those dealt with specifically elsewhere in Part 9);
- section 579: United Kingdom social security pensions;
- section 582: pensions and annuities under approved retirement benefits schemes;
- section 592: annuities under former approved superannuation funds;
- section 597: annuities under approved personal pension schemes;
- section 600: income withdrawals from approved personal pension schemes;
- section 618: certain overseas government pensions paid in the United Kingdom;
- section 622: payments from the House of Commons Members' Fund;
- section 636: voluntary annual payments;
- section 662: United Kingdom social security income.

The provisions of ICTA under which tax is charged on these kinds of income do not specify who is liable for the tax. In practice, however, the person who receives or is entitled to the income is liable for the tax. The sections of the Act mentioned above make this clear. (Note that in the case of voluntary annual payments – section 636 – the change only concerns payments made by or on behalf of a person who is in the United Kingdom.)

This change has no implications for the amount of tax paid or when it is paid. It is concerned with the person who is liable for the tax. It is expected to have no practical effect as it is in line with current practice.

Change 136: Marine pilots' benefit fund: unauthorised payments: section 587
This introduces a specific tax charge on a member of a marine pilots' benefit fund who receives an unauthorised payment from the fund.

Section 607 of ICTA allows the Board to approve a marine pilots' benefit fund as if it were an approved retirement benefits scheme. Section 587 of the Act deals with this by providing that in Chapter 6 of Part 9 the expression " approved retirement benefits scheme" includes a marine pilots' benefit fund approved under section 607.

If an approved retirement benefits scheme makes an unauthorised payment that payment is taxed under Schedule E by section 600 of ICTA. In the Act that charge is under section 583.

If a marine pilots' benefit scheme approved under section 607 of ICTA makes an unauthorised payment tax is charged under Schedule D Case VI by section 607(3)(b)(iv) of ICTA. The Act repeals section 607(3)(b)(iv) of ICTA. The effect of the repeal is that an unauthorised payment is taxed as pension income under section 583 of the Act.

This change has no implications for the amount of tax paid, who pays it or when. It affects administrative matters only (and does so only in principle and not in practice).

Change 137: Approved personal pension schemes: annuities: income chargeable: section 596
This makes clear that the amount of a personal pension scheme annuity on which tax is charged is the amount received in the tax year.

Section 648A of ICTA taxes annuities acquired using funds held for the purposes of an approved personal pension scheme. The tax is charged under Schedule E. Section 648A does not specify how to determine the amount of the annuity on which tax is charged; nor does any other provision of ICTA or any other Act. In practice, tax is charged on the amount of the annuity received in each tax year.

Section 596 of the Act makes clear that tax is charged on the amount received in the tax year.

This change is concerned with the amount of income liable to tax in a particular year. It is expected to have no practical effect as it is in line with current practice.

Change 138: Other employment-related annuities: income chargeable: foreign annuities: section 613

This ensures that 10% can be deducted when calculating what amount of certain foreign annuities is to be taxed and also that retrospective payments of these annuities can be spread out over previous tax years when calculating tax liability.

Sections 65(2) and 585(2) of ICTA both concern pensions taxable under Schedule D, Case V. Schedule D, Case V taxes foreign income and so most pensions arising outside the United Kingdom are taxed under it.

Under section 65(2) of ICTA, the amount of the pension which is taxed under Schedule D, Case V is reduced by 10%.

Section 585(2) of ICTA concerns any pension (or increase in a pension) taxed under Schedule D, Case V which is granted retrospectively (i.e. granted for a period before the time of the grant). The pension (or increase) is treated as arising in the period *for which* it is granted, not at the time when it is *actually* granted. This may allow the pensioner's liability to tax on the retrospective payment to be spread out over more than one tax year.

Section 65(2) and section 585(2) both refer only to pensions, not to annuities. However, certain kinds of annuities taxed under Schedule D are in the nature of pensions. In cases where annuities like these arise outside the United Kingdom (and so are also taxed under Case V), the practice of the Inland Revenue is to allow sections 65(2) and 585(2) to be applied.

The following provisions of Part 9 of the Act (pension income) provide for tax to be charged on those Schedule D annuities which are in the nature of pensions–

- section 609: annuities for the benefit of dependants;
- section 610: annuities under sponsored superannuation schemes; and
- section 611: annuities in recognition of another person's services.

In cases where these annuities arise outside the United Kingdom, the amount which is taxed is determined in accordance with section 613 of the Act. This section applies certain provisions of ICTA, including sections 65 and 585 (see section 613(1)(a) and (c)). Section 613(4) makes clear that when sections 65 and 585 apply for these purposes, the references in sections 65(2) and 585(2) to pensions are to be read as references to these kinds of annuity.

This change is in principle in taxpayers' favour but is expected to have no practical effect as it is in line with current practice.

Change 139: Pension income: return of surplus employee additional voluntary contributions: section 623
This introduces a specific tax charge on a member of a retirement benefits scheme if additional voluntary contributions are returned because they exceed the limits allowed under Inland Revenue approval rules.

A retirement benefits scheme which is approved by the Inland Revenue gains certain tax advantages: contributions to the scheme attract tax relief and the investment income of the scheme is exempt from tax. A scheme must comply with various rules before it can be approved by the Inland Revenue. One of these rules imposes a limit on the total benefits available to members. A member can boost the benefits available to him by making additional voluntary contributions (AVCs). If a scheme does particularly well it is possible, as a result of the AVCs, for the total benefits available to the member to exceed the Inland Revenue limits. If this happens, the scheme administrator must return the surplus to the member.

If there is such a duty to return surplus AVCs, section 599A(2) of ICTA imposes a tax charge on the scheme administrator. Under section 599A(5) of ICTA, the amount received by the member is treated for the purposes of calculating total income as if it were chargeable under Schedule D, Case VI (but the amount is treated as having been received after deduction of basic rate income tax).

Under section 623 of the Act, surplus AVCs which are returned by the scheme administrator are to be taxed as pension income of the member. Rather than treating the amount returned as if it were chargeable under Schedule D, Case VI (as ICTA does), the Act therefore provides for it to be taxed as pension income.

This change has no implications for the amount of tax paid, who pays it or when. It affects administrative matters only (and does so only in principle and not in practice).

Change 140: Pension income: exemption for certain lump sums: section 637
This makes clear that lump sums provided under retirement annuity contracts are exempt from income tax provided they are within section 620(3) of ICTA.

Under section 189 of ICTA, lump sums provided under certain approved pension schemes are exempt from tax under Schedule E. There is no provision exempting lump sums provided under retirement annuity contracts from tax. However, it is not intended that such lump sums should be taxed if they are within section 620(3) of ICTA.

Section 637 of the Act rewrites section 189 of ICTA. Section 637 includes retirement annuities in the list of schemes which attract the exemption.

This change is in principle in taxpayers' favour but is expected to have no practical effect as it is in line with current practice.

Change 141: Pension income: exemptions: wounds and disability pensions: section 641(1)
This extends the exemption from income tax which applies to various military or war-related wounds and disability pensions to pensions payable under schemes under the Pensions (Navy, Army, Air Force and Mercantile Marine) Act 1939.

Under section 315 of ICTA, various kinds of pensions payable to former members of the armed forces or payable under certain schemes relating to war injuries are exempt from income tax. The pensions which attract this exemption are listed in section 315(2).

Section 315 does not apply to disablement pensions payable under schemes made under section 3, 4 or 5 of the Pensions (Navy, Army, Air Force and Mercantile Marine Act) 1939. However, the practice of the Inland Revenue is to exempt pensions of this kind from income tax (see paragraph 840 of the Revenue's internal guidance on assessment procedures – AP840).

Section 641 of the Act rewrites section 315 of ICTA. Section 641 applies to disablement pensions payable under the 1939 Act (see section 641(1)(g)). This ensures that pensions of this kind are exempt from income tax.

This change is in principle in taxpayers' favour but is expected to have no practical effect as it is in line with current practice.

Change 142: Pension income: exemptions: disablement pensions: section 644
This gives statutory effect to ESC A62 (pensions to employees disabled at work).

ESC A62 concerns pensions which are paid to a person who has had to leave an office or employment because of disablement attributable either to the duties of the office or employment, or to war injuries. The concession exempts pensions of this kind from income tax.

Section 644 gives statutory effect to the concession.

This change is in principle in taxpayers' favour but is expected to have no practical effect as it is in line with current practice.

Change 143: United Kingdom social security income: incapacity benefit taxable: section 660
This makes clear that incapacity benefit is taxable.

Incapacity benefit replaced sickness benefit, invalidity benefit and invalidity pension ("the old benefits") with effect from the 13th April 1995.

The old benefits were payable under–

- Part 2 of the Social Security Contributions and Benefits Act 1992 ("SSCBA"); and

- Part 2 of the Social Security Contributions and Benefits (Northern Ireland) Act 1992 ("SSCB(NI)A").

Section 617(1) of ICTA taxes benefits payable under Part 2 of those Acts; but section 617(1)(a) excepts certain benefits from the charge. The old benefits were amongst those excepted. Accordingly, the old benefits were not subject to income tax under section 617(1). This was in line with government policy at that time.

Section 617(2)(c) of ICTA goes on to provide that benefits excepted from the section 617(1) charge by virtue of section 617(1)(a) are not to be treated as income for any purpose of the Income Tax Acts. This meant that the old benefits could be completely ignored for income tax purposes. Again this was in line with government policy at that time.

Incapacity benefit was introduced by the Social Security (Incapacity for Work) Act 1994. This Act introduced incapacity benefit by amending Part 2 of SSCBA and Part 2 of SSCB(NI)A. It repealed the provisions relating to the old benefits and inserted provisions relating to incapacity benefit.

Government policy was that incapacity benefit (with some exceptions) should be subject to income tax. Accordingly, section 139(1) of FA 1994 provides for the benefit to be taxed.

Because incapacity benefit is payable under Part 2 of SSCBA and Part 2 of SSCB(NI)A, it is caught by the charge under section 617(1) of ICTA. As section 139(1) of FA 1994 had introduced a specific charge on the benefit, this would have given rise to a double charge.

However, section 13(2) of the Social Security (Incapacity for Work) Act 1994 provides that any reference in any enactment to any of the old benefits is to be construed as a reference to incapacity benefit. This means that the references in section 617(1)(a) to the old benefits are now construed as references to incapacity benefit. The consequence is that incapacity benefit is not, in fact, charged to tax under section 617(1). This prevents any double charge.

It appears that the effect of section 617(2)(c) was overlooked at this time. As mentioned above, this provision says that any benefit which is excepted from the section 617(1) charge by virtue of section 617(1)(a) is not to be treated as income for

any income tax purpose. Because incapacity benefit falls within section 617(1)(a), section 617(2)(c) disregards it for all income tax purposes. This is in conflict with the charging provision in section 139(1) FA 1994.

Government policy when incapacity benefit was introduced was that it should be taxable. This has remained the case ever since. Inland Revenue practice has always been to tax incapacity benefit under section 139(1) of FA 1994.

Incapacity benefit is included in the table of United Kingdom social security benefits which are taxed under Part 10 of the Act (see section 660). This resolves the apparent conflict between section 617 of ICTA and section 139 of FA 1994.

This change is in principle adverse to some taxpayers but it is expected to have no practical effect as it is in line with current practice.

Change 144: United Kingdom social security income: exemptions: income support: taxable maximum: basis of calculation: section 668
This changes the method of calculating the maximum amount of income support which is taxable in cases where the income support is paid for a period of less than a week.

Income support is taxed under section 151 of ICTA. If the amount of income support paid is in excess of a certain amount (known as the taxable maximum), the excess is not taxed. The taxable maximum is determined in accordance with section 151(6) to (8) of ICTA.

The taxable maximum is determined by reference to a period of a week. However, income support can be paid for less than a week. In such a case, section 151(5) of ICTA provides for the taxable maximum for a week to be scaled down correspondingly. For each day of the week that income support is paid, $1/6^{th}$ of the weekly taxable maximum is allowed.

The use of a fraction of $1/6^{th}$ (rather than $1/7^{th}$) in making this reduction was probably carried forward from the calculations used for unemployment benefit and supplementary benefit. Regulation 73 of the Income Support (General) Regulations 1987 (S.I. 1987/1967), which explains how to calculate income support for part of a week, uses a fraction of $1/7^{th}$. The corresponding provisions relating to jobseeker's allowance (section 151A of ICTA and regulation 150 of the Jobseeker's Allowance Regulations 1996 (S.I. 1996/207)) also use a fraction of $1/7^{th}$.

Section 668 of the Act rewrites the legislation for calculating the taxable maximum. It uses a fraction of $1/7^{th}$ (see subsection (3), step 3).

This change is in taxpayers' favour in principle and may in practice benefit some although the numbers and amounts are thought to be negligible.

Change 145: Social security income: foreign benefits: introduction of charge to tax: section 678
This introduces an explicit charge to tax on foreign social security benefits.

Foreign social security benefits are taxed under Schedule D, Case V. This is because the benefits arise from rights under foreign social security law and those rights are "possessions out of the United Kingdom". However there is no explicit charge to tax on foreign social security benefits.

Part 9 of the Act imposes the charge to tax on "social security income". "Social security income" is defined in section 657(2) to include "foreign benefits to which section 678 applies". That section applies to foreign benefits which are substantially similar in character to the UK benefits charged as social security income. The Act therefore imposes an explicit charge on foreign benefits. This is intended to make the charge on benefits of this kind clearer.

This change is in principle adverse to some taxpayers but it is expected to have no practical effect as it is in line with current practice.

Change 146: Social security income: foreign benefits: exemptions: section 681
This gives statutory effect to ESC A24 (foreign social security benefits) by exempting a foreign benefit from tax if it is similar to a United Kingdom benefit which is exempt.

There is no explicit tax charge on foreign social security benefits. They simply fall within the general charge on foreign income – Schedule D, Case V. Similarly, there are no statutory exemptions from tax for any foreign social security benefits.

This creates an anomalous situation in cases where a foreign benefit is similar in nature to a UK benefit which is exempt from tax. The foreign benefit is subject to tax whilst the UK benefit is exempt. ESC A24 corrects this anomaly. Under the concession, the Inland Revenue exempts a foreign benefit from tax if it is similar to a UK benefit which is exempt from tax.

In practice ESC A24 is applied not only to the benefits set out in it, but to all foreign benefits that correspond to exempt UK benefits.

Section 681 gives statutory effect to this wider application of ESC A24.

This change is in principle in taxpayers' favour but is expected to have no practical effect as it is in line with current practice.

Change 147: PAYE: power to make different provision for different cases or classes of case and incidental, consequential, supplementary and transitional provision: section 684(2)

This provides that the powers to make different provision for different cases or classes of case, and such incidental, consequential, supplementary and transitional provision as appears to the Board to be expedient, apply for all PAYE regulations. In ICTA these powers are not expressly applied for all such regulations.

The powers are in sections 203L(4) and 206A(6) of ICTA and apply explicitly for regulations made under–

- sections 203B to 203J of that Act (the anti-avoidance provisions in sections 687 to 691, 693 to 702 and 710 of the Act); and

- section 206A of that Act (the provisions for PAYE settlement agreements in sections 703 to 707of the Act).

The provisions were included in sections 203L and 206A when they were enacted in 1994 and 1996 respectively – as they almost always are with modern powers to make regulations. Similar provisions were not included when the power to make PAYE regulations was enacted in 1943. It was not then standard practice to do so.

Explicitly applying the powers for the purposes of the whole of Part 11 of the Act is a change in the law to the extent that it reduces the scope for a person to argue that the regulations, by including different provisions for different cases and incidental provisions, are ultra vires. The chances of such an argument succeeding are thought to be extremely remote.

First, as already noted, the absence from ICTA of explicit powers to this effect in relation to some powers to make PAYE regulations is attributable to the way in which the drafting of powers to make regulations has changed over time.

Second, PAYE regulations have from the outset included provision for different cases or classes of case. The intention that different cases could be treated differently was signalled clearly in the White Paper which preceded the 1943 Act. An example of this is the special scheme for domestic employees.

Third, the PAYE regulations have from the outset also included incidental provisions such as requirements as to how notices are to be given.

It might be thought that changes to the legislation for PAYE are incapable of affecting tax liabilities. PAYE is essentially a system of payments on account of the income tax liability (or at least of so much of the income tax liability as relates to PAYE income) of the person liable for tax on the payments. Changes to PAYE might be thought to be incapable of affecting the amount of taxable income or the tax due on that amount.

In exceptional cases however an employer or other person making a payment of PAYE income may be required to account for the tax they ought to have deducted but did not; and the person liable for the tax entitled to a credit against their income tax liability for what should have been deducted but was not. This arises only very rarely as it does not apply where the employer or other payer makes an error in good faith despite having taken reasonable care. It does not affect the underlying income tax liability of the recipient of the income. But it does affect the net amount which they are required to pay.

It is also possible for the application of PAYE to notional payments (see section 710 of the Act) to affect an employee's taxable income. This is because tax which an employer is required to account for in respect of a notional payment but which the employer fails to deduct may give rise to an amount which is treated as earnings of the employee (see section 222 of the Act). In that context it is in principle possible for a change to PAYE which affects what is a notional payment, or deductions in respect of notional payments to affect employees' net taxable income and hence their income tax liabilities.

This change could in principle affect how tax is collected, and in exceptional cases even who pays what amount of tax, but it is expected to have no practical effect as it is in line with current practice.

Change 148: PAYE: directions as to income of non-resident or not ordinarily resident employees to apply only to income paid by or on behalf of the employer: section 690

Section 690(2) derives from section 203D(2) of ICTA, but differs in that it applies only to income paid by or on behalf of the employer and not to income generally.

Although section 203D(2) of ICTA is intended to deal only with directions involving Schedule E income paid by or on behalf of the employer, it is not explicitly restricted to such income. To remove any doubt, the conditions in subsection (2)(a) and (b) of section 690 (taken with subsection (3)(b)) have been framed so as to refer to income paid to the employee by the employer, a person acting on behalf of the employer and at the expense of the employer or a person connected with the employer. That wording has been borrowed from section 203B(4)(a) of ICTA and accordingly attracts the definition of "connected person" in section 839 of ICTA (see section 718 of the Act).

The change is also reflected in subsections (7) and (8) of section 690 of the Act, derived from section 203D(7) and (8), which deal with what happens when a direction is made (or not made). Those subsections have been framed so as to apply PAYE only to payments of income made by the employer, a person acting on behalf of the employer and at the expense of the employer or a person connected with the employer.

This change could in principle affect how tax is collected, and in exceptional cases even who pays what amount of tax (for the reasons discussed in Change 147), but it is expected to have no practical effect as it is in line with current practice.

Change 149: PAYE: scope of power to give directions as to income of non-resident or not ordinarily resident employees and applications for such directions: section 690

This enables a direction under section 690 of the Act to be given–

- where the amount of income assessable on a non-resident etc employee is known at the time the direction is given; and

- to a person who is required to operate PAYE by section 689 of the Act.

Section 690 makes special provisions for PAYE for employees who are both non-resident etc and working partly in the UK and partly not. It derives from section 203D of ICTA. Among other things it allows the Inland Revenue to give, on receipt of an application from the "appropriate person" (see subsection (3)), a direction stating what proportion of income from that employment is to be subject to PAYE deductions. In the absence of such a direction all payments are subject to PAYE (subsection (8)).

The section includes two changes to extend the circumstances in which the benefit of such a direction is available.

First, section 203D(2)(b) is unclear where the amount of income which is not assessable is known at the time of the direction. It is possible to read it as prohibiting a direction in such circumstances but allowing a direction to be given where the assessable amount is *not* known. This reading would deny relief from PAYE for income which is not assessable just because the amount of it could be quantified.

The conditions in subsection (2) of this section are different. They make it clear that the direction can be given even if the amount not assessable is ascertainable.

Second, the meaning of the "appropriate person" who may apply for a direction is extended by subsection (10) to include persons who are treated by section 689 (derived from section 203C) as making payments of PAYE income or persons they designate as the "appropriate person". Section 203D does not cater for direction to be given in circumstances where both it and section 203C apply, and so leaves the possibility of payments being wholly subject to PAYE even though they are only partly chargeable to income tax. The change deals with this anomaly.

These changes could in principle affect how tax is collected, and in exceptional cases even who pays what amount of tax (for the reasons discussed in Change 147),

but they are expected to have no practical effect as they are in line with current practice.

Change 150: PAYE: inclusion in the Act of provision relating to organised arrangements for sharing tips made by subordinate legislation: section 692
Section 692 of the Act explicitly provides for regulations to make in relation to organised arrangements for sharing tips such provision as is contained in regulation 5 of the Income Tax (Employments) Regulations 1993 (S.I. 1993/744).

The inclusion of this material is a change in the law because someone aggrieved by regulation 5 might argue that its provisions are not within the powers granted to the Board by section 203 of ICTA (despite the very broad terms of section 203(2)). The scope for such arguments is reduced by section 692 being part of the Act.

These changes could in principle affect how tax is collected, and in exceptional cases even who pays what amount of tax (for the reasons discussed in Change 147), but they are expected to have no practical effect as they are in line with current practice.

Change 151: PAYE (gains from share options): limit on the amount of the consideration that is to be treated as a payment of PAYE income: section 700
Two changes in section 700 of the Act–

- limit the amount of the consideration that is to be treated as a payment of PAYE income to the amount chargeable under section 476 or 477 of the Act less any relief due under section 481 of the Act where consideration takes the form of a payment; and

- apportion that limit between consideration provided in the form of a payment and in the form of an asset.

Section 203FB(3)(a) of ICTA, which deals with PAYE on the payment of consideration for assignment or release of a share option, does not deal with any relief due under section 187A of ICTA (relief where the employer and employee agree that liability for secondary NIC contributions in respect of share option gains is recovered from the employee). Section 203FB(6A), which deals with the amount where consideration is given in the form of an asset, contrasts with 203FB(3)(a) by making it clear that the amount chargeable is less any relief due under section 187A. Section 700(3)(a) removes the inconsistency by taking the relief likely to be due under section 187A (rewritten as section 481) into account when arriving at the limit for the amount on which PAYE is due on a payment as it is for consideration in the form of an asset.

The second change concerns cases where consideration is provided partly in the form of payment and partly in the form of an asset. In such cases section 203FB(3)(a) applies to the payment and section 203FB(3)(b) to the asset. The amount which is treated as a payment of assessable income is:

- in the case of a payment, so much of the payment as does not exceed the amount assessable under section 135 of ICTA; and

- in the case of an asset, the amount determined by section 203FB(6A) which provides that it is the amount likely to be chargeable under section 135 (less the amount of any relief due under section 187A).

There is no provision to take into account in arriving at either amount an amount which is treated as a payment for PAYE purposes under the other provision. The effect of reading the provisions in this way in such cases could be that the total amount treated as paid for PAYE purposes exceeded the amount chargeable under section 135.

Section 700(3) and (4) of the Act provide that the amount treated as PAYE income is to be the relevant proportion of the amount chargeable. The "relevant proportion" is defined in subsection (6) as the proportion the payment or asset (as the case may be) bears to the total consideration. The effect of this is to limit the total amount treated as a payment of PAYE income to the amount chargeable.

These changes could in principle affect how tax is collected, and in exceptional cases even who pays what amount of tax (for the reasons discussed in Change 147), but they are expected to have no practical effect as they are in line with current practice.

Change 152: PAYE (gains from share options): cases where the consideration for an assignment or release of a share option is a readily convertible asset in the form of a voucher or credit-token: section 700

This extends the scope of PAYE to cases where the consideration for an assignment or release of a share option is a voucher or credit-token of a kind which (if provided by the employer) would attract PAYE.

Section 203FB(9) of ICTA defines "asset" for the purposes of the section to include any non-cash voucher, credit token or cash voucher. This might be thought to give rise to an amount treated as a payment of PAYE income where consideration for the assignment or release of a share option is or includes a voucher or credit token of the kind which would fall within sections 203G to 203I of ICTA (sections 693 to 695 of the Act).

However this effect is not necessarily achieved. Section 203FB(3) provides that "sections 203 to 203F shall have effect …as if the provision of that asset were the

provision … of assessable income in the form of that asset". But section 203F(4) then provides that for the purposes of that section "asset" does not include any non-cash voucher, credit-token or cash voucher. Section 203FB(9)(b) does not remove or modify that exclusion. So it could be argued that it is not effective in achieving, via section 203F, an obligation to treat an amount as a payment.

Section 700 of the Act removes the scope for a person to argue that consideration in the form of a voucher or credit token cannot give rise to PAYE income. Subsection (6) provides explicitly that vouchers and credit tokens as defined in subsection (7) are to be treated as readily convertible assets for the purposes of section 696.

This change could in principle affect how tax is collected, and in exceptional cases even who pays what amount of tax (for the reasons discussed in Change 147), but it is expected to have no practical effect as it is in line with current practice.

Change 153: PAYE: tax accounted for under PAYE on a notional payment to be credited to the employee in respect of his liability to income tax: section 710
This makes it clear that the tax accounted for under PAYE on a notional payment is credited to the employee, in respect of his liability to income tax, at the time the notional payment is made.

Section 203J(5) of ICTA provides that any income tax which an employer deducts, or (where the tax is not deducted) accounts for, is to be treated as an amount paid by the employee in question in respect of his liability to income tax for the year of assessment specified in PAYE regulations. No such regulations have been made. Moreover section 203J does not provide for the regulations to deal with the time at which the payment is treated as made. This leaves uncertain the time at which a person is entitled to take credit for the amount.

Section 710(6) of the Act removes this uncertainty. It provides that any amount deducted or accounted for is to be treated as paid by the employee at the time the notional payment is made.

This change has no implications for the amount of tax paid or who pays. It affects only when and how tax is paid (and does so only in principle and not in practice).

Change 154: Donations to charity: payroll deduction scheme: operation of deduction from payments of PAYE income: section 713(3), (4), and (5); Schedule 6, paragraphs 72 and 73
This relates to the circumstances in which tax relief is available for charitable donations deducted from payments of PAYE income.

Section 202(2) of ICTA provides that the donations "…shall, in assessing tax under Schedule E, be allowed to be deducted as expenses incurred in the year of assessment in which they are withheld".

Under the structure of the Act, it is considered that the amounts withheld ought not to be characterised as "expenses". Section 713(3) simply refers to relief being given as a deduction "in calculating the amount of the individual's income which is charged to tax in accordance with subsection (4)". Subsection (4) then clarifies how the timing of the deduction is to operate according to the type of income in question. The reasoning behind this formula is explained below.

Section 202 was introduced by section 27 of FA 1986 and the treatment of sums deducted "as expenses" followed the model adopted for section 592 of ICTA, which in turn was (ultimately) based on section 32 of FA 1921. This provision provided a deduction for contributions to superannuation funds to be given "as an expense incurred in the year in which the sum is paid." This was held (in *Frame v. Farrand* (13 TC 861) to mean that the deduction was to be applied to reduce the amount of income in arriving at the amount assessable to which reliefs (in that case earned income relief) could then be applied.

The intention that this continuity of treatment be followed for payroll giving and pension contributions appears to be consistent with the introduction of "net pay arrangements" in 1986. Under Regulation 2(1) of the PAYE Regulations (S.I. 1993/744), "emoluments" is defined as the "full amount of any income to be taken into account in assessing liability under Schedule E" after deduction of the amount represented by such payments.

The concept of "income assessable under Schedule E" has been dispensed with in the Act. It is replaced, for the purposes of PAYE, by "PAYE income" (see section 683 and *Note 55*). PAYE income may consist of PAYE employment income, PAYE pension income and PAYE social security income.

It is considered, in the light of the legislative background and case law referred to above, that these deductions are to be made from the particular income (relating to a particular employment, pension or benefit, as the case may be) in respect of which donations are made, rather than operating as deductions from the aggregate Schedule E income or aggregate type of income (employment, pension or social security) relating to an individual taxpayer. This approach therefore crystallises the latent ambiguity of the original provision in favour of a particular mechanism for giving the deduction.

Under this section the placement of the deduction within the overall operation of the charge to tax is made clear. Subsection (4) provides for the amount of deductions given under this section to be set off in arriving at the figure for the "net taxable" income in question.

Section 202(2) of ICTA stipulates that donations are allowed for "the year of assessment in which they are withheld". This rule may give rise to problems where the income from which the donation is withheld is not taxable in the year in which the donation is made. The "expense" would then be allowed in a different year to that in which the income is taxable. But donors might not be able to benefit from the deduction if they have no other income in that year.

Section 713(4) of the Act makes clear that the deduction is given in taxing the income out of which the donation has been made. This accords with how the deductions are operated in practice. Hence the references to "net taxable" income under each of paragraphs (a) to (d).

For similar reasons, consequential amendments have been made to sections 592(7) and 594(1) of ICTA. These sections also provided for deductions to be given as "expenses" in assessing Schedule E income. Paragraphs 72 and 73 of Schedule 6 to the Act substitute "shall be allowed to be deducted from employment income for" for "shall, in assessing tax under Schedule E, be allowed to be deducted as an expense incurred in".

Although this change could in principle be favourable to some taxpayers and adverse to others, and affect the timing of a tax charge, it is entirely in line with current practice, so will have no practical effect.

Change 155: Donations to charity: payroll deduction scheme: meaning of "approved agent": section 714(2)

This relates to the circumstances in which tax relief is available for charitable donations deducted from payments of PAYE income.

Section 202(4) of ICTA refers to "a person ("the agent")". That means that an agent could be an individual. Under the source legislation an agent must be a body. That is because an agency is an approved agent if it is a "body" approved under Regulation 5 of the Charitable Deductions (Approved Schemes) Regulations 1986 (S.I. 1986/2211). That regulation is couched in terms of an agent being "any charity…".

Section 714(2)(a) of the Act reflects that reality by referring to donations paid to "a body which is an approved agent".

This change has no implications for the amount of tax paid, who pays it or when. It affects administrative matters only (and does so only in principle and not in practice).

Change 156: Donations to charity: approval of payroll deduction schemes: regulation by the Treasury: section 715(3)
This section describes the powers reserved for the Treasury to regulate the approval of schemes by the Inland Revenue, to prescribe requirements for scheme participants, to make provision for appeals and generally for giving effect to sections 713 and 714.

Section 202(9) of ICTA provides that regulations may make provision that a participating employer or agent shall comply with any notice which is "served on" him by the Board of Inland Revenue.

Section 715(3)(a) of the Act substitutes "give to" in rewriting this notice provision. This is consistent with similar changes made by the Act in other contexts, see *Change 16*.

This change has no implications for the amount of tax paid, who pays it or when. It affects administrative matters only (and does so only in principle and not in practice).

Change 157: Control: application of the definition in section 840 of ICTA for the purposes of paragraphs 3(2) and (4) and 19(3) of Schedule 12 to FA 2000: section 719
This involves applying the definition of "control" in section 840 of ICTA for the purposes of paragraphs 3(2) and (4) and 19(3) of Schedule 12 to FA 2000 (which relate to the provision of services through intermediaries). See sections 51(2) and (4) and 60(3) of the Act.

Those provisions use the expression "control", but without defining it. Section 719 of the Act applies the definition of "control" in section 840 of ICTA for the purposes of the Act (including those provisions) unless otherwise indicated. No useful purpose would be served by giving such an indication in this case. As things stand the courts would be more likely than not to apply the section 840 definition.

The change is in principle in taxpayers' favour but is expected to have no practical effect as it is line with current practice.

Change 158: References to "the Inland Revenue": section 720
This converts references in the rewritten legislation to an inspector or to the Board of Inland Revenue into references to any officer of the Board.

(A) References to an inspector The legislation rewritten in the Act contains a substantial number of references to an "inspector" (which means an inspector of taxes: see section 832(1) of ICTA). The Act replaces such references with references to "the Inland Revenue". This expression is defined by section 720(1) of the Act to mean any officer of the Board of Inland Revenue. For the purposes of the Act "the

Board of Inland Revenue" means the Commissioners of Inland Revenue appointed under section 1 of the Inland Revenue Regulation Act 1890: see section 720(2) of the Act.

As a result, the provisions affected will expressly authorise or require things to be done by or in relation to an officer of the Board instead of by or in relation to an inspector. This is consistent with the internal reorganisation of the Inland Revenue which took place in the mid-1990s and resulted in the merger of the previously separate networks of collection and tax offices and less rigid specialisation in relation to particular functions.

This represents only a minor change in the law because a similar result could in many cases be achieved by a different means under section 1(2B) of TMA 1970, which was inserted by FA 1990. Under that provision a person who is not an inspector may for particular purposes exercise functions conferred on inspectors if, in accordance with the Board's administrative practices, he or she has been authorised to act as an inspector for those purposes.

(B) References to the Board of Inland Revenue The legislation rewritten in the Act also contains a number of references to "the Board" (which means the Commissioners of Inland Revenue: see section 832(1) of ICTA). In many contexts the Act replaces such references with references to "the Inland Revenue". As mentioned above, this expression is in turn defined by section 720(1) of the Act to mean any officer of the Board of Inland Revenue.

As a result, the provisions affected will expressly authorise or require things to be done by or in relation to an officer of the Board instead of by or in relation to the Board itself. However, as with the conversion of references to an inspector, this reflects the current organisation of the Inland Revenue.

Under section 4A of the Inland Revenue Regulation Act 1890 (which was introduced by FA 1969) any function conferred on the Board by or under any enactment, including any future enactment, may be exercised by any officer of the Board acting on their authority. All of the functions under the provisions affected by the conversion of references to the Board, which are in the main concerned with administrative processes, have in fact been devolved to officers of the Board, and the Board itself is no longer directly involved in their exercise.

Each of the provisions affected by the conversion of references to the inspector or to the Board are identified in the Table of Origins by a cross-reference to this change.

This change has no implications for the amount of tax paid, who pays it or when. It affects administrative matters only (and does so only in principle and not in practice).

Change 159: Definition of "personal representatives" and replacement of the expression "executors or administrators" with "personal representatives": section 721

This change involves replacing the expressions "personal representatives" and "executors and administrators", where they are used in existing legislation without definition, with a defined term, "personal representatives".

The term "personal representatives" is used (or referred to), without definition, in the following provisions of existing legislation which are rewritten in the Act–

- section 595(5) of ICTA (which provides that the provision of benefits "for" an employee under a non-approved retirement benefits scheme includes the provision of benefits payable to the employee's personal representatives) (see section 386 of the Act)

- section 596A(8) and (11) of ICTA (referring to section 595(5)) (see sections 396 and 397 of the Act)

- paragraph 2 of Schedule 11 to ICTA (payments and other benefits in connection with termination of employment to which section 148 applies include those received by the former employee's personal representatives) (see sections 401 and 403 of the Act)

- paragraphs 20, 79, 121 and 122 of Schedule 8 to FA 2000 (meaning of "associate", and provisions concerning transfer of shares, in relation to SIPs) (see section 501 of, and paragraphs 22, 90 and 96 of Schedule 2 to the Act)

- section 417(3) of ICTA (meaning of "associate", which applies by virtue of section 187(3) in relation to share option schemes) (see paragraph 14 of Schedule 3, and paragraph 12 of Schedule 4, to the Act)

- paragraph 34 of Schedule 14 to FA 2000 (meaning of "associate" for purposes of "material interest" test in relation to enterprise management incentives) (see paragraph 31 of Schedule 5 to the Act).

The expression "executors or administrators" is used, also without definition, in the following provisions of existing legislation which are rewritten in the Act (using "personal representatives" in place of that expression)–

- section 202A(3) of ICTA (assessment on receipts basis) (see section 13 of the Act)

- section 585(8) of ICTA (relief from tax on delayed remittances) (see section 37 of the Act)

- section 92(10) of FA 1995 (which provides an exemption from the charge to tax under section 148 of ICTA) (see section 410 of the Act).

The new definition, in section 721 of the Act, provides –

> ""personal representatives", in relation to a person who has died, means–
>
> (a) in the United Kingdom, persons responsible for administering the estate of the deceased, and
>
> (b) in a country or territory outside the United Kingdom, those persons having functions under its law equivalent to those of administering the estate of the deceased".

Examples of existing definitions of "personal representatives" in tax legislation (but which do not apply to any of the provisions listed above) are those in section 229(1) of ICTA, which provides that–

> ""personal representatives" means persons responsible for administering the estate of a deceased person;",

and section 111(3) of FA 1989, which provides–

> "(3) In this section "personal representatives" means–
>
> (a) in relation to England and Wales, the deceased person's personal representatives as defined by section 55 of the Administration of Estates Act 1925;
>
> (b) in relation to Scotland, his executor or the judicial factor on his estate;
>
> (c) in relation to Northern Ireland, his personal representatives as defined by section 45(1) of the Administration of Estates Act (Northern Ireland) 1955; and
>
> (d) in relation to another country or territory, the persons having in relation to him under its law any functions corresponding to the functions for administration purposes of personal representatives under the law of England and Wales."

Section 55(1)(xi) of the Administration of Estates Act 1925 provides–

> ""personal representative" means the executor, original or by representation, or administrator for the time being of a deceased person, and as regards any liability for the payment of death duties includes any person who takes possession of or intermeddles with the property of a deceased person without the authority of the personal representatives or the court, and "executor" includes a person deemed to be appointed executor as respects settled land".

Section 45(1) of the Administration of Estates Act (Northern Ireland) 1955 provides–

> ""personal representatives" means the executors or executor, original or by representation, or the administrators or administrator for the time being of a deceased person.

Under English law, executors are generally appointed by the will. Administrators are appointed by the court in the absence of anyone appointed as executor or where the

deceased dies without leaving a valid will. English law recognises three other categories of executor: "executor according to the tenor" who on the terms of the will is appointed to perform the essential duties of an executor where the deceased person has failed to nominate a person to be his executor, "executor de son tort", who is a person who takes upon himself the position of executor or intermeddles with the goods of the deceased person without having been appointed executor or administrator, and "special executor", the term given to a person who is a trustee of settled land at the time of the death. The position is similar for Northern Ireland.

For the purposes of Scottish law, an executor is appointed either expressly or impliedly by the deceased, in which case he is known as an executor nominate, or by the court, in which case he is known as an executor dative. The term "executor" under Scottish law is thus broadly equivalent to an "executor or administrator" under English law. Scottish law also recognises judicial factors and executor-creditors who may be appointed by the court to administer the deceased's estate or part of it. Although a judicial factor could not be described as an executor, he might be regarded as an "administrator".

Thus, in relation to any part of the United Kingdom, a deceased person's personal representatives within the definition in section 111(3) of FA 1989 are the persons responsible for administering the person's estate and there is not thought to be anyone who falls within that description but is not a personal representative. The proposed definition therefore appears, in relation to any part of the United Kingdom, to catch the same persons as that in section 111(3) of FA 1989 but does so more succinctly.

In relation to countries and territories outside the United Kingdom, although the terms "executor" and "administrator" are not terms of art, it seems likely that a court would hold that "personal representatives" in tax legislation would, in the absence of a definition, cover the people that most closely correspond with executors or administrators in the United Kingdom. In view of what is said above, that means the people who have functions corresponding to those of personal representatives in the United Kingdom.

In the following cases, it seems clear from the context that adopting the new definition should not alter the position–

- in sections 595 and 596A of, and paragraph 2 of Schedule 11 to, ICTA, section 92(10) of FA 1995 and paragraphs 79, 121 and 122 of Schedule 8 to FA 2000, it is clear that the references to "personal representatives" (or "executors or administrators") are references to whoever it is to whom, in the normal course, one would pay or transfer something where the person for whom it was intended had died;

- in relation to the definition of "associate", as it applies for the purposes of the "material interest" test for share schemes (section 417(3) of ICTA, and paragraph 20 of Schedule 8, and paragraph 34 of Schedule 14, to FA 2000) the

reference to the "personal representatives of a deceased's estate" applies where a person is interested in shares which form part of a deceased's estate. In that context, clearly the reference is to the person who is holding the property in the deceased's estate. (Adopting the new definition here even preserves the existing room for uncertainty in the rare cases where different executors or administrators hold different parts of the deceased's estate.)

Sections 202A(3) and 585(8) of ICTA provide for tax to be charged, where the person who would normally be charged to tax under section 202A or 585 has died, on "his executors or administrators". In the rewritten versions of sections 202A(3) and 585(8) that expression is replaced by "personal representatives", defined by reference to their functions.

Although "executors" and "administrators" are terms of art recognised by the law of the constituent parts of the United Kingdom, it seems unlikely that a court would hold the expression “executors or administrators” in section 202A(3) or 585(8) to have no meaning outside the United Kingdom. As explained above, the better view is that the expression refers to persons holding positions corresponding to those of executors and administrators in the country or territory in question. So the change removes any argument that a person administering an estate overseas escapes liability under section 202A or 585 – but that is an argument that is unlikely to have succeeded anyway.

It is therefore not thought that this change will affect anyone's liability to tax.

Change 160: Share related income: share incentive plans: restriction on participating in both share incentive plan and approved profit sharing scheme in a tax year: paragraph 18 of Schedule 2

This involves omitting the provision that has the effect of preventing certain tax advantages being obtained in relation to both a SIP and an approved profit sharing scheme in any tax year because, by the tax year 2003-04, the tax advantages in question will no longer apply in relation to an approved profit sharing scheme.

Paragraph 16(1)(a) of Schedule 8 to FA 2000 requires an approved employee ownership plan to prohibit free shares being awarded to an employee who has already had shares appropriated to him during the tax year (or would at the same time have shares appropriated to him) under an approved profit sharing scheme. Paragraph 16(1)(b) of that Schedule contains a corresponding restriction where the employee has participated (or would simultaneously participate) in another employee share ownership plan. The restrictions apply only where both of the schemes in question are established by the same company or connected companies. Paragraph 16(1)(b) is rewritten as paragraph 18 of Schedule 2 to the Act.

The object of the restrictions is to ensure that, generally, an employee cannot enjoy the tax advantages that attach to an award of shares under a SIP or an appropriation of

shares under an approved profit sharing scheme in relation to more than one such award or appropriation of shares in each tax year.

The tax advantages that attach to the appropriation of shares under an approved profit sharing scheme are found in section 186 of ICTA, which is not being rewritten in the Act because, as the result of an amendment made by section 49(3) of FA 2000 (phasing out of approved profit sharing schemes), those tax advantages do not apply in relation to any appropriation of shares made after 31st December 2002.

Paragraph 16(1)(a) of Schedule 8 to FA 2000 is not spent because–

- approved profit sharing schemes will not automatically cease to be approved as a result of the phasing out of approved profit sharing schemes (even though the tax advantages in section 186 of ICTA will no longer be available), and

- there is no statutory provision preventing the appropriation of shares under any profit sharing scheme that continues to be approved.

So a person to whom shares were appropriated under an approved profit sharing scheme on or after 6th April 2003 would (but for this change) be disqualified from having shares appropriated to him under a share incentive plan established by the same company or a connected company, even though the person would not enjoy any tax advantage under section 186 of ICTA from the appropriation under the profit sharing scheme

By the tax year 2003-04, there will be no possibility of the very double tax advantages arising which paragraph 16(1)(a) of Schedule 8 to FA 2000 is designed to preclude; by that tax year, it could also operate to deny any tax advantages under either Schedule 8 to FA 2000 or section 186 of ICTA, as in the case described above. Accordingly paragraph 16(1)(a) is not rewritten in the Act.

This change is in taxpayers' favour in principle and may in practice benefit some although the numbers and amounts are thought to be negligible.

Change 161: Share-related income: share incentive plans: information to be given about performance targets and measures: paragraph 40 of Schedule 2
This modifies the requirement to notify employees of the performance targets and measures that will be used to determine the number of free shares to be awarded to them under a share incentive plan.

Paragraph 28 of Schedule 8 to FA 2000 deals with the information that must be given to employees if a share incentive plan (a "SIP") provides for performance allowances in relation to an award of shares. (A SIP provides for performance allowances if it provides for an award of free shares to employees that depends on their meeting performance targets.) Paragraph 28(1)(a) contains a requirement for "each employee

participating in the award" to be notified of the performance targets and measures that will be used to determine the number of free shares to be awarded to him.

The difficulty with this reference to an employee "participating" in the award is that, according to paragraph 3(2) of Schedule 8, an employee "participates" in an award of shares as and when shares are appropriated to him or acquired on his behalf. This is too late in the day if the purpose of the notification requirement is (as indeed it must be) to give the employee information in advance about the performance targets and measures that are *to be* used for deciding how many free shares are to be awarded to him.

In rewriting paragraph 28(1)(a) in paragraph 40(1)(a) of Schedule 2 to the Act, the words "each qualifying employee who has accepted an invitation to participate in the award" have replaced "each employee participating in the award" in order to ensure that the information is given to each employee who may benefit from a particular award of shares, as opposed to each employee who actually does benefit. (A "qualifying employee" is essentially one who is eligible to be awarded shares: see paragraph 8(6) of Schedule 2 to the Act.)

This change has no implications for the amount of tax paid, who pays it or when. It affects administrative matters only (and does so only in principle and not in practice).

Change 162: Share-related income: share incentive plans: authorisation of deductions from salary under partnership share agreements: paragraph 44 of Schedule 2

This clarifies which company is to be authorised by an employee to deduct amounts for the purchase of partnership shares under a share incentive plan.

Paragraph 34 of Schedule 8 to FA 2000 applies where a share incentive plan (a "SIP") provides for partnership shares. It requires the plan to provide for qualifying employees to enter into agreements with *the company* ("partnership share agreements") under which the employee authorises *the company* to deduct part of his salary for the purchase of partnership shares.

The difficulty with this second reference to the company is that "the company" is defined by paragraph 1(4) of Schedule 8 as meaning the company which established the plan. That company may not be the employee's employer if the plan is a group plan established under paragraph 2 of the Schedule. If that company is not the employee's employer, it would not be appropriate for the employee to authorise it to make deductions from his salary.

In rewriting paragraph 34 in paragraph 44 of Schedule 2 to the Act, the second reference to the company has been replaced by a reference to "the employer company". This expression is defined by paragraph 44(3) to mean the company by

reference to which the employee meets the employment requirement in relation to the plan (see paragraph 15 of Schedule 2).

This change has no implications for the amount of tax paid, who pays it or when. It affects administrative matters only (and does so only in principle and not in practice).

Change 163: Share-related income: share incentive plans: duration of accumulation periods: paragraph 51 of Schedule 2

This clarifies the wording of the requirement that accumulation periods under a share incentive plan must be the same for all participants.

Paragraph 41 of Schedule 8 to FA 2000 deals with accumulation periods under share incentive plans. These are periods during which amounts deducted from participants' salaries are retained by the trustees of the plan pending the acquisition of partnership shares on behalf of the participants. Paragraph 41(2)(b) says that the accumulation period which applies in relation to each award of partnership shares must be the same for all individuals who are eligible to participate in the award.

It is thought that the reference to all individuals who are *eligible to participate in the award* goes too wide because paragraph 8 of Schedule 8 to FA 2000 allows for the possibility that there are employees who are eligible to participate in an award but who either do not accept an invitation to participate in it (see sub-paragraph (1)) or are not invited to do so (see sub-paragraph (3)). If employees have not accepted an invitation to participate in an award, there is no need for them to be brought within the ambit of the protection afforded by paragraph 41(2)(b) of the Schedule.

In rewriting paragraph 41(2)(b) in paragraph 51(4)(b) of Schedule 2 to the Act, the words "all individuals who are eligible to participate in the award" have therefore been replaced by "all individuals entering into the partnership agreements".

This change is a clarification with no tax effects either in principle or in practice.

Change 164: Share-related income: share incentive plans: approval procedure: paragraph 81 of Schedule 2

This modifies the procedure for obtaining approval of a share incentive plan by requiring an application for approval to be in writing, and requiring the Inland Revenue to give notice of any decision they reach on such an application.

Paragraph 4 of Schedule 8 to FA 2000 relates to applications to the Inland Revenue for approval of share incentive plans ("SIPs").

Although paragraph 4(2) requires an application to contain information, and be supported by, evidence required by the Inland Revenue, there is no express

requirement that the application should be in writing. This is different from the position under paragraph 1(2) of Schedule 9 to ICTA, which imposes such a requirement in relation to applications for approval of SAYE and CSOP schemes. Schedule 9 to ICTA is rewritten in Schedules 3 and 4 to the Act.

Paragraph 5(2) of Schedule 8 to FA 2000 requires an applicant wishing to appeal against a refusal of approval to give notice of appeal to the Inland Revenue "within 30 days after their decision is notified" to the applicant. But the Schedule does not contain any express requirement for the Revenue to notify an applicant of their decision to refuse approval of a SIP, or indeed of a decision by them to approve a SIP.

In rewriting paragraph 4 of Schedule 8 to FA 2000, paragraph 81 of Schedule 2 to the Act contains express requirements–

- for an application for approval of a SIP to be in writing, and

- for the Inland Revenue to give the applicant notice of any decision they reach on such an application.

This change has no implications for the amount of tax paid, who pays it or when. It affects administrative matters only (and does so only in principle and not in practice).

Change 165: Share-related income: share incentive plans: effect of plan termination notice: paragraph 90 of Schedule 2
This extends the circumstances in which references to a participant in the provisions relating to plan termination notices are to be read as references to his personal representatives.

Paragraph 121 of Schedule 8 to FA 2000 deals with the procedure that is to apply where the company that has established a share incentive plan (a "SIP") issues a notice terminating the plan under paragraph 120 of the Schedule. Paragraph 121(3) requires the trustees of the SIP to remove participants' shares from the plan as soon as practicable after a specified point in time.

Paragraph 121(8) explains that removing a participant's shares from the plan means transferring the shares to (or at the direction of) the participant, or disposing of the shares and then accounting for the proceeds to (or at the direction of) the participant. Paragraph 121(9) says that, where a participant has died, references to the participant in paragraph 121(8) are to be read as references to his personal representatives.

Paragraph 121(9) does not, however, apply in connection with the references to a participant in paragraph 121(5) and (6), which allow a participant to consent to his shares being removed from the SIP at time earlier than the specified point in time mentioned above. But there seems no reason why the consent procedure in paragraph

121(5) and (6) should not be available to the participant's personal representatives where he has died.

In rewriting paragraph 121 of Schedule 8 to FA 2000 in paragraph 90 of Schedule 2 to the Act, paragraph 90(9) provides for all references to the participant in the paragraph to be read as references to his personal representatives where he has died.

This change has no implications for the amount of tax paid, who pays it or when. It affects administrative matters only (and does so only in principle and not in practice).

Change 166: Share-related income: SAYE option schemes: all-employee nature of schemes: paragraph 6 of Schedule 3

This clarifies the requirement that a savings-related share option scheme is not to have any features that would discourage eligible employees or former employees from participating in the scheme.

Paragraph 2(3)(a) of Schedule 9 to ICTA contains one of the conditions that must be satisfied by a savings-related share option scheme (an "SAYE option scheme") if it is to be approved by the Board of Inland Revenue under the Schedule. It provides that the Board must be satisfied that an SAYE option scheme does not have any features (other than those required by the Schedule) which have or would have the effect of discouraging any description of employees or former employees who fulfil the conditions in paragraph 26(1) of the Schedule from obtaining and exercising options under the scheme. Paragraph 26(1) sets out the conditions for employees and full-time directors to be eligible to obtain and exercise options under an SAYE option scheme.

As drafted, paragraph 2(3)(a) refers only to employees, and therefore appears to confer no protection as regards full-time directors. Moreover, the reference to former employees who fulfil the conditions in paragraph 26(1) does not fit with the conditions set out in paragraph 26(1) since they are in terms of current employees (and directors).

In rewriting paragraph 2(3)(a) in paragraph 6(3) of Schedule 3 to the Act, the reference to employees or former employees who fulfil the relevant conditions has been replaced by a reference to any description of persons who meet those conditions or did so before ceasing to be employees or full-time directors. The relevant conditions are contained in paragraph 6(2) of Schedule 3 to the Act.

This change has no implications for the amount of tax paid, who pays it or when. It affects administrative matters only (and does so only in principle and not in practice).

Change 167: Share-related income: SAYE option schemes and CSOP schemes: disregarding of interests in SIPs: paragraph 13 of Schedule 3 and paragraph 11 of Schedule 4

This ensures that interests and rights of trustees in unappropriated shares subject to an approved share incentive plan are to be disregarded when deciding whether a person has a material interest for the purposes of the rules relating to savings-related share option schemes or company share option schemes.

Paragraph 8 of Schedule 9 to ICTA applies to both savings-related share option schemes ("SAYE" option schemes) and other share option schemes ("CSOP schemes"). It says that a scheme must provide that a person is not to be eligible to obtain and exercise options under it if he has, or within the preceding 12 months has had, a "material interest" in a close company whose shares may be acquired under the scheme (or which satisfies certain other conditions). The concept of a person having a material interest is explained at length in section 187(3) of ICTA and in Part 6 of Schedule 9 to that Act. Essentially, such an interest may arise out of his interest in the share capital of the company or his potential interest in its assets on a winding up or other specified event.

Paragraph 39 of Schedule 9 to ICTA has the effect that, in deciding whether a person has a material interest in a company, there are to be disregarded–

- the interest of the trustees of an approved profit-sharing scheme in any shares held by them under the scheme but which have not yet been appropriated to him, and

- any rights exercisable by the trustees by virtue of that interest.

But there is no provision that would enable similar interests and rights to be disregarded in the case of unappropriated shares subject to an approved share incentive plan (a "SIP"). Such a provision does, however, appear in similar contexts in paragraph 19 of Schedule 8 to FA 2000 (approval of SIPs) and paragraph 33 of Schedule 14 to that Act (enterprise management incentives). Those paragraphs have been rewritten in paragraph 21(6) of Schedule 2 and paragraph 30(7) of Schedule 5 to the Act.

In rewriting the provisions relating to material interests as regards SAYE option schemes and CSOP schemes, provisions have been included that would enable trustees' interests and rights in connection with unappropriated shares subject to an approved SIP to be disregarded. See paragraph 13(5) of Schedule 3 and paragraph 11(5) of Schedule 4 to the Act.

This change is in taxpayers' favour in principle and may in practice benefit some although the numbers and amounts are thought to be negligible.

Change 168: Share-related income: SAYE option schemes and CSOP schemes: restrictions to which scheme shares may be subject: paragraph 21 of Schedule 3 and paragraph 19 of Schedule 4

This modifies the provisions that limit the restrictions that may be attached to shares obtained under approved share option schemes.

(A) Paragraph 12(1)(c) of Schedule 9 to ICTA applies to both savings-related share option schemes ("SAYE option schemes") and other share option schemes ("CSOP schemes"). It provides that shares obtained under such schemes must not be subject to any restrictions other than those that attach to all shares of the same class or those that are permitted by paragraph 12(2). The scope of this prohibition is explained by paragraph 13 of Schedule 9.

Paragraph 12(2) and (3) authorise the imposition of certain restrictions where they are imposed by the articles of association of the company whose shares they are. But the restrictions so authorised do not cater for two sets of provisions that may be found in a company's articles of association–

- provisions allowing a company to require ex-employees to offer for sale any shares obtained by them under a scheme (paragraph 12(2)(a) only permits a restriction requiring such shares to be "disposed of", which may not be possible if an ex-employee cannot secure a sale of his shares);

- provisions giving the directors of the company a discretion to refuse to accept a transfer of shares.

The second point is already dealt with in a Revenue Press Release dated 11th June 1985. Under the terms of the Press Release, such a discretion may be disregarded for the purposes of paragraph 12 if the directors have undertaken to the Revenue not to exercise it in a discriminatory way and all those who are eligible to participate in the scheme have been notified of the undertaking. Both of the points in the previous paragraph are already addressed by the provisions relating to share incentive plans ("SIPs"): see paragraphs 63(3) and 66(1) of Schedule 8 to FA 2000 (rewritten as paragraphs 30(4) and 33(1) of Schedule 2 to the Act).

In rewriting paragraph 12 of Schedule 9 to ICTA, provisions have been included that deal with both of those points. See paragraph 21(2) and (6) of Schedule 3 (SAYE option schemes) and paragraph 19(2) and (7) of Schedule 4 (CSOP schemes) to the Act.

(B) As mentioned above, paragraph 13 of Schedule 9 to ICTA explains the scope of the prohibition imposed by paragraph 12(1)(c). Paragraph 13(2) indicates that the prohibition does not cover "so much of any contract, agreement, arrangement or condition as contains provisions similar in purpose and effect to any of the provisions of the Model Rules set out in the Model Code for Securities Transactions by Directors of Listed Companies issued by the Stock Exchange in November 1984."

The Model Rules have been replaced by the listing rules issued by the competent authority for listing in the United Kingdom under section 74(4) of the Financial Services and Markets Act 2000. This is recognised in the analogous provision relating to SIPs: see paragraph 63(4) of Schedule 8 to FA 2000 (rewritten as paragraphs 30(3) of Schedule 2 to the Act).

The reference to the Model Rules has therefore been corrected in rewriting paragraph 13(2) of Schedule 9 to ICTA. See paragraph 21(5) of Schedule 3 (SAYE option schemes) and paragraph 19(5) of Schedule 4 (CSOP schemes) to the Act.

(C) See *Note 44* in connection with extending the references to articles of association in paragraph 12 of Schedule 9 so as to include foreign equivalents.

This change has no implications for the amount of tax paid, who pays it or when. It affects administrative matters only (and does so only in principle and not in practice).

Change 169: Share-related income: SAYE option schemes and CSOP schemes: price for acquisition of shares: paragraph 28 of Schedule 3 and paragraph 22 of Schedule 4

This allows an approved share option scheme to provide for matters other than just the acquisition price of shares to be varied in order to take account of variations in the share capital of which the shares form part.

(A) Paragraph 25 of Schedule 9 to ICTA applies to a savings-related share option scheme (a "SAYE" option scheme). It allows such a scheme to provide for the price at which shares may be acquired under it to be varied so far as necessary to take account of variations in the share capital of which the shares form part.

In practice, however, if there is a variation of the share capital, it may not just be the price that needs to be varied. In reality, the number and description of the shares to be acquired may also be affected. This has been recognised in practice by the Inland Revenue's published guidance material, which provides for an SAYE option scheme to include rules allowing for these other matters to be varied so long as the scheme requires the Revenue's approval to be obtained in advance.

In rewriting paragraph 25 of Schedule 9, express provision has been included in paragraph 28 of Schedule 3 to the Act that will allow an SAYE option scheme to provide for the number and description of shares to be varied so far as necessary to take account of a variation in the share capital of which the shares form part. But paragraph 28(4) of Schedule 3 will require such a scheme to provide that no variation (including a variation as to price) is to be made without the prior approval of the Revenue.

(B) Comparable provisions relating to share option schemes other than SAYE option schemes ("CSOP schemes") appear in paragraph 29 of Schedule 9 to ICTA.

Paragraph 29 of Schedule 9 has been rewritten in paragraph 22 of Schedule 4 to the Act in the same way as paragraph 25 of the Schedule has been rewritten in paragraph 28 of Schedule 3 (see above).

This change has no implications for the amount of tax paid, who pays it or when. It affects administrative matters only (and does so only in principle and not in practice).

Change 170: Share-related income: SAYE option schemes and CSOP schemes: notice to be given by Inland Revenue of decision to grant, refuse or withdraw approval of scheme etc: paragraphs 40, 42 and 43 of Schedule 3 and paragraphs 28, 30 and 31 of Schedule 4

This imposes requirements on the Inland Revenue to give notice of a decision to grant, refuse or withdraw approval of a share option scheme or to grant or refuse approval of an alteration in such a scheme.

Paragraphs 1 to 5 of Schedule 9 to ICTA contain provisions relating to the approval of savings-related share option schemes ("SAYE option schemes") and other share option schemes ("CSOP schemes").

Paragraph 5 of Schedule 9 requires a company wishing to appeal against a decision of the Board of Inland Revenue–

- refusing to approve a scheme,
- refusing to approve an alteration in a scheme, or
- withdrawing approval of a scheme,

to give notice of appeal to the Board "within 30 days from the date on which it is notified of the Board's decision". But the Schedule does not contain any express requirement for the Board to notify a company of any of these decisions, or indeed of a decision by them to approve a scheme or an alteration in a scheme.

In rewriting provisions of paragraphs 1 to 5 of Schedule 9 to ICTA–

- paragraph 40 of Schedule 3 (SAYE option schemes) and paragraph 28 of Schedule 4 (CSOP schemes) to the Act contain an express requirement for the Inland Revenue to give an applicant for approval of a scheme notice of any decision they reach on such an application;

- paragraph 42 of Schedule 3 and paragraph 30 of Schedule 4 to the Act refer to the Inland Revenue giving notice of any withdrawal of approval of a scheme; and

- paragraph 43 of Schedule 3 and paragraph 31 of Schedule 4 to the Act refer to the Inland Revenue giving notice of a decision by them to grant or refuse approval of an alteration in a scheme.

This change has no implications for the amount of tax paid, who pays it or when. It affects administrative matters only (and does so only in principle and not in practice).

Change 171: Share-related income: SAYE option schemes and CSOP schemes: appeals against decisions by Inland Revenue to grant, refuse or withdraw approval of schemes: paragraphs 41 and 44 of Schedule 3 and paragraphs 29 and 32 of Schedule 4

This modifies the procedure relating to appeals against decisions of the Inland Revenue to grant, refuse or withdraw approval of share option schemes.

Paragraph 5 of Schedule 9 to ICTA applies to savings-related share option schemes ("SAYE option schemes") and other share option schemes ("CSOP schemes"). It enables a company that has established one of these schemes, if aggrieved by a decision of the Board of Inland Revenue–

- refusing to approve a scheme,

- refusing to approve an alteration in a scheme, or

- withdrawing approval of a scheme,

to require the matter to be determined by the Special Commissioners. The Special Commissioners are required to "hear and determine the matter in like manner as an appeal."

(A) It has been decided to simplify matters in rewriting paragraph 5 of Schedule 9 to ICTA in paragraphs 41 and 44 of Schedule 3 (SAYE option schemes) and paragraphs 29 and 32 of Schedule 4 (CSOP schemes) to the Act. The procedure whereby a "matter" is referred to the Special Commissioners for them to "hear and determine the matter in like manner as an appeal" has been replaced by a straightforward right to appeal against any of the decisions in question. This is consistent with the approach adopted in rewriting section 207 of ICTA (see *Change 9*), and will also bring the appeal procedure into line with that provided in connection with share incentive plans ("SIPs") by paragraph 5(1) of Schedule 8 to FA 2000 (rewritten in paragraph 82 of Schedule 2 to the Act).

(B) Paragraph 5 of Schedule 9 to ICTA does not currently empower the Special Commissioners, where they allow an appeal against the refusal of the Board to approve a scheme, to direct the Board to approve the scheme with effect from a specified date. This contrasts with the position relating to appeals in connection with SIPs: under paragraph 5(3) of Schedule 8 to FA 2000 the Special Commissioners can direct the Revenue to approve a SIP as from a specified date (which is not earlier than the date of the application for approval).

Similar provision has been included in the provisions of the Act rewriting paragraph 5 of Schedule 9 to ICTA: see paragraph 41(3) and (4) of Schedule 3 (SAYE option schemes) and paragraph 29(3) and (4) of Schedule 4 (CSOP schemes).

(C) It may be mentioned that in rewriting paragraph 5 of Schedule 9 to ICTA the right of appeal under paragraph 5(b) has been omitted. This is a right to appeal against a failure of the Board to decide that a condition subject to which an SAYE option scheme has been approved is satisfied. There is no longer any reference in ICTA to schemes being approved conditionally, so the omission of this right of appeal amounts to the removal of unnecessary material.

This change has no implications for the amount of tax paid, who pays it or when. It affects administrative matters only (and does so only in principle and not in practice).

Change 172: Share-related income: SAYE option schemes and CSOP schemes: information to be given to Inland Revenue: paragraph 45 of Schedule 3 and paragraph 33 of Schedule 4

This modifies the powers of the Inland Revenue to require information in connection with their functions in relation to share option schemes.

Paragraph 6 of Schedule 9 to ICTA enables the Board of Inland Revenue to require information in connection with their functions in relation to savings-related share option schemes ("SAYE option schemes") and other share option schemes ("CSOP schemes"). Among other things, paragraph 6 provides–

- that the Board can require the provision of "such information *as the Board think necessary* for the performance of" those functions;

- that any information required by them must be provided *within such time as the Board may direct (not being less than 30 days)*.

(A) In rewriting paragraph 6 of Schedule 9 to ICTA in paragraph 45 of Schedule 3 (SAYE option schemes) and paragraph 33 of Schedule 4 (CSOP schemes), the subjective test of what the Board think necessary has been replaced by an objective test of what the Inland Revenue reasonably require. This matches the test applicable

in relation to share incentive plans ("SIPs") under paragraph 117 of Schedule 8 to FA 2000 (rewritten in paragraph 93 of Schedule 2 to the Act). See also *Change 179*.

(B) In addition, the time limit for providing information has been extended from 30 days to 3 months. This matches the time limit applicable in relation to SIPs under paragraph 117 of Schedule 8 to FA 2000 (rewritten in paragraph 93 of Schedule 2 to the Act) and that applicable in relation to enterprise management incentives under paragraph 64 of Schedule 14 to that Act (rewritten in paragraph 51 of Schedule 5 to the Act).

This change has no implications for the amount of tax paid, who pays it or when. It affects (in principle and in practice) only administrative matters.

Change 173: Share-related income: SAYE option schemes and CSOP schemes: jointly owned companies: paragraph 46 of Schedule 3 and paragraph 34 of Schedule 4

This gives statutory effect to ESC B27 (jointly owned companies) in connection with the approval of share option schemes.

Paragraph 1(3) of Schedule 9 to ICTA applies to both savings-related share option schemes ("SAYE option schemes") and other share option schemes ("CSOP schemes"). It allows a company that has established one of these schemes to extend the scheme to all or any companies of which it has control within the meaning given in section 840 of ICTA. In such a case the scheme will count as a "group scheme" for the purposes of the Schedule and the companies will be "participating companies".

Under paragraph 1(3) there is a difficulty in connection with jointly owned companies. Since neither of the joint owners of a jointly owned company controls the company, paragraph 1(2) does not apply and a scheme established by either of them therefore cannot be made to extend to the company as a group scheme. Similarly it cannot be made to extend to any company controlled by the joint company.

However, ESC B27 currently permits a jointly owned company and companies controlled by it to be participating companies in a group scheme established by either of its joint owners, so long as certain conditions set out in the ESC are met. Provisions based on the ESC already apply to share incentive plans (see paragraph 127 of Schedule 8 to FA 2000, rewritten as paragraph 91 of Schedule 2 to the Act).

Paragraph 46 of Schedule 3 and paragraph 34 of Schedule 4give statutory effect to the ESC in connection with SAYE option schemes and CSOP schemes respectively.

This change is in principle in taxpayers' favour but is expected to have no practical effect as it is in line with current practice.

Change 174: Share-related income: the EMI code: meaning of "qualifying subsidiary": paragraph 11 of Schedule 5

This extends the meaning of "qualifying subsidiary" for the purposes of the provisions relating to enterprise management incentives.

Paragraph 1 of Schedule 14 to FA 2000 (enterprise management incentives) sets out the requirements that must be met if a share option is to count as a qualifying option for the purposes of the Schedule. A number of those requirements are framed in terms of a "qualifying company"; and paragraph 14(1) of the Schedule says that a company that has one or more subsidiaries is not a "qualifying company" unless each subsidiary is a "qualifying subsidiary".

The conditions that have to be met if a subsidiary ("company S") is to be a "qualifying subsidiary" of a company ("company C") are set out in paragraph 15(2) of Schedule 14. These conditions contain various requirements that have to be satisfied in relation to company C "or another of its subsidiaries". Section 6 of the Interpretation Act 1978 means that, in principle, it is possible to read the words "or another of its subsidiaries" as meaning "or one or more of its other subsidiaries". But, even if that meant that the interests of two or more subsidiaries in company S could be taken together, paragraph 15(2) does not appear to deal with a case where both company C and one or more of its other subsidiaries have interests in company S, so as to allow those interests to be taken together in deciding whether the requirements are duly satisfied.

It is thought that it would accord with the intention behind paragraph 15(2) if, when considering the status of company S, the interests in that company of all of the members of the group were to be taken into account. This would mean that one should–

- look at the group of companies consisting of company C and all its subsidiaries, and

- then decide whether the requirements in question are satisfied in relation to any member of the group, or any two or more members taken together.

In rewriting paragraph 15(2) of Schedule 14 to FA 2000 in paragraph 11 of Schedule 5 to the Act, the references to the company or another of its subsidiaries have been replaced by references to "the holding company". This expression is then defined in a way that reflects the approach mentioned in the previous paragraph.

This change is in taxpayers' favour in principle and may in practice benefit some although the numbers and amounts are thought to be negligible.

Change 175: Share-related income: the EMI code: "qualifying trade" (leasing of ships): paragraph 18 of Schedule 5

This clarifies the extent of a relaxation as regards the transactions involving the leasing of ships that can be carried on in the course of a "qualifying trade" for the purposes of the provisions relating to enterprise management incentives.

One of the factors relevant to deciding whether a company is a "qualifying company" for the purposes of Schedule 14 to FA 2000 (see *Change 174*) is whether the company, or a member of the group to which it belongs, is carrying on a "qualifying trade" (or preparing to do so).

Paragraph 21 of the Schedule in effect allows a trade consisting of the chartering of a ship in certain circumstances to count as a "qualifying trade" in certain circumstances. But this is subject to (among other things) each of the charters being an arm's length bargain made between persons who are not connected with each other. Sub-paragraph (4) purports to disapply this requirement where there is a charterparty made between two companies and–

- one is the company carrying on the trade and the other is a qualifying subsidiary of that company, or
- both are qualifying subsidiaries of the company carrying on the trade.

However, the second scenario can never arise because paragraph 21 only deals with charters made by the company carrying on the trade.

In rewriting paragraph 21 of the Schedule in paragraph 18 of Schedule 5 to the Act, this defect has been corrected by adopting the approach contained in section 297(7) of ICTA (the Enterprise Investment Scheme). Under paragraph 18(6) of Schedule 5 there will be 3 scenarios where the arm's length requirement will not apply–

- where the charterer is a qualifying subsidiary of the company carrying on the trade;
- where the latter is a qualifying subsidiary of the former, and
- where both are qualifying subsidiaries of a third company.

This change is in taxpayers' favour in principle and may in practice benefit some although the numbers and amounts are thought to be negligible.

Change 176: Share-related income: the EMI code: "eligible employees": paragraph 26 of Schedule 5

This modifies the requirement as to commitment of working time that must be met by an employee in order to be an "eligible employee" for the purposes of the provisions relating to enterprise management incentives.

As previously mentioned (see C*hange 174*), paragraph 1 of Schedule 14 to FA 2000 (enterprise management incentives) sets out the requirements that must be met if a share option is to count as a qualifying option for the purposes of the Schedule. One of these requirements is that the individual to whom the option is granted is an "eligible employee".

Paragraph 29(1) of Schedule 14 says in effect that an employee is not an "eligible employee" in relation to a company unless the time that he is required to spend on the business of the company (or of the group, if it is a parent company) amounts to –

- at least 25 hours a week, or
- if less, 75% of his working time.

There are two difficulties here. In the first place, nothing in paragraph 29 makes it clear that the reference to 75% of the employee's working time imposes a *minimum* requirement (comparable to the alternative requirement for the employee to spend *at least* 25 hours a week). But it must be assumed that this is how the reference would be interpreted by a court if the point ever arose: it is inconceivable that Parliament intended this requirement to be satisfied only where the time which the employee is required to spend as mentioned above amounted to *exactly* 75% of his working time. In rewriting paragraph 29 of the Schedule in paragraph 26 of Schedule 5 to the Act, it has been therefore made clear that both of these requirements are minimum requirements. They have been expressed as a "statutory threshold" which must be either equalled *or exceeded* by the amount of time spent by the employee on the business of the company or group.

Secondly, the requirements as framed at present are thought to produce unfair results for employees who work flexi-time: the hours worked by such employees may in some weeks fall below 25 hours, even though on average they would meet this requirement (see also *Change 130*). The requirements have therefore been rewritten in paragraph 26 of Schedule 5 to the Act in a way that means that what will count is *the average amount per week* of the time that the employee is required to spend on the business of the company (or of the group, if it is a parent company).

This change is in taxpayers' favour in principle and may in practice benefit some although the numbers and amounts are thought to be negligible.

Change 177: Share-related income: the EMI code: further requirements to be met as to replacement option: paragraphs 41 and 43 of Schedule 5
This is concerned with valuing the shares subject to replacement options granted in connection with company reorganisations.

Paragraphs 59 to 63 of Schedule 14 to FA 2000 (enterprise management incentives) contain provisions relating to a company reorganisations.

Paragraph 61 of Schedule 14 sets out the main rules applying to a rollover of qualifying options (whereby old options are deemed to be 'rolled over' into new options relating to shares in the acquiring company). These rules include the condition that the requirements of paragraph 63 are met. If all the conditions are met the "new option" (paragraph 61(1)) is treated as a replacement option under paragraph 61 (2).

Paragraph 63(b)(ii) has the effect that the test in paragraph 11 of the Schedule (under which the value of shares subject to unexercised options is not to exceed £3 million) is re-imposed at the time of the rollover of the options. Because this sub-paragraph re-imposes the test in relation to the new option, it requires a valuation of the shares in the acquiring company. However, there is a potential difficulty if the value of the shares subject to the new option exceeds the market value of the shares subject to the old option at the time when that option was granted. Whereas the latter value may have kept the old option within the £3 million limit, the value of the shares subject to the new option may result in it being exceeded. In practice the Inland Revenue apply this test as requiring a valuation of the shares in the acquired company as at the time of the grant of the old option.

Paragraph 61(3) of the Schedule applies to a new option which satisfies all the tests and is therefore a "replacement option". It fixes the time when the replacement option is deemed to have been granted, namely at the time when the old option was granted. This gives rise to a further potential difficulty since, when the shares subject to the replacement option are to be valued for the purpose of any of the limits in paragraph 10 (maximum entitlement of employee) or 11 (maximum value of shares subject to unexercised options), the valuation rules in paragraph 10(7) mean that one has to value the shares as at the time when the old option was granted. But the shares in question are of course shares in the acquiring company, and it might well be the case that the acquiring company was not in existence at the time when the old option was granted.

These provisions could therefore in some cases be unworkable, to the extent that they require a valuation of the shares in the acquiring company at a time when it may not have existed. In other cases valuing the shares in the acquiring company as at the date of the old option could produce random and perverse results. In practice, the value of the shares subject to the original option is used for the purposes of the tests in paragraphs 10 and 11 of Schedule 14.

In rewriting paragraphs 61 and 63 of Schedule 14 in paragraphs 41 and 43 of Schedule 5 to the Act it is made clear that, even though the tests under paragraphs 5, 6 and 7 of Schedule 5, at and after the reorganisation, apply to the acquiring company, the subject of the valuation is the shares in the acquired company. This is achieved by applying the method of valuation in paragraph 5(6) to (8) to the shares that were subject to the old option as the measure of the valuation of the shares subject to the new or replacement option: see paragraphs 41(6) and 43(4) of Schedule 5 to the Act.

This change is in principle adverse to some taxpayers and favourable to others in relation to the rules on the rollover of share options but it is expected to have no practical effect as it is in line with current practice, as described above.

Change 178: Share-related income: the EMI code: notices following notification of option: paragraphs 45 and 46 of Schedule 5

This clarifies the provisions about the giving of notices following notification of the grant of a share option for the purposes of the provisions relating to enterprise management incentives.

Paragraph 2 of Schedule 14 to FA 2000 (enterprise management incentives) requires an employer company to give the Inland Revenue notice of the grant of a share option in order for the option to count as a qualifying option for the purposes of the Schedule. Paragraph 3 of the Schedule enables the Revenue to issue a notice correcting obvious errors or omissions in such a notice, and paragraph 4 enables the Revenue to enquire into any option of which they have been given notice.

(A) Paragraph 3(4) of the Schedule provides that a correction made by the Inland Revenue is to be of no effect if the employer company "gives notice rejecting the correction" within 3 months from the date of issue of the notice of correction.

Although paragraph 3(4) does not expressly require the employer company to give the notice rejecting the correction *to the Inland Revenue*, this must clearly have been intended. This has accordingly been made clear in rewriting paragraph 3(4) in paragraph 45(4) of Schedule 5 to the Act.

(B) Paragraph 4(4) of the Schedule contains the general time limit which applies to a notice of enquiry given by the Inland Revenue under paragraph 4. Such a notice may be given "at any time within the period of 12 months beginning with the end of the period of 92 days mentioned in paragraph 2(1)". This 92-day period is the period within which an option is to be notified to the Revenue if it is to count as a qualifying option, and it runs from the grant of the option.

The current wording suggests that a notice of enquiry can *only* be issued *within* the period of 12 months mentioned in paragraph 4(4). But it is considered that that period was intended to provide an *overall* time limit, with the result that, although no notice can be given after the end of it, a notice *can* be given *before* it begins. This has

accordingly been made clear in rewriting paragraph 4(4) in paragraph 46(5) of Schedule 5 to the Act.

This change has no implications for the amount of tax paid, who pays it or when. It affects administrative matters only (and does so only in principle and not in practice).

Change 179: Share-related income: the EMI code: information to be given to Inland Revenue: paragraph 51 of Schedule 5
This modifies the powers of the Inland Revenue to require information in connection with their functions in relation to enterprise management incentives.

Paragraph 64 of Schedule 14 to FA 2000 (enterprise management incentives) enables the Inland Revenue to require information in connection with their functions under that Schedule. The information must be (among other things) "such information as … the Inland Revenue think necessary" for the performance of their functions under the Schedule.

In rewriting paragraph 64 of Schedule 14 to FA 2000 in paragraph 51 of Schedule 5to the Act, the subjective test of what the Board think necessary has been replaced by an objective test of what the Inland Revenue reasonably require. This matches the test applicable in relation to share incentive plans under paragraph 117 of Schedule 8 to FA 2000 (rewritten in paragraph 93 of Schedule 2 to the Act). See also *Change 172*.

This change has no implications for the amount of tax paid, who pays it or when. It affects administrative matters only (and does so only in principle and not in practice).

Change 180: Share-related income: the EMI code: amendment of monetary limits: paragraph 54 of Schedule 5
This extends the power of the Treasury to amend monetary limits under provisions relating to enterprise management incentives.

Paragraph 69(b) of Schedule 14 to FA 2000 (enterprise management incentives) enables the Treasury to make an order amending the monetary limits set out in paragraph 10(1), (4) and (5) of the Schedule (maximum entitlement of employee as regards qualifying options). No order has so far been made as regards paragraph 10(1), (4) and (5), with the result that they each continue to specify a limit of £100,000.

There is a further limit of £100,000 set out in paragraph 47(1)(g) of the Schedule. It seems that, in view of the related objectives of these provisions, any alteration in the limits in paragraph 10 ought to be reflected by an alteration of the limit in paragraph

47(1)(g). However, the power of amendment conferred by paragraph 64(b) does not currently extend to paragraph 47(1)(g).

This omission has been corrected in rewriting paragraph 69(b) of Schedule 14 to FA 2000 in paragraph 54 of Schedule 5 to the Act. Paragraph 54(2) will enable any alteration in the limits in paragraphs 5 and 6 (which rewrite paragraph 10 of Schedule 14 to FA 2000) to be reflected by an alteration of the limit in section 536(1)(e) (which rewrites paragraph 47(1)(g) of Schedule 14).

This change will be in taxpayers' favour (in principle and in practice) on the basis that it is expected that the limits will only ever be altered upwards.

Change 181: Relief from tax on annual payments under certain insurance policies: section 580A(7) of ICTA: paragraph 65 of Schedule 6

This relates to the consequential amendment of section 580A(7) of ICTA in paragraph 65 of Schedule 6 to the Act.

Section 580A of ICTA exempts payments made under certain ill health and employment risk policies. Typically these policies pay out sums that would be taxed under Schedule D Case III as annual payments. The primary purpose of section 580A is to exempt these Schedule D Case III payments.

But section 580A(7) of ICTA applies to payments that would be taxed under Schedule E. It applies if a person takes out a policy on behalf of another person and that other person contributes to the premiums. Section 580A(7) exempts the proportion of the payment that represents the other person's share of the premium payments.

Paragraph 65 of Schedule 6 to the Act amends section 580A(7) so it applies to employment income and pension income. One effect of this amendment is that the exemption will apply to foreign pensions. In ICTA those pensions are taxed under Schedule D Case V.

This change is in principle in taxpayers' favour but it is expected to have no practical effect as it is in line with current practice.

Change 182: Deductible payments: combined claims: paragraph 217 of Schedule 6

This allows a former employee who has paid certain employment-related liabilities and insurance premiums to make a combined claim for a deduction from total income and for a set-off against capital gains tax.

Under section 92(1) of FA 1995 a person who has ceased to hold an office or employment is entitled to make certain deductions when calculating his total income for a year of assessment. The former employee may deduct–

- the amount of any liability incurred in connection with acts or omissions relating to the office or employment; and

- the premium of any insurance policy taken out to meet liabilities of that kind.

Section 92(1) provides that the former employee is entitled to these deductions only if he makes a claim for the purpose.

Section 92(6) of FA 1995 deals with the case where the amount which is deductible under section 92(1) exceeds the former employee's total income for the year in question. In such a case, the former employee is entitled to set the excess off against liability to capital gains tax. Like section 92(1), section 92(6) provides that the former employee is entitled to this set off only if he makes a claim for the purpose.

Section 92 of FA 1995 does not permit a combined claim under section 92(1) and (6). However, the current practice of the Inland Revenue is to treat a claim under section 92(1) as also being a claim under section 92(6), if the circumstances require it.

The entitlement to make deductions from total income (given by section 92(1) of FA 1995) is rewritten in section 555(2) of the Act. The requirement to make a claim to these deductions is rewritten in section 555(3) of the Act.

The entitlement to a set off against capital gains tax (given by section 92(6) of FA 1995) is rewritten as a consequential amendment of TCGA 1992. A new section 263ZA is inserted in TCGA 1992 by paragraph 217 of Schedule 6 to the Act. The entitlement to the set off is rewritten in subsection (3) of the new section 263ZA. The requirement to make a claim to the set off is also rewritten in the same place (see the second paragraph of subsection (3)).

The rewritten provisions set out expressly that a claim to the deduction from total income and to the set off against capital gains tax may be combined: see subsection (6) of the new section 263ZA of TCGA 1992.

This change has no implications for the amount of tax paid, who pays it or when. It affects (in principle and in practice) only administrative matters.

Change 183: PAYE: paragraph 10 of Schedule 2 to the Tax Credits Act 1999: paragraph 241 of Schedule 6

This provides a reference to PAYE regulations in provisions for recovery of overpayments in respect of tax credit as if they were underpayments of tax.

Paragraph 10 of Schedule 2 to the Tax Credits Act 1999 operates on section 71 of the Social Security Administration Act 1992, and section 69 of the Social Security Administration (Northern Ireland) Act 1992. It provides that they shall have effect in any case where an overpayment was made in respect of tax credit as if for subsections (8) and (9) there were substituted the provisions there set out. The substituted subsection (8)(b) provides, among other things, that an amount recoverable under subsection (1) in any year of assessment shall be treated for the purposes of section 203(2)(a) of the Income and Corporation Taxes Act 1988 (PAYE) as if it were an underpayment of tax for a previous year of assessment.

The explicit reference to section 203(2)(a) of ICTA could conceivably be construed as excluding the rest of section 203(2). For example, the power to make regulations to collect unpaid tax in section 203(2)(c) and the power to make regulations to collect interest in section 203(2)(d).

This construction might lead to the conclusion that paragraph 10 of Schedule 2 to the Tax Credits Act 1999 was ineffective and that overpayments of tax credits cannot be recovered through PAYE. That would however leave the provisions with no effect.

Paragraph 241 of Schedule 6 to the Act accordingly amends paragraph 10 of Schedule 2 to the Tax Credits Act 1999 so as to substitute "under PAYE regulations" for "for the purposes of section 203(2)(a) of the Income and Corporation Taxes Act 1988 (PAYE)". This removes any doubt as to the ability to recover overpayments of tax credit in the same way as underpayments of tax on PAYE income.

This change could in principle affect how an overpayment of tax credits is recovered and in exceptional cases even who pays what amount of tax (for the reasons discussed in Change 147), but it is expected to have no practical effect as it is in line with current practice.

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Note 1: Explanations of "employment" and "office": sections 4 and 5
This deals with the introduction of partial explanations of "employment" and "office". These are intended to provide a measure of statutory guidance as to the meaning of these expressions by identifying certain arrangements which seem to be clearly covered by them, but without seeking to alter their scope.

Tax is charged under Cases I to III of Schedule E "in respect of any office or employment on emoluments therefrom": see section 19(1) of ICTA. There is nothing in current tax legislation that defines either "office" or "employment".

(A) To take "employment" first, the decisions of the courts have given rise to a number of different tests, none of which has proved to be definitive. Given the diversity of approach in the courts it seems unlikely that an exhaustive definition of "employment" could be produced, or indeed that one could produce more than an incomplete list of criteria that might or might not be useful in a given case for determining whether an employment exists.

On the other hand it is thought that it would be helpful to have a non-exhaustive explanation which gave an indication of the *core* meaning of "employment" by listing certain arrangements that on any view constitute an employment. As such, it would not attempt to delineate the boundary between employment and self-employment.

Section 4 of the Act contains such an explanation. It states that "employment" includes in particular–

- any employment under a contract of service,
- any employment under a contract of apprenticeship, and
- any employment in the service of the Crown.

The reference to "any employment in the service of the Crown" is specifically included because it is not settled that all Crown servants have contracts of service.

(B) The concept of an "office" is one that has also been considered by the courts: see in particular *Great Western Railway Company v Bater* (1922) 8 TC 231 and *Edwards v Clinch* (1981) 56 TC 367. But in this case it does seem possible to construct a definition based on the guidelines established by the courts. However, since these are only guidelines, any explanation can, again, only be non-exhaustive.

Section 5(3) of the Act contains such an explanation. It states that "office" includes in particular any position which has an existence independent of the person who holds it and may be filled by successive holders. Section 5(2) is another new (but rather less significant) interpretation provision relating to offices: it simply spells out how provisions worded in terms of employments are to apply to offices.

Section 4 applies for the purposes of the employment income Parts (Parts 2 to 7 of the Act), while section 5 applies unless excluded. These sections are also applied for the purposes of other particular provisions of the Act. For example, Part 9 of the Act, which deals with the liabilities of former employees and office holders, contains provisions corresponding to section 4 of the Act (see section 562) and section 5 of the Act (see section 564). A similar approach is adopted in section 712 of the Act, which relates to PAYE.

Note 2: "Employment income", "general earnings" and "specific employment income": section 7

This deals with the introduction of the labels "employment income", "general earnings" and "specific employment income" in the Act.

At present ICTA does not use any expression that encompasses the entirety of employment-related income chargeable to tax under Schedule E. There are two main strands of such income–

- Cases I to III in paragraph 1 of the Schedule charge emoluments. These include amounts treated as emoluments. Whether emoluments are taxable depends on the tests of residence in the Cases and the rules about receipts set out in sections 202A and 202B of ICTA;

- paragraph 5 of the Schedule charges other income on which another provision of the Tax Acts directs tax to be charged under the Schedule. Whether such income is taxable does not depend on the same rules about residence and receipts but on the terms of the provision concerned.

The label "employment income" has been adopted in the Act as an expression that will encompass all of the types of income mentioned above. Thus section 7(2) of the Act defines "employment income" as meaning–

- earnings within Chapter 1 of Part 3 (which replace "emoluments": see *Note 13*);

- amounts treated as earnings (which accordingly replace amounts treated as emoluments); and

- any amounts which count as employment income (which replace income within paragraph 5 of Schedule E: see *Note 3*).

However, for the purpose of operating the charge to tax on employment income under Part 2 of the Act, two further labels have been devised to reflect the two main strands of income mentioned above: see section 7(3) and (4). These are–

- general earnings (consisting of earnings and amounts treated as earnings); and

- specific employment income (consisting of any amount counting as employment income).

Because these labels are to operate for the purposes of the charge to tax, neither general earnings nor specific employment income includes any exempt income (see section 8 of the Act).

Note 3: Employment income other than earnings: operation of tax charges: sections 7, 476, 477 and 504 to 507

This deals with the way in which specific charges on employment-related income other than earnings are rewritten in Parts 6 and 7 of the Act.

At present the main charge on employment-related income is the charge under paragraph 1 of Schedule E (see section 19(1) of ICTA) which taxes emoluments and amounts treated as emoluments. This charge is rewritten as the charge under Part 2 of the Act on general earnings: see Chapters 2 and 3 of Part 2 of the Act.

The Tax Acts also contain a number of specific (or "free-standing") charges to tax on employment-related income, and these are brought within Schedule E by paragraph 5 of the Schedule.

(A) In rewriting the provisions that currently impose specific charges to tax, it has been decided not to use a form of words that would suggest that the provisions themselves impose separate charges to tax. Under the new scheme contained in the employment income Parts of the Act, the function of these provisions is rather to *identify* amounts of income that will fall within the charge to tax on employment income under Part 2 of the Act.

The way that these provisions identify such amounts is to say that they are to "count as employment income". As indicated in section 7(3) of the Act, the majority of these provisions appear in–

- Part 6 of the Act (income which is not earnings or share-related), and

- Part 7 of the Act (share-related income and exemptions).

Such amounts then fall within the charge under Part 2 of the Act on specific employment income (see section 9 of the Act) because "specific employment income" is defined by section 7(4) and (6) of the Act as meaning any amount that counts as employment income by virtue of Part 6 or 7 of the Act (or any other enactment).

The use of the expression "counts as employment income" therefore involves a change of approach and wording from the current position but does not have any practical effect on tax liability.

(B) There is another issue which arises in connection with this type of employment income. This concerns the tax year in which such income is to be charged to tax.

There are general rules for attributing amounts of income to particular tax years in sections 202A and 202B of ICTA, but they apply only to emoluments and not to income chargeable under paragraph 5 of Schedule E. The timing of the tax charge for the latter sort of income is, in general, set out in the provision charging it to tax. In the remaining cases, the tax year in question is readily identifiable in the context of the provision charging it to tax: see section 135(1) and (6) of ICTA (rewritten in sections 476 and 477 of the Act) and paragraphs 81, 82, 85 and 86 of Schedule 8 to FA 2000 (rewritten in sections 504 to 507 of the Act).

In rewriting the provisions that currently impose specific charges to tax, it has been decided to adopt a standard approach whereby the tax year in which such income is to be charged to tax is set out in each case. Thus each of the rewritten provisions states that the amount in question is to count as employment income "for the relevant tax year", and that year is then specified.

Again, this involves a change of approach and wording from the current position but does not have any practical effect on tax liability.

Note 4: Net taxable earnings and net taxable specific income: sections 11 and 12
This relates to the calculation of net taxable earnings and net taxable specific income under Part 2 of the Act.

Calculation of net taxable earnings At present ICTA does not spell out the method for calculating the income chargeable to tax under Cases I to III of Schedule E (see section 19(1) of ICTA). But section 131(1) makes clear that it is the full amount of such emoluments that is chargeable "subject to such deductions only as may be authorised by the Tax Acts". This proposition is in effect rewritten in section 11(1) of the Act.

Section 11(2) to (4) of the Act simply reflect the way that the amount of income chargeable to tax under Cases I to III is calculated under the existing legislation. It is clear from the wording of, for example, section 198(1) of ICTA (relief for necessary expenses) that deductions may only be made from the emoluments of the employment to which they relate. So the process of subtracting deductions from emoluments involves a separate calculation for each of an employee's employments.

In the normal way the general rules relating to deductions (see section 329(1) of the Act) will mean that deductions allowed in respect of an employment cannot exceed the taxable earnings from the employment. The consequence of this is that the result of the calculation in section 11(1) of the Act in such cases cannot be less than nil, and section 11(2) will not come into play. However, in exceptional cases, the result of the calculation in section 11(1) may be a negative amount. In such cases section 11(2) will come into play to ensure that the net taxable earnings from the employment are nil.

Calculation of net taxable specific income Paragraph 5 of Schedule E (see section 19(1) of ICTA) brings within the overall charge to tax under Schedule E amounts that are directed to be charged under that Schedule by other provisions of the Tax Acts. Such amounts are called "specific employment income" in the Act.

ICTA is silent on how the amount of a charge to tax under paragraph 5 of Schedule E is to be calculated. Section 12 fills this gap in connection with specific employment income under the Act: subsection (1) sets out the arithmetic process for calculating net taxable specific income, and subsection (2) ensures that this can never be less than nil.

Paragraph 5 of Schedule E does not provide for amounts within that paragraph to be added together. It simply ensures that the charge to tax under Schedule E extends to such amounts, each of which falls to be calculated in accordance with separate rules contained in the provisions of the Tax Acts directing them to be chargeable under Schedule E. Section 12(3) reflects this by ensuring that each kind of specific employment income is to be subject to a separate calculation in order to arrive at the net taxable specific income in that case.

Note 5: Taxable earnings: person liable for tax: section 13
This relates to clarification of the persons who are liable for tax on employment income.

At present the charge to tax on emoluments under Cases I to III of Schedule E (see section 19(1) of ICTA) is a charge on emoluments from an office or employment. There is nothing in ICTA that says expressly that the person chargeable to tax on emoluments is the person whose emoluments they are (or are treated as being), namely the office-holder or employee. However, there can be no doubt that this is the case.

In rewriting this charge to tax in Part 2 of the Act as it applies to general earnings (see *Note 2*), it seems sensible to make clear who is to be liable for tax on such earnings. Section 13(2) of the Act therefore spells out the primary rule that it is to be the employee who is so liable. The secondary rule, which applies where the employee has died, is contained in section 13(4) and (5) and derives from section 202A(3) of ICTA. (References in the Act to employees in general include office-holders: see section 5 of

the Act.) These provisions will not affect the operation of PAYE Regulations, which impose obligations on employers as regards the deduction and payment of amounts in respect of tax for which their employees are liable.

Section 13(3) similarly spells out who is to be liable for tax under Part 2 of the Act as it applies to specific employment income (see *Note 2*). This will always be the person in relation to whom such income is to count as employment income (see *Note 3*). For the most part, the provisions currently imposing charges to tax on such income spell out who is to be chargeable to tax on it. The one exception is section 595(1) of ICTA, but even there it is clear in the context that it must be the person (i.e. the employee) whose chargeable income the sum in question is to deemed to be.

Note 6: Taxable earnings: meaning of earnings "for" a tax year: sections 16 and 29

This relates to clarification of references to general earnings "for" a tax year.

At present it is necessary to know whether emoluments are emoluments "for" a particular tax year in order to apply the residence tests contained in Cases I to III of Schedule E (see section 19(1) of ICTA). Cases I to III are rewritten in Chapters 4 and 5 of Part 2 of the Act; and it is similarly necessary, in order to apply the residence tests under those Chapters, to know whether general earnings (see *Note 2)* are general earnings for a particular tax year.

ICTA currently gives no explanation of when emoluments are to be regarded as emoluments "for" a particular tax year. Consultation on an early draft of the charging provisions indicated a need to clarify this point.

Sections 16 and 29 of the Act therefore spell out that general earnings are "for" a particular period consisting of the whole or part of a tax year if they are general earnings earned in or otherwise in respect of that period. It is thought that this reflects the meaning that a court would give to "for" if the point ever arose. On the same basis the sections provide for earnings for a period that extends beyond a single tax year to be apportioned between the tax years in question.

The propositions in sections 16 and 29 do not override provisions of Part 3 of the Act that require amounts to be treated as earnings for a particular year (see *Note 7*).

Note 7: Taxable benefits: tax year for which amounts are treated as earnings: sections 17(4) and 30(4), Chapters 3 to 10 of Part 3 and sections 223 and 224

This relates to the tax year for which amounts are to be treated as earnings under provisions of the benefits code or other provisions that treat payments as earnings.

(A) Sections 17 and 30 of the Act rewrite paragraph 4A of Schedule E (see section 19(1) of ICTA), which contains special rules for dealing with cases where the emoluments from an employment would otherwise be earnings for a year in which the employment is not held. Sections 17(4) and 30(4) of the Act state that those special rules do not apply in connection with determining the year for which amounts are to be treated as earnings under Chapters 2 to 11 of Part 3 (the benefits code).

The reason for this is that it is thought that, on analysis, paragraph 4A of Schedule E has no application in relation to deemed emoluments under the current benefits code provisions. For the most part, the way in which those provisions operate means that any deemed emoluments will necessarily be for a year in which the employment is held. The exceptions are section 160(3) (beneficial loan arrangements) and section 162(5) and (7) (employee shareholdings) of ICTA, which provide for amounts to be treated as emoluments where loans are released or written off, or shares are disposed of, after the employment has terminated. However, in such cases the relevant provisions of those sections are stated to apply "as if the employment had not terminated". Since the year for which amounts are to be treated as emoluments is either readily identifiable (in relation to a section 160(3) case) or spelt out (in relation to a section 162(5) or (7) case), it is thought that there is no room for paragraph 4A of Schedule E to apply. Sections 17(4) and 30(4) of the Act make this point explicit.

(B) Chapters 3 to 10 of Part 3 of the Act (taxable benefits) and sections 223 and 224 (certain payments treated as earnings) rewrite provisions of ICTA whose effect is to require amounts of one sort or another to be treated as a person's emoluments for the purposes of Schedule E. With the exception of section 162(5) and (6) of ICTA (employee shareholdings) none of those provisions specifies the tax year for which the amount in question is to be treated as emoluments.

The tax year for which amounts are to be treated as emoluments is relevant for the purpose of applying the residence and other tests contained in Cases I to III of Schedule E. Accordingly, in the absence of anything expressly identifying the relevant tax year in each case, that year currently needs to be inferred from the provisions in question. It seems that this can readily be done by looking at the time, period or tax year at or in which the payment or other benefit is made or provided. This is consistent with the rules set out in section 202B of ICTA, which are aimed at identifying the tax year *in which* emoluments are to be treated as *received* for the purposes of section 202A(1)(a) (taxation on receipts basis under Case I or II of Schedule E).

Cases I to III of Schedule E are rewritten in Chapters 4 and 5 of Part 2 of the Act. It is similarly necessary, for the purpose of applying the residence and other tests under the charging provisions of those Chapters, to know the tax year for which amounts are to be treated as earnings under Chapters 3 to 10 of Part 3 of the Act and sections 223 and 224. Rather than leave the relevant tax year to be inferred as mentioned above, Chapters 3 to 10 and sections 223 and 224 contain provisions identifying that year: see section 72(1) and similar provisions of Chapters 4 to 10, section 223(4) and

section 224(1). In so doing they simply make explicit what is considered to be implicit in the existing provisions of ICTA.

Note 8: Taxable earnings: chargeable overseas earnings constituting taxable earnings: sections 21 and 22

This relates to the basis for taxing what are currently described as "foreign emoluments".

As mentioned in *Change 3*, section 192(2) of ICTA provides that where–

- the duties of an office or employment are performed wholly outside the United Kingdom, and

- the emoluments from the office or employment are "foreign emoluments" (i.e. they are emoluments of a person domiciled outside the United Kingdom and the employment is with a foreign employer: see section 192(1)),

the emoluments are excepted from the main charge on employment income under Case I of Schedule E (which applies where the person holding the office or employment is resident and ordinarily resident in the United Kingdom: see section 19(1) of ICTA). However, the amount of foreign emoluments so excepted is limited to the amount that remains after subtracting capital allowances and deductions under section 192(5) of ICTA (see *Change 3*). So the amount of the foreign emoluments which is *not* so excepted stays within the Case I charge.

Neither section 192(2) nor section 19(1) of ICTA specifies the basis on which emoluments are to be charged where they are excepted from the charge under Case I. But the present reality is that they are charged under Case III of Schedule E if they satisfy the conditions of that Case. Case III charges any emoluments for any year of assessment in which the person holding the office or employment is resident in the United Kingdom (whether or not ordinarily resident there) so far as the emoluments are received in the United Kingdom.

The exception for "foreign emoluments" has been rewritten in section 22 of the Act in way that is intended to reflect more clearly the current Case III charge. In that section–

- the "foreign emoluments" excepted from the Case I charge rewritten in section 21 are referred to as "chargeable overseas earnings" (as calculated under section 23),

- there is express provision for "chargeable overseas earnings" to be an amount of "taxable earnings" for the purposes of the charge to tax under Part 2 of the Act, and

- that provision operates by reference to earnings received in the United Kingdom in a tax year (although, as mentioned in *Note 9,* the Act refers to such earnings as being "remitted to" the United Kingdom).

Note 9: Taxable earnings: earnings remitted to the United Kingdom: sections 22 and 26

This deals with the introduction of references to earnings "remitted to" the United Kingdom.

Section 202A of ICTA contains the rules for charging tax on emoluments under Schedule E. In any tax year, tax is charged–

- under Case I or II, on the full amount of emoluments *received* in the year;

- under Case III, on the full amount of emoluments *received in the United Kingdom* in the year. (This wording follows that of Case III itself: see section 19(1) of ICTA.)

The use of "received" in both of these contexts is capable of confusing the reader, who might wonder what distinction was being drawn by section 202A. Why are emoluments "received in the United Kingdom" not also emoluments that are "received"? In fact, section 202A was intended to reflect the distinction between the charge under Case I or II on emoluments wherever they are received and the Case III charge, which only applies to emoluments remitted to the United Kingdom.

In rewriting the provisions of ICTA relating to the charging of Case III emoluments, the Act makes the intended distinction clearer by referring to amounts "remitted to" the United Kingdom: see sections 22 and 26 of the Act.

Note 10: Taxable earnings: earnings from overseas Crown employment subject to UK tax: sections 25, 27 and 28

This relates to the way in which earnings from overseas Crown employment are charged to tax under the Act.

Section 132(4)(a) of ICTA deems certain duties to be performed in the United Kingdom for the purposes of Cases I and II of Schedule (see section 19(1) of ICTA). These are duties of any office or employment under the Crown which is of a public nature and which is paid for out of the public revenue of the United Kingdom or of Northern Ireland.

Case II of Schedule E charges emoluments *in respect of duties performed in the United Kingdom* for a tax year in which the office holder or employee is–

- not resident in the United Kingdom; or

- resident in the United Kingdom but not ordinarily resident there.

The effect of the deeming provision in section 132(4)(a) is that duties of Crown employment wherever performed will count as performed in the United Kingdom for the purposes of Case II.

However, there is in fact no need for this deeming provision in connection with duties of Crown employment performed in the United Kingdom: Case II will apply anyway. Furthermore, as regards those performed outside the United Kingdom, it seems preferable to dispense with the fiction that they are to be deemed to be performed in the United Kingdom: it seems better to structure the Case II charge so that it expressly covers duties of Crown employment performed outside the United Kingdom.

This is therefore the approach that has been adopted in rewriting Case II in sections 25 and 27, which refer to "general earnings from overseas Crown employment subject to UK tax" in addition to general earnings in respect of duties performed in the United Kingdom. Section 28(1) to (3) then define "general earnings from overseas Crown employment subject to UK tax" as earnings of a particular description *in respect of duties performed outside the United Kingdom*.

It may be mentioned that there seems to be no possible application of section 132(4)(a) for the purposes of the actual charge to tax under Case I of Schedule E, and the Act accordingly does not contain anything that would seek to reflect any application for those purposes.

Note 11: Relief for delayed remittances: condition requiring the impossibility of obtaining "foreign currency": section 35(2)(c)(iii)
This relates to the condition for a claim for relief for delayed remittances which requires that the inability to transfer the income to the United Kingdom was due to the impossibility of obtaining "foreign currency".

Section 585 of ICTA provides that relief from tax on Schedule E Case III income may be claimed if the conditions set out in subsection (1)(a) to (c) are met.

- Subsection (1)(a) requires the taxpayer to have been unable to transfer the income to the United Kingdom.

- Subsection (1)(b) requires the inability to transfer to have been due to one of three reasons–

  - the laws of the territory where the income arose,
  - executive action of its government, or

– the impossibility of obtaining foreign currency in that territory.

- Subsection (1)(c) requires the inability to transfer to have been not due to any want of "reasonable endeavours" on the part of the taxpayer.

In relation to the third reason referred to in section 585(1)(b) of ICTA, "foreign" clearly means foreign to the local territory. This view is supported by a comparison with the express reference to "sterling" in section 584(1)(b) of ICTA (relief for unremittable overseas income).

In rewriting the third reason in section 35(2)(c)(iii) of the Act the meaning of "foreign currency" has been made clear.

Note 12 Intermediaries: the Act does not rewrite paragraph 1(5) of Schedule 12 to FA 2000: section 49

This involves the omission from the Act of paragraph 1(5) of Schedule 12 to FA 2000. That sub-paragraph provides–

> "The fact that the worker holds an office with the client does not affect the application of this Schedule."

Even without such a statement, the fact that a worker holds an office with the client has no relevance to the operation of Schedule 12. The removal of this unnecessary material will not affect anyone's liability to tax.

Note 13: "Earnings": section 62

This relates to the concept of "earnings" as used in the employment income Parts of the Act.

At present the main charge to tax on employment-related income is the charge on "emoluments" under paragraph 1 of Schedule E. Although there is a great deal of judicial authority as to the meaning of "emoluments", the word has a distinctly antiquated flavour. "Emoluments" as a concept integral to the workings of the employment income Parts has therefore been replaced by the concept of "earnings".

"Earnings" are defined in section 62 of the Act. To a large extent this new definition of "earnings" follows the existing definition of "emoluments" in section 131(1) of ICTA, which says that "emoluments" includes "all salaries, fees, wages, perquisites and profits whatsoever". Indeed, there is a reference at the end of the new definition to "anything else that constitutes an emolument of the employment". This is intended to ensure that the existing case law will apply to bring in anything that counts as an emolument but is not listed in the new definition.

There is one significant departure, however. The existing reference to "all…perquisites and profits whatsoever" has been replaced by "any gratuity or other profit or incidental benefit of any kind obtained by the employee if it is money or money's worth". "Money's worth" is then defined by section 62(3) of the Act to mean something of, or convertible into, direct monetary value to the employee.

The words "any gratuity or other profit or incidental benefit of any kind obtained by the employee" are simply intended as a more modern equivalent of the reference to all perquisites and profits whatsoever. But the words "if it is money or money's worth" are new and reflect the fact that it is now accepted that only money or money's worth fall within the scope of section 131 of ICTA.

It seems that, whatever its meaning under the general law, "money's worth" in the context of emoluments entails something that can be converted into money or is of direct monetary value to the employee. The early case of *Tennant v Smith* (1892) 3 TC 158 established that a benefit obtained by an employee from his employment that could not be converted into money was not a perquisite for Schedule E purposes. However, "money's worth" may be something that cannot be actually converted if it is nevertheless of direct monetary value to the employee: see, for example, *Hartland v Diggines* (1926) 10 TC 247, where the benefit was the discharge of a debt owed by the employee. The effect of these authorities is reflected in the definition of "money's worth" in section 62(3).

Note 14: Taxable benefits and payments: time of employment for purposes of charge on certain payments and benefits: Chapters 3 and 10 of Part 3 and section 223

This relates to clarification of the time when an employment must be held if there is to be a charge to tax on expenses payments or under the general charge on benefits.

Section 153 of ICTA (payments in respect of expenses) applies where *in any year* a person is employed in employment to which Chapter 2 of Part 5 of that Act applies and by reason of his employment he is paid sums in respect of expenses that are not otherwise chargeable as his income. Similarly, section 154 (general charging provision) applies where *in any year* a person is employed in employment to which Chapter 2 of Part 5 of that Act applies and by reason of his employment he is provided with a benefit to which the section applies and the cost of providing it is not otherwise chargeable as his income.

In rewriting the relevant provisions of sections 153 and 154 in sections 70 and 201 of the Act the effect of the words "where in any year a person is employed…" has been clarified. The sections spell out that it is does not matter whether the employment is held at the time when the payment of expenses is made or the benefit is provided so long as it is held at some point in the tax year in which the payment or benefit is made or provided. This accords with the Revenue's current approach. Since the

consequence of this proposition is that the sections may cover payments made or benefits provided before or after an employment is held, the sections further spell out that references in the relevant Chapter to an employee include a prospective or former employee.

A similar approach has been adopted in rewriting the words "where in any year" in section 164(1) of ICTA (payment of director's tax): see section 223(2) and (3) of the Act.

Note 15: Taxable benefits: cash vouchers: meaning of references to "vouchers": sections 75(1) and 77

This relates to the meaning of certain references to "vouchers" in provisions concerning the charge to tax on the benefit of cash vouchers.

Section 143(3) of ICTA provides that a "cash voucher" means "any voucher, stamp or similar document" capable of being exchanged for a sum greater than, equal to or not substantially less than the expense incurred "by the person at whose cost the voucher is provided".

Section 143(3) of ICTA does not expressly provide that it is the expense incurred "by the person at whose cost the voucher, stamp or similar document is provided". But section 143(3) cannot sensibly be read in any other way. This is spelt out in section 75(1) of the Act.

Section 144(3) of ICTA provides for the apportionment of the expense incurred in connection with "the provision of vouchers" where the vouchers are provided for two or more employees as members of a group or class. That expense is relevant to the definition of "cash voucher" in section 143(3) of ICTA.

Section 144(3) of ICTA does not expressly refer in the context of "cash vouchers" to "the provision of vouchers, stamps or similar documents". But the reference to "the provision of vouchers" in section 144(3) cannot sensibly be read in any other way since it applies for the purposes of section 143 of ICTA. This is spelt out in section 77 of the Act.

Note 16: Taxable benefits: period during which living accommodation is provided: section 102

This relates to clarification of the period when living accommodation is provided which is relevant for the purposes of the charge to tax on the benefit of such accommodation.

Both section 145(1) and section 146(1) of ICTA (charges in respect of living accommodation provided for employee) refer to living accommodation being provided for a person "in any period" by reason of his employment. The amount of the person's deemed emoluments chargeable to tax under those sections is then described as the value or additional value of the accommodation "for the period". The person chargeable is referred to as "the employee".

At present these references to any period are at large and there is no explicit link with a tax year or tax years. However, the purpose of sections 145 and 146 is to enable the person's deemed emoluments to be calculated for each tax year during the whole or part of which the accommodation is provided.

At the same time, although sections 145 and 146 refer to living accommodation being provided for a person "in any period" by reason of his employment, they do not spell out that the person should be in that employment for the whole of that period. However, it is thought that the whole tenor of those sections is that they are dealing with a person who *is* an employee during the period when the accommodation is provided for him. They therefore adopt a different approach from sections 153 and 154 (see *Note 14*).

In rewriting the relevant provisions of these sections, section 102(1) of the Act (calculation of cash equivalent of living accommodation) accordingly refers to living accommodation being provided in any period–

- which consists of the whole or part of a tax year, and
- throughout which the employee holds the employment.

This period is referred to as "the taxable period" in sections 105 and 106, which contain the rules for calculating the cash equivalent of the benefit of the accommodation for the tax year in question.

Note 17: Taxable benefits: vans: calculation of cash equivalent of benefit of shared van: sections 155(4) and 161

This relates to how the cash equivalent of the benefit of a shared van is calculated.

Section 159AA of ICTA charges an employee where a van is made available to the employee or a member of the employee's family or household by reason of the employment. An amount equal to the cash equivalent of the benefit of the van is treated as emoluments of the employee.

The cash equivalent of the benefit of a van is determined under Schedule 6A to ICTA. That Schedule is divided into three Parts–

- Part 1 deals with the cash equivalent of the benefit of a van which is not shared or, where it is shared for part of the tax year in question, the benefit of the van for the period when it is not shared.

- Part 2 deals with the cash equivalent of the benefit of a shared van.

- Part 3 deals with the interaction between Parts 1 and 2 where a van is a shared van for only part of the year.

In section 155 of the Act the method of calculating the cash equivalent of the benefit of a van is described in terms of calculating the "value of exclusive availability" and the "value of shared availability". The "value of exclusive availability" is calculated in accordance with section 157 of the Act (which rewrites the substance of Part 1 of Schedule 6A to ICTA). The "value of shared availability" is calculated in accordance with section 160 of the Act (which rewrites the substance of Part 2 of Schedule 6A to ICTA).

(A) In calculating the cash equivalent of the benefit of a shared van, Part 2 of Schedule 6A to ICTA focuses on the value of all the shared vans made available by the employee's employer whether or not they were all made available to the employee whose tax liability is being calculated or to a member of his family or household. The emphasis is on calculating the cash equivalent of the benefit to each "participating employee" i.e. an employee to whom one or more of the shared vans is available and who makes private use of the van while it is a shared van. Therefore under paragraph 5 of that Schedule the basic value of all the shared vans is calculated and then divided by the number of "participating employees". The resulting figure is the cash equivalent of the benefit to each participating employee of the shared vans available to him.

Paragraph 5 of Schedule 6A to ICTA has been rewritten in section 161 of the Act by means of a method statement. The method statement concentrates on calculating the value of shared availability of the shared van or vans made available to the employee whose tax liability is being calculated rather than on calculating that value for all the "participating employees". This is a change of form rather than substance – the value of shared availability is still calculated by reference to the value of all the shared vans made available by the employee's employer (whether or not to the employee in question or to a member of his family or household) and by reference to the number of "participating employees". It is thought that, by focussing on the employee whose tax liability is being calculated, the method statement in section 161 of the Act is easier to follow than paragraph 5 of Schedule 6A.

(B) Paragraph 5 of Schedule 6A to ICTA does not expressly provide that if the employee in question is not a "participating employee" the benefit to the employee of the shared van is nil. But that is thought to be implicit from paragraph 5(6) of the Schedule which provides that "the figure found for a participating employee shall be taken to be the cash equivalent of the benefit to him in the year of the van…..or the

vans….". This point is made explicit in Step 2 of the method statement in section 161(1) of the Act.

(C) Part 3 of Schedule 6A to ICTA deals with the case where a van is a shared van for only part of the year and there is therefore a cash equivalent of the benefit of the van calculated under Part 1 and under Part 2 of the Schedule. Paragraph 10(2) provides that the employee is to "be charged to tax as if the van concerned were different vans, one having a cash equivalent found under Part 1 of this Schedule and the other having (or counting towards) a cash equivalent found under Part 2 of this Schedule".

It is thought that there is no reason why this proposition could not be simplified so that there is one cash equivalent of the benefit of the van consisting of the sum of the figures found under Part 1 and Part 2 of Schedule 6A. The net result would appear to be the same.

This has been done in section 155(4) of the Act where the cash equivalent of the benefit of the van is stated to be the total of the value of exclusive availability and the value of shared availability.

Note 18: Taxable benefits: cars & vans: exception for pooled cars and vans: sections 167(2)(b) and 168(2)(b)

This relates to the exception for pooled cars and vans from the provisions which charge to tax a car or van provided by reason of an employment or a benefit so provided which is not otherwise chargeable to tax.

Sections 157 and 159AA of ICTA charge an employee where a car or van is made available to the employee or a member of the employee's family or household by reason of the employment. An amount equal to the cash equivalent of the benefit of the car or van is treated as emoluments of the employee. It is a requirement of both sections that the car or van is available for the employee's or member's private use.

Section 154 of ICTA charges an employee where a benefit is provided for the employee or a member of the employee's family or household by reason of the employment and the benefit is not otherwise chargeable to tax. There is no requirement that the benefit is available for the employee's private use.

Section 159(3) of ICTA provides that where a car has for any year been included in a car pool for the use of the employees of one or more employers then "for the year in question the car is to be treated under sections 154 and 157 as not having been available for the private use of any of the employees". Section 159(3) is applied with modifications by section 159AB of ICTA in relation to pooled vans.

In section 159(3) of ICTA the reference to "private use" in the context of section 154 of ICTA presents difficulties. Unlike sections 157 and 159AA of ICTA, section 154

contains no requirement that the benefit must be available for the private use of any of the employees. The only way in which section 159(3) can sensibly be read in relation to section 154 would seem to be in terms that the pooled car or van is not to be treated as a benefit falling within section 154 in relation to the employees in question. That accords with how the Inland Revenue apply section 159(3) in practice.

Sections 167(2)(b) and 168(2)(b) of the Act therefore provide that the pooled car or van is not to be treated in relation to the employees concerned as an employment-related benefit within Chapter 10 of Part 3 of the Act (which rewrites section 154 of ICTA).

Note 19: Taxable benefits: loans: scope of the exception preventing a double charge where loan released or written off: section 189(2)(3)
This relates to the effect of the two exceptions from the provision which prevents an employee being charged under section 160(2) of ICTA in respect of the release or writing off of a loan if the amount released or written off is also charged under another provision.

Section 160(2) of ICTA charges an employee where a loan obtained by reason of his employment is released or written off. The amount released or written off is treated as emoluments of the employee.

Section 161(5) of ICTA provides that section 160(2) does not apply "where the amount released or written off is chargeable to income tax as income of the employee apart from that section" except–

> (a) "where it is chargeable only by virtue of section 148" (payments and other benefits in connection with termination of employment), and
>
> (b) "to the extent that the amount exceeds the sums previously falling to be treated as the employee's income under section 677" (a provision concerning the treatment as income of capital sums paid by the trustees of a settlement to the settlor).

In relation to (a), section 161(5) of ICTA does not expressly provide that the consequence is that the charge under section 160(2) of ICTA takes priority to the charge under section 148 of ICTA so that the employee is charged under section 160(2) only. But it is clear that must have been the intention. Section 189(2) of the Act spells this out.

In relation to (b), section 161(5) of ICTA does not expressly require that "the sums previously falling to be treated as the employee's income under section 677" of ICTA

must have related to the release or writing-off of the loan. Again, it is clear that must have been the intention. Section 189(3) of the Act therefore provides that an amount must have been treated as the employee's income under section 677 of ICTA "in respect of a capital sum paid in relation to the release or writing-off of the loan".

Note 20: Taxable benefits: loans: calculation of cash equivalent of benefit of loan where employee has died: section 190(1)(b)
This relates to how the cash equivalent of the benefit of a loan is calculated where the employee has died.

Section 160(1) of ICTA charges an employee where an interest-free or low-interest loan is made to the employee or a relative of the employee by reason of the employment. The loan must be outstanding for the whole or part of the tax year in question. An amount equal to the cash equivalent of the benefit of the loan is treated as emoluments of the employee.

Paragraph 3 of Schedule 7 to ICTA provides that the cash equivalent of the benefit of a loan for a tax year is–

- the amount of interest which would have been payable on the loan for that year at the official rate, less

- the amount of interest actually paid on it for that year.

Paragraphs 4 and 5 of that Schedule then provide the "normal" and the "alternative" methods of calculating the amount of interest which would have been payable at the official rate.

The "normal" method under paragraph 4 involves calculating half the aggregate of–

- the maximum amount of the loan outstanding at the beginning of the tax year or (if later) the date on which the loan was made, and

- the maximum amount of the loan outstanding at the end of the tax year or "if the loan was discharged in that year, the date of discharge".

Account is then taken of the period in the year when the loan is outstanding and of the official rate of interest in that period.

Section 161(6)(a) of ICTA provides that on the employee's death "a loan within subsection (1) of section 160 ceases to be outstanding for the purposes of the operation of that subsection". The loan therefore cannot be a taxable cheap loan for any period after the employee's death. The period after the employee's death will also be excluded when determining the period when the loan is outstanding for the

purposes of calculating the amount of interest that would have been payable at the official rate.

Section 161(6)(a) of ICTA does not expressly provide that the loan is also to be treated as discharged on the date of death for the purposes of that calculation. However it seems clear that it must have been intended that the loan should be treated as discharged on the date of death. If that were not the case, the calculation of the amount of interest that would have been payable at the official rate would be unbalanced as the effect of the death would be taken into account at some but not at other stages of the calculation.

Section 190(1)(b) of the Act expressly provides that for the purposes of that calculation the loan is to be treated as discharged on the date of death.

Note 21: Taxable benefits: notional loans in respect of acquisitions of shares and disposals of shares for more than market value: presumption that right or opportunity made available by employer is made available by reason of employment: sections 192(3) and 198(4)

This relates to the inclusion in Chapters 8 and 9 of Part 3 of provisions based on section 168(3) of ICTA.

Section 168(3) of ICTA provides that for the purposes of Chapter 2 of Part 5 of ICTA "all such provision as is mentioned in this Chapter which is made for an employee, or for members of his family or household, by his employer" is "deemed to be paid to or made for him or them by reason of his employment, except any such payment or provision which is made by the employer, being an individual, in the normal course of his domestic, family or personal relationships."

Section 162 of ICTA is in Chapter 2 of Part 5 of ICTA. The question is whether section 168(3) applies to section 162. Section 162 does not in terms refer to "provision being made" for an employee, or for members of his family or household. Section 162(1) and (6) apply where shares are acquired "in pursuance of a right or opportunity made available by reason of the employment". On a narrow reading of section 168(3) of ICTA, section 168(3) would not apply to section 162.

However, it is thought that the better view is that the making available of a right or opportunity counts as provision being made for the purposes of section 168(3) of ICTA. A court would be hard put to find a policy reason for distinguishing between a benefit under section 162 of ICTA and other benefits. Furthermore, section 168(3) of ICTA only enacts what could legitimately be inferred anyway, ie. that it is to be assumed that a right or opportunity made available by the employer is made available by reason of the employment. It also contains an exception in the taxpayer's favour for domestic arrangements.

The Inland Revenue have always taken the view that section 168(3) of ICTA does apply to section 162. The view was also accepted by respondents in consultation.

Accordingly, sections 192(3) and 198(4) of the Act are based on section 168(3)(b) of ICTA.

Note 22: Taxable benefits: notional loans in respect of acquisitions of shares: the amount of the notional loan initially outstanding: section 194
This relates to the amount of the notional loan initially outstanding.

Section 162(3) of ICTA provides that the amount initially outstanding of the notional loan is "so much of the under-value on acquisition as is not chargeable to tax as an emolument of the employee". Section 162(2)(b) of ICTA provides that, "… any reference, in relation to any shares, to the under-value on acquisition is a reference to the market value of fully paid up shares of that class less any payment then made for the shares".

The effect of these provisions is that the amount of the notional loan initially outstanding is calculated by deducting from the market value of fully paid up shares of the class the total of any payment then made for the shares and so much of the under-value on acquisition as is chargeable to tax as an emolument of the employee. Section 194(1) of the Act provides for this calculation. Subsection (2)(a) provides for the deduction of any payment then made for the shares. It has been extended to include payments made for the shares before the acquisition; see *Change 36.*

The words "so much of the under-value on acquisition as is chargeable to tax as emolument of the employee" have not been included in section 194(2) of the Act because it was thought to be more helpful to identify the charges to tax as emoluments that might arise in respect of the under-value on acquisition by naming them. Accordingly, section 194(2)(b) and (c)(i) and (ii) of the Act identify the three liabilities to tax that might be relevant.

The amounts described in section 194(2)(c)(i) and (ii) of the Act are relevant because under section 135(5)(a) of ICTA these amounts are deducted in arriving at the amount charged to tax under Schedule E under section 135 of ICTA in respect of the exercise of a share option. It follows that if shares are acquired as a result of the exercise of a share option, the total amount of the liability to tax that may have arisen has to be calculated by adding together the amounts of any liabilities to tax in respect of the receipt of the share option and in respect of its exercise.

Section 194(2)(c)(iii) of the Act reflects the practice of deducting an amount charged to tax under Schedule E under section 135 of ICTA in respect of the exercise of a share option, if the acquisition results from the exercise of the share option; see *Change 38*.

Section 194(2)(d) of the Act is based on section 185(8)(b) of ICTA. It was thought that it should be rewritten with all the other provisions about the calculation of the amount of the notional loan initially outstanding, rather than in Chapter 8 of Part 7 (approved CSOP schemes).

Note 23: Taxable benefits: acquisitions and disposals of shares: share-related income: share options: meaning of "market value": sections 197(1), 200(1) and 475(3)

This relates to the alignment of different definitions of market value.

Sections 140(3) and 162(10)(d) of ICTA provide that ""market value" has the same meaning as, for the purposes of the 1992 Act, it has by virtue of section 272 of that Act". Section 187(2) of ICTA, paragraph 125 of Schedule 8 to FA 2000 and paragraph 66(1) of Schedule 14 to that Act all have the effect that "market value" has the same meaning as for the purposes of TCGA 1992 it has by virtue of Part 8 of that Act.

It is thought that the only possible difference between the two formulations relates to whether sections 273 and 274 of TCGA 1992 are brought in. Section 273(1) of TCGA 1992 provides that the provisions of subsection (3) (which deals with the information available to a prospective purchaser of unquoted shares and securities) shall have effect in any case where there falls to be determined by virtue of section 272(1) the price which unquoted shares or securities might reasonably be expected to fetch on a sale in the open market. Section 274 of TCGA 1992 provides that if an asset has been valued for inheritance tax purposes, that value is to be taken for the purposes of TCGA 1992 to be the market value of that asset at the date of the death.

It is considered that where market value is determined in accordance with sections 140(3) and 162(10)(d) of ICTA, section 273 of TCGA 1992 will apply because it comes in as a gloss on section 272 of TCGA 1992 that applies in the case of unquoted shares and securities. It is also considered that section 274 of TCGA 1992 could not apply in the circumstances where the definitions in sections 140(3) and 162(10)(d) of ICTA apply. The conclusion is therefore that there is no difference in practice between the two formulations.

It is clearly undesirable to use different formulations for the same definition in different sections of the Act. Accordingly, the formulation ""market value" has the same meaning as it has for the purposes of TCGA 1992 by virtue of Part 8 of that Act" is used in sections 197(1) and 200(1) of the Act (based on section 162(10)(d) of ICTA) and in section 475(3) of the Act (based on section 140(3) of ICTA) as well as in paragraph 92(1) of Schedule 2 to the Act (based on paragraph 125 of Schedule 8 to FA 2000), paragraph 48 of Schedule 3 and paragraph 36 of Schedule 4 to the Act (both based on section 187(2) of ICTA) and paragraph 55 of Schedule 5 to the Act (based on paragraph 66(1) of Schedule 14 to FA 2000).

Note 24: Taxable benefits: disposals of shares for more than market value: references to excluded employment: section 199(4)
This explains the references to excluded employment.

Section 162(6) of ICTA applies where shares have been acquired, whether or not at an under-value, but otherwise as mentioned in section 162(1) of ICTA and the shares are subsequently disposed of. If the disposal is for a consideration which exceeds the then market value of the shares, the amount of the excess is treated as emoluments of the employee's employment.

Section 162(1) applies, "…where a person employed or about to be employed in employment to which this Chapter applies ("the employee"), or a person connected with him, acquires shares in a company". Section 167 of ICTA gives the meaning of "employment to which this Chapter applies". The basic meaning is employment as a director of a company and employment with emoluments at the rate of £8,500 or more a year.

It follows that the employee must have been earning more than £8,500 a year or a director when the shares were acquired for there to be a charge to tax under section 162(6) of ICTA. But there is nothing in section 162(6) to (8) of ICTA which requires this to be the case at the time of the disposal of the shares.

In contrast to Chapter 2 of Part 5 of ICTA, Part 3 of the Act applies to all taxable employments under Part 2 but section 216(1) and (4) (provisions not applicable to lower-paid employments) provide that certain Chapters of Part 3, including Chapter 9, do not apply to an employment if it is lower-paid employment in relation to the tax year in question and one of two conditions is met (an "excluded employment").

The effect of section 216(1) and (4) of the Act is that there would be no liability to tax under Chapter 9 if the employment was an excluded employment at the time of the acquisition or the disposal. This is not the correct result because it should not matter that the employment has become an excluded employment at the time of the disposal. Accordingly, subsection (6) of section 216 provides that subsection (1) of that section is subject to section 199(4) of the Act and section 199(4) treats employment which has become an excluded employment before the disposal as if it had not become an excluded employment. So if the employment has in fact become an excluded employment, it is treated as if it were not an excluded employment and section 199(1) to (3) of the Act will apply. The Act therefore achieves the same result as the current law.

Note 25: Taxable benefits: residual liability to charge: excluded benefits : section 202

This concerns the identification of the benefits which are excluded from the general charge on employment-related benefits in kind.

Under section 154 of ICTA, benefits in kind provided for an employee, or for a member of an employee's family or household, are taxed unless the cost of the benefit is otherwise chargeable to tax as income of the employee. ICTA does not specify the particular provisions under which the cost of the benefit must be chargeable if it is not to be charged under section 154.

In the Act, the taxation of benefits in kind is dealt with in Part 3 ("the benefits code"). Chapter 10 of Part 3 applies to "employment-related benefits". These are defined as any benefit, other than an excluded benefit, provided to an employee etc by reason of his employment (see section 201 of the Act). "Excluded benefit" is defined in section 202 of the Act. It means-

- any benefit to which any of Chapters 3 to 9 of the benefits code applies;
- any benefit to which one of those Chapters would apply but for an exception; and
- sickness payments to which section 221 applies.

Unlike ICTA, the Act therefore specifies the provisions under which a benefit must be charged in order for it not to be charged under the general provisions of Chapter 10. The Act also makes clear that a benefit which is excepted from the charge under another Chapter of the benefits code is not to fall within the residual charge under Chapter 10. (There is one exception to this latter rule, for transport vouchers under pre-26th March 1982 arrangements.) Making both these points clear in the Act is intended to be more helpful to the reader.

Note 26: Taxable benefits: provisions not applicable to lower-paid employments: Chapter 11 of Part 3

This relates to the way in which the provisions limiting the application of existing benefits code provisions to "higher-paid" employees have been rewritten in Chapter 11 of Part 3 of the Act.

At present, section 167(1) of ICTA ensures that Chapter 2 of Part 5 of the Act (taxable benefits) applies only to employments with emoluments at the rate of £8,500 a year or more and to certain company directors whose emoluments are below that rate.

(A) The original classification of "higher-paid" employees, eventually defined as those with annual earnings of £8,500 or more, was abandoned in 1989. The threshold of £8,500 had not been changed since 1979 and was no longer considered to represent "higher pay". Given that the threshold remains unchanged and only a minority of employees now earn less than £8,500, it seems more logical to rewrite the provisions of Chapter 2 of Part 5 of ICTA so that they are of *general* application but are *excluded* from applying to *lower-paid* employees.

This approach has therefore been adopted in rewriting these provisions in the benefits code contained in Chapters 2 to 11 of Part 3 of the Act. Chapter 11 is designed to disapply the rewritten provisions in respect of lower-paid employment: see section 216. (Some of the provisions of the benefits code will apply to lower-paid employees because they do not derive from Chapter 2 of Part 5 of ICTA and are therefore not currently restricted to "higher-paid" employees.)

Although this involves a substantial change of approach, it does not involve any change in the substance of the law.

(B) Section 167(2) applies for the purpose of deciding whether the emoluments of an employment are at a rate of £8,500 a year or more. It requires the emoluments of an employment for a tax year to be calculated–

- on the basis that they include certain specified amounts, and
- without any deduction under section 198, 201 or 332(3) of ICTA.

These provisions relate to deductions on account of necessary expenses, fees and subscriptions and expenses of ministers of religion.

It is considered that the implication of the exclusion of certain specified deductions is that other deductions *can* be taken into account, and that it would be more helpful if, in rewriting section 167(2), these permitted deductions were spelt out. This has been done in section 218(4) of the Act.

Again, this involves a change of approach but does not involve any change in the substance of the law.

Note 27: Payments where employee absent because of sickness or disability: section 221

This concerns the removal of the reference to members of the employee's household from the provision under which certain sick pay is taxed.

Under section 149 of ICTA, certain sick pay is taxed under Schedule E as emoluments. The sick pay is taxed under this section if it is paid to (or to the order or benefit of)–

- the sick employee; or
- a member of the sick employee's family or household.

The reference to members of the sick employee's household is considered to be unnecessary. There is no intention that the sick employee should be taxed if sick pay is paid to a person who is not a member of his family. So, where the sick pay is paid to a member of the employee's household, the tax charge should only arise if that person is also a member of the employee's family.

In addition to this reference being unnecessary, there is also the danger that it could be misleading. This is because of the reference to the members of an employee's household in section 154(2) of ICTA.

Section 154(2) taxes the provision of a benefit in kind if the benefit is provided to an employee or to a member of his family or household. In this case, it *is* intended that the reference to members of the employee's household should extend beyond members of his family. The effect of section 168(4) (which defines member of the family or household) is that section 154(2) applies where a benefit is provided to the employee's servants, dependants and guests.

It would be misleading if the provisions rewriting sections 149 and 154 both referred to members of an employee's household, when this expression was intended to have different meanings in each place. Accordingly, section 221 of the Act, which rewrites section 149 of ICTA, refers only to the employee and members of his family (see subsection (6)(a)). There is no reference in this provision to members of the employee's household.

Note 28: Employment income, pension income, United Kingdom social security income: exemptions: no liability to income tax arises: Part 4 generally, Chapters 16 to 18 of Part 9 and Chapters 4, 5 and 7 of Part 10

This relates to the expression of the exemptions from income tax rewritten in the Act, using the phrase "no liability to income tax arises".

The provisions of ICTA which exempt income from tax use a variety of expressions to achieve their result. For example–

- Sections 151 (income support) and 151A (jobseeker's allowance): "shall not be taxable".

- Section 155(1A) (parking provision and expenses): "Section 154 does not apply".

- Section 155(4) (death or retirement benefit provision): "Section 154 does not apply to a benefit consisting in".

- Section 157(3) (payments and benefits connected with taxable cars): "he shall not be taxable–

  - under Schedule E in respect of the discharge of any liability of his in connection with the car;
  - under section 141 or 142 in respect of any non-cash voucher or credit-token …
  - under section 153 in respect of".

- Section 189 (lump sum benefits on retirement): "shall not be chargeable to income tax".

- Section 190 (termination payments to MPs and others ceasing to hold office): "shall be exempt from income tax under Schedule E as emoluments".

- Sections 197 (armed forces' leave travel facilities) and 197G (recreational benefits): "No charge to tax under Schedule E shall arise".

- Section 197A (parking provision and expenses): "shall not be regarded as an emolument of the office or employment for any purpose of Schedule E".

- Section 197AA (works transport services): "There is no charge to tax under section 154".

- Sections 200 (expenses of MPs) and 200ZA (overnight expenses of other elected representatives): "shall not be regarded as income for any purpose of the Income Tax Acts".

- Sections 200B (exemption of work-related training provision) and 200E (exemption for contribution to individual learning account training): "the emoluments of the employee from the office or employment shall not be taken to include".

- Section 315 (wounds and disability pensions): "shall be exempt from income tax and shall not be reckoned in computing income for any purposes of the Income Tax Acts".

- Section 316 (armed forces' allowances): "shall not be regarded as income for any income tax purposes".

- Section 317 (Victoria Cross and other awards): "shall be disregarded for all the purposes of the Income Tax Acts".

- Section 318 (other pensions in respect of death due to war service): "shall not be treated as income for any purposes of the Income Tax Acts".

- Sections 319 (Crown employees' foreign service allowances) and 330 (compensation for National-Socialist persecution): "shall not be regarded as income for any income tax purpose".

- Section 615 (certain overseas pensions): "shall not be liable to charge to income tax".

- Section 617(2) (social security benefits): "shall not be treated as income for any purpose of the Income Tax Acts".

In the Act, the single expression "no liability to income tax arises" has been used to rewrite all these exemptions and exceptions. No practical difference between this and the expressions used in ICTA has been found. The use of this more concise expression ensures a consistency of approach across the rewritten provisions. However, small variations have been used on a consistent basis to indicate that the scope of the exemption from liability is confined, for instance, to liability in respect of emoluments (see, for example, section 271(1) of the Act) or liability by virtue of section 154 of ICTA (see, for example, section 239(4) of the Act). Moreover, it has been made clear in section 228 of the Act that, in the case of the exemptions mentioned in section 228(2), liability to income tax under any enactment is covered.

Note 29: Exemptions of parking provision and expenses: definitions: section 237
This involves the substitution for "place of work" in the provisions relating to the exemption of workplace parking of the defined expression "workplace" and the omission of definitions of "motor cycle" and "cycle" for the purposes of the exemption of the provision of a parking space at an employee's workplace.

(A) Section 155(1A) of ICTA provides that section 154 of that Act does not apply to the provision of a car parking space near the employee's place of work. Section 197A of ICTA provides that expenditure incurred in paying or reimbursing expenses in connection with the provision of such a space is not regarded as an emolument.

"Place of work" is not defined in these provisions, but it appears to have the same meaning as the expression "workplace" which is used and defined in a number of the provisions exempting travel benefits. (See sections 197AA(7), 197AB(4) and 197AC(6) of ICTA.) The same definition is used for travel deductions. (See paragraph 2(3) of Schedule 12A to ICTA.)

In rewriting sections 155(1A) and 197A in section 237 the expression "workplace" has been used instead of "place of work" and so has attracted the definition of "workplace" that applies for those other exemption and deduction provisions. See section 249.

(B) Section 49 of FA 1999 applies to motor cycle parking spaces and facilities for parking cycles the exemptions connected with car parking spaces that are conferred by sections 141(6A), 142(3A) 155(1A) and 197A of ICTA. Section 49(3) defines "motor cycle" and "cycle" for this purpose, but these definitions have not been rewritten in the exemption for such parking spaces and facilities in section 237 of the Act because it is considered that they are unnecessary for the meaning of a parking space for a motor cycle or facilities for a cycle.

Note 30: Exemptions: education and training: disapplication where retraining course exemption applies : sections 250 and 255

This involves the omission of the condition for the exemption of education and training provision that the provision is not already exempted as retraining in connection with the termination of employment.

Section 200C(4) of ICTA provides that the exemption under section 200B of ICTA for expenditure on work-related training does not apply to expenditure that is exempt under section 588 of ICTA. Section 588 exempts retraining courses undertaken when an employment ceases and has been rewritten in section 311 of the Act. In rewriting the exemption in section 200B in section 250 of the Act, section 200C(4) has not been rewritten because it seems to be misconceived. It is not necessary to say that one exemption has priority over another: both may apply.

The same point applies as respects section 200H of ICTA, which provides that the exemption in section 200E for individual learning account training does not apply to expenditure to the extent that either section 200B or section 588(1) has effect. Accordingly, section 200H has not been rewritten either.

Note 31: Exemptions: work-related training and contributions to individual learning account training: meaning of "training materials": sections 254(3) and 259(3)

This relates to the definitions of "training materials" that apply for the exemptions relating to training materials provided in the course of work-related training or individual learning account training.

Section 200B of ICTA provides that a person's emoluments from an employment do not include any amount in respect of expenditure by "the employer" on work-related training. Generally, this exemption does not cover expenditure on assets, but

expenditure on training materials is included by section 200C(3)(c) of ICTA. "Training materials" are defined exhaustively in section 200C(7), but in practice the Inland Revenue would interpret the list as including anything else appearing to them to be such materials. Therefore the definition has been rewritten as an inclusive rather than an exhaustive list. See section 254(3) of the Act.

Similarly, the definition of "training materials" in section 200F(5) of ICTA, which applies for the purpose of the exemption of expenditure provided for individual learning account training, has been rewritten as an inclusive definition rather than as an exhaustive list. See section 259(3) of the Act.

Note 32: Exemptions: contributions to individual learning account training: requirement for existing arrangements where third parties incur expenditure: section 260(1) and (2)

This relates to the requirement for fair opportunity arrangements to be in place for the exemption for the provision of individual learning account training to apply, where the relevant expenditure is incurred by third parties.

Section 200E(2) of ICTA provides that the emoluments of an employee shall not be taken to include any amount in respect of expenditure in respect of individual learning account training or the payment or reimbursement of related costs. But section 200G(1) of ICTA stops the exemption applying unless the expenditure is incurred in giving effect to fair-opportunity arrangements in place when *the employer* agreed to incur the expenditure. Under section 200G(2) such arrangements are in place at a time if at that time there are arrangements that provide for *the employer* to make contributions to the relevant training and for the contributions to be generally available to the employer's staff.

Section 200J of ICTA extends the exemption under section 200E. It provides that, where the amount that would be included in an employee's emoluments includes an amount that does not represent expenditure by the employer, the questions whether and to what extent the employee's emoluments shall be taken to include an amount in respect of the benefit of individual learning account training shall be determined in accordance with sections 200E to 200H as if the benefit had been provided by an amount provided by the employer.

That hypothesis does not go far enough to enable the references to the employer, in the requirements in section 200G relating to the fair opportunity arrangements, to be read as references to any person incurring the expenditure. But it seems clear that that was the intention. So in section 260(1) and (2) of the Act, which rewrite section 200G(1) and (2), the requirements that the arrangements should provide for expenditure to be incurred by *the employer* and that they be in place when *the employer* agrees to incur it have been widened so as to refer to any person and not just the employer.

Note 33: Exemptions: non-cash vouchers and credit-tokens used for obtaining goods, services or money in connection with taxable vehicle or tax-exempt heavy goods vehicle: section 269(3)(b) and (4)(b)

This involves the clarification of the tax year in which the benefit of a car or van must be taxable, or the private use of a heavy goods vehicle be exempt, in order for the exemption in respect of non-cash vouchers and credit-tokens used to obtain goods or services or money in connection with the vehicle to apply.

Section 157(3)(b) of ICTA provides that, where in any tax year the benefit of a car is chargeable under section 157 as the employee's income, he is not liable to tax under section 141 or 142 of ICTA in respect of a non-cash voucher or credit-token to the extent that it is used for obtaining money which is spent on goods or services in connection with the car or for obtaining such goods or services directly. By virtue of section 141 the chargeable expense of a non-cash voucher is chargeable when the expense is incurred by the person providing the voucher or, if later, when the voucher is received by the employee. (See section 141(2)(b).) But, in fact, the employee may not use the voucher until a later tax year. It is therefore unclear from section 157(3)(b) in which tax year the car must be taxable for the exemption to apply: the year when the non-cash voucher is chargeable (apart from the exemption), or the year when the employee uses the voucher in connection with the vehicle. And a similar problem arises with section 159AA(3)(b) of ICTA, which makes corresponding provision in relation to taxable vans, and with section 159AC(3)(b) of ICTA, which makes corresponding provision in relation to heavy goods vehicles that are made available to the employee in such circumstances that the benefit of their availability is excepted by section 159AC from the charge by virtue of section 154 of ICTA. (The charge on credit-tokens under section 142 does not create the same difficulty, because the benefit of the token is charged when it is used. See section 142(1)(a) of ICTA.)

However, since the use of the voucher is required to be in connection with the vehicle, and so the vehicle must be available to the employee at the time of use, it seems that the tax year which is referred to in sections 157(3)(b), 159AA(3)(b) and 159AC(3)(b) must be that in which the voucher is used. So subsections (3)(b) and (4)(b) of section 269 of the Act, which rewrite those sections, make it clear that the voucher or token must be used in the tax year in which the benefit of the car or van is taxable or the heavy goods vehicle available for private use.

Note 34: Exemption of accommodation benefits of ministers of religion: sections 290(5) and 351(5)

This involves applying the definition of "charity" in section 506(1) of ICTA for the purposes of both the exemption of payments made in connection with accommodation where a minister of religion resides in a residence in which a charity has an interest,

and the allowance of deductions in respect of expenses in relation to such accommodation.

Section 332(1) and (2) of ICTA exempt the making good to ministers of religion of amounts paid and deductions made in pursuance of statutory provisions in connection with premises occupied by them as a residence if a charity or ecclesiastical corporation has an interest in the premises and the minister resides there in right of that interest. The exemption also extends to payments on the minister's behalf of such amounts, and to the value to the minister of expenses incurred in connection with the provision of the residence for him. Section 332(3) provides for expenses in relation to such accommodation to be allowed as a deduction.

"Charity" is not defined in section 332. But there is a general definition of "charity" in section 506(1) of ICTA as a body or persons or trust established for charitable purposes only and that is often applied in provisions referring to charities. The definition appears to reflect the normal meaning of "charity". Accordingly, for clarity and consistency that definition has been adopted for the purposes of section 290 of the Act, which rewrites section 332(1) and (2), and section 351 of the Act, which rewrites section 332(3). See sections 290 (5) and 351(5) of the Act.

Note 35: Exemption of mobile telephones: irrelevance of whether provided with car: section 319

This involves the omission of a provision stating that the exemption for mobile telephones provided to employees or members of their families or households applies even where the phone is provided in connection with a car or van that is taxable or a heavy goods vehicle the private use of which is exempt.

Section 155AA of ICTA excludes from section 154 of ICTA the benefit arising from the provision of a mobile telephone. Section 155AA(3) provides that phones to which the exemption applies include phones provided in connection with a car or van that is taxable under section 157 or 159AA of ICTA, or a heavy goods vehicle the private use of which is exempt under section 159AC of ICTA. Possibly, this provision was included in section 155AA because that section reversed the previous law under which section 159A specifically charged mobile telephones separately from vehicles. In any event, it no longer appears necessary to make any special mention of mobile phones that are so provided, as benefits provided in connection with the vehicles mentioned in section 155A(3) are covered in general by section 239(4) of the Act.

Note 36: Deductions for employee's expenses: expenses paid on behalf of employee and the effect of reimbursement: sections 333(1)(b) and (2), 334 and 353(2)

This involves the availability of deductions for expenses where reimbursement and other payments in respect of expenses by persons other than the employee occur.

(A) As described in *Change 81*, the requirement in section 198(1) of ICTA and other deductions provisions, that to be deductible expenses must have been met out of the emoluments of the employment, has not been rewritten but has been replaced with the rule that deductions from earnings are not to exceed earnings.

However, it has long been accepted that the various forms of wording used in these provisions requiring an employee to have incurred, defrayed or paid expenses out of his emoluments should be interpreted so as to include the situation where the employee has incurred the expense but the actual liability is met by someone else, usually the employer. Where this is done the amount paid is an emolument. So the expense is regarded as having been met out of the employee's emoluments.

This requirement in those provisions has been rewritten in section 333(1) of the Act as a general rule for Chapter 2 of Part 5. The rule expressly provides that the employee must either have paid the amount of the expenses or the expenses may have been paid on the employee's behalf by someone else if the amount paid is included in the employee's earnings.

The rest of Chapter 2 of Part 5 is drafted in terms of the employee paying an amount, but section 333(2) of the Act contains a general interpretation rule under which any such reference includes a reference to someone else paying the amount on the employee's behalf if and to the extent that the amount is included in the person's earnings.

(B) Section 334 of the Act spells out two propositions that are connected with the general rule in section 333(1) of the Act and are accepted as a matter of law and Inland Revenue practice in cases where there is reimbursement or a payment is made by a person other than the employee in respect of the amount of the expenses.

Where expenses are reimbursed or a payment to the employee is made in respect of them, the amount reimbursed or paid may or may not constitute emoluments from the employment, depending on the exact circumstances. It is accepted, however, that where the method of payment chosen is such that the amount does constitute emoluments on which the employee is taxable, then the appropriate course is for the employee to be allowed a deduction in respect of the expenses, and the reimbursement is not taken to affect the question whether the employee has incurred, defrayed or paid the amount in question.

Conversely, where the method of payment chosen is such that the amount paid or reimbursed does not form part of the employee's emoluments on which he is taxable,

so that after receiving the payment the employee is not worse off, the employee is not regarded as having incurred, defrayed or paid the expenses out of his emoluments. Similarly, where there is only partial reimbursement, the employee is not regarded as having paid the expenses to the extent that they have been reimbursed or a payment has been made in respect of them. Therefore the expenses are not allowed to that extent. (See, for example, the speeches of Lord Guest and Lord Pearce in *Pook (HM Inspector of Taxes) v Owen* (1969) 45 TC 571 (at pages 589H and 592E-F respectively).)

Section 334(1) of the Act states that the fact that an amount has been reimbursed in respect of expenses or that any other payment has been made in respect of them does not prevent an employee from being regarded as paying the expenses. It appears to be desirable to state this in case the references to an employee paying the amount of expenses were interpreted restrictively as references to the employee actually bearing the expenses without reimbursement.

Section 334(2) then makes it clear that deductibility depends on the extent to which the amount reimbursed or in respect of which the payment is made is included in the employee's earnings.

As explained in *Change 81,* in the case of the provisions of ICTA that are rewritten in the provisions of the Act that are listed in section 332 ("the deductibility provisions"), the assumption that the employee paid for the amounts or expenses in question out of emoluments has not been rewritten. Therefore it will not be assumed by virtue of those words that if there has been reimbursement the reimbursement constitutes taxable emoluments. So, in order to avoid confusion about the application of the general rules in section 334, it is provided in section 334(4) that section 334 is to be disregarded for the purposes of the deductibility provisions.

Note 37: Deductions for employee's expenses: disallowance of expenses relating to earnings taxed on different basis or untaxed: section 354(3)
This explains why the rules in section 198(2) and (3) of ICTA have been expressly disapplied for the purposes of references in certain provisions to the deductibility of certain amounts.

The effect of section 198(2) and (3) of ICTA is that the deduction of expenses allowed under section 198(1) of ICTA is restricted, so that expenses may only be deducted from emoluments within Case I or II of Schedule E if the expenses relate to the duties for which those emoluments are paid, and there is a similar rule for Case III emoluments. These rules are rewritten in section 354(1) and (2).

It follows from these rules that no deductions are allowed in respect of expenses relating to duties the emoluments for which are not taxable because they are not remitted or are not within the charge to income tax.

The sections of ICTA that are rewritten in the provisions of the Act that are listed in section 332 ("the deductibility provisions") refer to amounts or expenses that would be deductible under provisions including section 198(1) of ICTA if the employee incurred and paid for the amounts or expenses in question out of emoluments of the employment. (See ICTA ss.141(3), 142(3), 145(3), 156(8), 168(5), (5A), 200A(1), (3), 200C(2A), 200F(2A), 589(6), 589B(4).) But it seems clear that these provisions do not intend to import the requirements of section 192(2) and (3). Indeed, in the case of some provisions, like sections 200C(2A), 200F(2A), 589(6), 589B(4) of ICTA, where the result of making the assumption is that the amounts or expenses will be exempt, the effect of applying section 198(2) or (3) appears always to result in the amounts or expenses in question not being deductible. Therefore, it is provided in section 354(3) that section 354 is to be disregarded for the purposes of the deductibility provisions.

Note 38: Deduction of business gifts and expenses: exception where employer's expenses disallowed: section 357

This relates to the exception from the rule disallowing the deduction by an employee of business entertaining and gifts expenses where the employer's deduction for the expense is disallowed and explains why the reference to the employer's deduction for sums being disallowed "in whole or in part" has not been rewritten.

Section 577(1)(a) of ICTA provides that no deduction is to be made in computing profits chargeable to tax under Schedule D for expenses incurred in providing business entertainment, and section 577(1)(b) provides that no deduction for expenses so incurred is to be made from emoluments charged to tax under Schedule E. The main exception to the prohibition in section 577(1)(b) is provided by section 577(3), which is rewritten at section 357 of the Act. This applies where–

- the employee's earnings include an amount in respect of the expenses, for example an allowance, and

- the deduction of the expense involved in putting the employee in funds for this purpose is disallowed *in whole or in part* by virtue of section 577.

Section 577 originated in section 15 of FA 1965, under which the cost of entertaining overseas customers, but not suppliers, was allowed. The allowability of these expenses was removed by section 72 of FA 1988. As it is not now possible for a sum to be disallowed only in part, the words "in whole or in part" have not been rewritten.

Note 39: Deductions: costs and expenses in respect of personal security assets and services: sections 377(7) and 721(5)
This involves applying the definition of member of a person's family or household that applies for the purposes of the benefits code for the purposes of the deduction available for amounts included in an employee's earnings in respect of assets or services provided to him to improve his personal security.

Section 50 of FA 1989 provides for a deduction to be allowed where amounts are included in an employee's earnings in respect of assets or services provided to him to improve his personal security. Section 52(2) of FA 1989 provides that the fact that an asset or service improves the personal physical security of a member of the employee's family or household, as well as that of the employee, does not prevent the deduction being allowed.

The expression "member of the employee's family or household" is not defined for this purpose. However, it is defined by section 168(4) of ICTA for the purposes of Chapter 2 of Part 5 of ICTA (benefits for employees earning £8,500 or more and directors). In fact, the overall effect of section 50 of FA 1989 is to enable a deduction to be made which exactly balances out the charge that would otherwise be made on any amount included in the employee's emoluments in respect of the personal security assets or services. That amount would be chargeable under Chapter 2 of Part 5 where the employee was provided with an asset or services or there was a payment of expenses incurred for that purpose and the employee was within that Chapter. So it seems reasonable to adopt the meaning given by section 168(4) of ICTA in this context. Accordingly, section 377(7) of the Act has not been excluded from the general definitions in section 721(4) and (5) of the Act which reflect section 168(4).

Note 40: Benefits from non-approved retirement benefits schemes: section 393
This explains why pensions provided from non-approved retirement benefits schemes are no longer taxed in the same way as other benefits from such schemes.

Under section 596A(1) of ICTA, a benefit received from a retirement benefits scheme is taxed unless the scheme is of a kind mentioned in section 596(1) of ICTA. (Section 596(1) concerns approved schemes, certain schemes established under statute and foreign government schemes.)

However, section 596A(6) provides that a *pension* is not charged under section 596A(1) if it also taxed–

- under Schedule E by virtue of section 19(1) of ICTA; or
- under section 58 of ICTA.

Section 596A(6) is qualified by section 596A(7) if the pension is taxed under Schedule E (rather than section 58). If section 596A(1) would produce a greater amount of tax on the pension than Schedule E, the exception in section 596A(6) does not apply. The Schedule E charge still applies and, in addition, the excess tax under section 596A(1) is also charged. So the section 596A(1) amount is charged: but partly under Schedule E and partly under section 596A.

It was decided to take a more straightforward approach in the Act (where section 596A is rewritten in Chapter 2 of Part 6). Pensions have been completely excluded from the effect of the provisions rewriting section 596A (see section 393(2)). A pension can therefore only be taxed under the provisions of the Act that deal with pension income (see Part 9). Since a pension can no longer be taxed under the provisions rewriting the Schedule E charge on pensions and under the provisions rewriting section 596A, there is no need for provision replicating section 596A(7).

It is believed that the approach taken in the Act will make no difference to the amount of tax due on a pension paid from an unapproved retirement benefits scheme. This is because amendments made to section 596A(6) since it was first enacted have reduced the potential effect of section 596A(7): so much so that it is believed that no tax could any longer be charged under it. If this view were incorrect, however, the effect could only be favourable to the taxpayer, since it is no longer possible to collect an extra amount of tax on a pension under the provisions rewriting section 596A.

Note 41: Benefits from non–approved retirement benefits schemes: certain lump sums: reduction of amount which counts as employment income: definition of market value: section 397(10)

This expands the definition of market value which is used to calculate the deduction allowed from the amount of tax charged when a lump sum is provided from certain non-approved retirement benefits schemes.

Under section 596A(1) of ICTA, a benefit received from a retirement benefits scheme is taxed unless the scheme is of a kind mentioned in section 596(1) of ICTA. (Section 596(1) concerns approved schemes, certain schemes established under statute and foreign government schemes.)

If the provision of a lump sum is taxed under section 596A(1), section 596A(9) allows certain deductions to be made from the amount taxed if specified conditions are met.

There are two methods of calculating the amount of the deduction which is allowed under section 596A(9). The second of these methods is used if–

- the lump sum is provided on the disposal of a part of an asset, or on the surrender of any part of, or share in, any rights in an asset; and

- the employee, or certain other people related to or connected with the employee, has the right to receive, or the expectation of receiving, further lump sums on a further disposal or surrender.

When this method is used, the amount of the deduction is calculated using the formula in section 596A(12) of ICTA. One of the amounts used in this formula is the market value of the asset immediately before the disposal or surrender. Section 596A(17) of ICTA defines "market value" to mean the same as in section 272 of TCGA 1992.

Section 272(1) of TCGA 1992 provides that "market value" in relation to any assets means "the price at which those assets might reasonably be expected to fetch on a sale on the open market". Subsections (2) to (6) provide some additional rules for determining market value for these purposes.

Section 273 of TCGA 1992 also provides further rules for determining market value. These rules relate to unquoted shares and securities. However, section 596A(17) does not refer to section 273 of TCGA 1992.

Section 397 of the Act rewrites section 596A(9). Section 397(10) contains the definition of market value and now includes a reference to section 273 of TCGA 1992.

Note 42: Payments and benefits on termination of employment etc: section 401
This relates to the omission of section 148(5) of ICTA.

Under section 148(1) of ICTA payments and other benefits received in connection with the termination, or a change in the duties of, or earnings from, a person's employment are chargeable to tax if and to the extent that they exceed £30,000 and are not otherwise chargeable. Section 148(5) provides that section 148 applies–

- whether the payment or other benefit is provided by the employer or former employer or by someone else, and

- whether or not the payment or other benefit is provided in pursuance of a legal obligation.

It is not considered that the other provisions about the charge under section 148 raise any inference that the payment or benefit must be provided by anyone in particular or may not be provided in pursuance of such an obligation. So section 148(5) has not been rewritten.

Note 43: Share-related income: negative amounts treated as nil: section 420
This is concerned with cases where applying a formula under Part 7 of the Act would produce a negative amount.

Part 7 of the Act (share-related income and exemptions) rewrites provisions of ICTA and FA 2000 that impose, or affect, specific charges to tax that fall within paragraph 5 of Schedule E (see section 19(1) of ICTA). In some of the provisions of Part 7 a formula has been used to determine the amount of a charge to tax in place of a verbal description of the calculation involved. The question has arisen as to how the Act should deal with cases where the mathematical result of applying a formula would be a negative amount.

Relevant formulas are used in the following provisions of Part 7 of the Act–

- Chapter 2 (conditional interests in shares): see section 428,
- Chapter 3 (convertible shares): see section 439,
- Chapter 4 (post-acquisition benefits from shares): see section 455,
- Chapter 5 (share options): see sections 475, 479 and 480,
- Chapter 9 (Enterprise management incentives): see sections 531 and 532.

In the case of the provisions of Chapters 2, 3 and 9 mentioned above, it is plain from the wording of the provisions of the existing law which they rewrite that a negative amount could not arise. For example, the amount of a charge is currently expressed to be the amount by which sum X *exceeds* sum Y. In such cases this can readily be reflected in Part 7 of the Act by providing that, where a negative result would otherwise be produced by a formula, the result is to be taken to be nil instead: see section 420 of the Act.

In the other cases mentioned above, the current wording does not in terms make clear that a negative amount could not arise. But it is in any event considered that an allowable loss cannot arise under paragraph 5 of Schedule E. Deductions might reduce a chargeable amount to nil. But beyond this point they cannot be used to create a negative amount (and hence an allowable loss). So, in these cases too, the Act provides that, where a negative result would otherwise be produced by a formula, the result is to be taken to be nil instead: see section 420 of the Act.

Note 44: Share-related income: allowing the foreign equivalents of articles of association to be used: section 424(5), paragraph 21(7) of Schedule 3 and paragraph 19(8) of Schedule 4

This relates to whether "articles of association" includes the foreign equivalents of articles of association in the case of a company incorporated under the law of a country outside the UK.

Section 140C of ICTA provides for the cases where an interest in shares is to be treated as only conditional for the purposes of sections 140A and 140B of ICTA. The effect of subsections (1A) and (3) of section 140C is that a person is not to be taken to have an interest which is only conditional by reason only that the articles of association of the company require that the shares be offered for sale or transferred if the person ceases to be an officer or employee of the company or of certain related companies.

Paragraph 12(1) of Schedule 9 to ICTA provides that shares which are to be subject to a SAYE option scheme or CSOP scheme must not be subject to any restriction, other than those permitted by sub-paragraph (1A). Those so permitted include a restriction authorised by sub-paragraph (2). Sub-paragraph (2) provides that the shares may be subject to two kinds of restrictions imposed by the company's articles of association. The first is one requiring all shares held by directors or employees of certain companies to be disposed of on ceasing to be so held. The second is one requiring all shares acquired, in pursuance of rights or interests obtained by such directors or employees, by persons who are not, or have ceased to be, such directors or employees to be disposed of when they are acquired.

In an article in Tax Bulletin 46 published in April 2000 (Employee Share Plans: Conditional Shares), the Inland Revenue accepted that in paragraph 12 of Schedule 9 to ICTA "articles of association" included "equivalent foreign documents" in the case of companies incorporated outside the UK. In the same article they said that the reference to "articles of association" in section 140C(3) of ICTA should not be construed in the same way. They did accept, however, that the articles of association of a company which was incorporated in a country whose corporate legal system was based on that of the United Kingdom would be regarded as "articles of association" for the purposes of section 140C(3) of ICTA, if they were the same in all respects as UK articles of association. But they did not accept that any other foreign equivalents should count as articles of association for the purposes of section 140C(3).

The Inland Revenue have now changed their view as to the proper interpretation of section 140C(3) of ICTA and consider that equivalent foreign documents count as "articles of association" for the purposes of the subsection, as they already do in practice for the purposes of paragraph 12 of Schedule 9 to ICTA. They now consider that the name of the document is not decisive, but that the question is whether the document performs similar functions to the articles of association of a company incorporated in the UK. An article in Tax Bulletin 60 published in August 2002 sets out the Inland Revenue's revised views.

It is considered that the views of the Inland Revenue accord with the construction that a court would give to these references to articles of association. In the provisions being rewritten the shares may be in a company incorporated outside the UK. In many other jurisdictions, including most other countries in the European Union, companies do not have a document called "articles of association". If "articles of association" in section 140C(3) of and paragraph 12(2) of Schedule 9 to ICTA is interpreted narrowly so that it only means documents called articles of association, the law will be different in the case of foreign companies incorporated in a jurisdiction which does not use the word "articles of association" for its constitutional documents. A requirement in the foreign equivalent of articles of association would not count for the purposes of section 140C(1A) and (3) of ICTA so an interest in shares might be treated as only conditional, contrary to the position for UK companies. Restrictions on shares of a kind that fall within paragraph 12(2) of Schedule 9 to ICTA made in foreign equivalents of articles of association would not be permitted under paragraph 12 of Schedule 9.

It is considered that a court is likely to hold that this was not the result intended by Parliament and that "articles of association" should be construed in a way that makes the provisions being rewritten work in a similar way for companies incorporated outside the UK, as for UK companies. In relation to companies incorporated in other European Community countries, it was held in *Commission v France* [1986] ECR 273 that the risk of tax avoidance does not justify discrimination against foreign companies. Black's Legal Dictionary defines "articles of association" in a multi-jurisdictional context as "the document that sets forth the basic terms of a corporation's existence, including the number and classes of shares and the purposes and duration of the corporation." It is considered that a court is likely to hold that in the case of a company incorporated outside the UK "articles of association" includes equivalent documents relating to the company.

Section 424(5) of the Act and paragraph 21(7) of Schedule 3 and paragraph 19(8) of Schedule 4 to the Act reflect this view and make explicit what is thought to be implicit in the provisions being rewritten.

Note 45: Share-related income: listing the tax liabilities arising in respect of the acquisition of shares that are deductible amounts: sections 428(2)(b) to (d) and 439(2)(c) to (e)

This relates to whether an amount for which a person has already become liable to tax may be deducted from the amount for which the person becomes liable to tax when he disposes of a conditional interest in shares, when that interest ceases to be conditional or on the conversion of convertible shares.

Section 140A(4) of ICTA provides that where an employee has an interest in shares that is only conditional, there is a charge to tax if the interest is disposed of or if it ceases to be conditional. Section 140A(5) to (7) of ICTA provide for the amount of

the charge. It is the amount by which the sum of the deductible amounts is exceeded by the market value of the employee's interest at a particular time. Subsection (7) lists the deductible amounts. Paragraph (b) specifies "any amounts on which the employee has become chargeable to tax under Schedule E in respect of his acquisition of the employee's interest".

This leaves the reader to work out whether any amount on which the employee has become chargeable to tax can be said to be in respect of the employee's acquisition of the employee's interest. It was thought that it would be more helpful to specify all the possibilities. Accordingly, section 428(2)(b) to (d) of the Act set out all the possible tax liabilities that might have arisen in respect of the acquisition of the employee's interest.

Section 140D(3) of ICTA provides that an employee is chargeable to tax if shares in which he has a beneficial interest are converted into shares of a different class. Subsections (5) to (7) provide for the amount of the charge. It is the amount by which the market value of the shares into which the convertible shares are converted exceeds the sum of the deductible amounts. Subsection (6) lists the deductible amounts. Paragraph (c) specifies "any amounts on which the employee has become chargeable to tax under Schedule E in respect of his acquisition of those shares".

As in the case of section 140A(7)(b) of ICTA, it was thought that it would be more helpful to specify all the possible tax liabilities that might have arisen in respect of the acquisition of the convertible shares. Accordingly, section 439(2)(c) to (e) of the Act do so.

Note 46: Shares: post-acquisition benefits from shares: deemed acquisitions by director or employee: section 447

This relates to provisions of the Act under which shares (or an interest in shares) acquired by a person connected with a director or employee are to be treated as having been acquired by the director or employee for the purposes of the provisions charging post-acquisition benefits from shares.

Section 83(1) of FA 1988 is designed to extend the scope of operation of Chapter 2 of Part 3 of that Act, which imposes charges to tax in respect of shares (or an interest in shares) acquired by a director or employee of a company by reason of that person's office or employment. In broad terms, section 83(1) provides for shares (or an interest in shares) acquired by a person as a result of being a person connected with a director or employee of a company to be treated for the purposes of the Chapter as acquired by the director or employee.

Section 83(1) does not expressly provide that in such a case–

- the beneficial interest in the shares is to be regarded as held by the director or employee for as long as it is held by the connected person, and

- the acquisition is to be treated as an acquisition by that person as a director or employee *of the company concerned.*

However, section 83(1) would not succeed in its objective of extending the scope of operation of the Chapter unless these two propositions were implied consequences of that provision–

- the charging provisions of sections 78 and 79 of the Act contain references to the beneficial interest of the person acquiring the shares which would not work in a section 83(1) case unless the first of these propositions was an implied consequence;

- similarly, the reference in section 78(4)(b) to the company as a director or employee of which that person acquired the shares would not work in such a case unless the second proposition was also an implied consequence.

Section 83(1) has been rewritten in a way that spells out both of these consequences: see section 447(5) of the Act.

Note 47: Share-related income: post-acquisition benefits from shares: requirement that director or employee must be chargeable to tax as UK resident: section 448

This relates to the requirement that a director or employee must be chargeable to tax as a person resident and ordinarily resident in the United Kingdom in order for the provisions charging post-acquisition benefits from shares to apply.

Section 77(2) of FA 1988 provides that Chapter 2 of Part 3 of the Act (provisions charging post-acquisition benefits from shares) does not apply in relation to an acquisition of shares (or an interest in shares) by a person who is not chargeable to tax under Case I of Schedule E in respect of the directorship or employment in question. Case I charges emoluments for a tax year in which a person is resident or ordinarily resident in the United Kingdom (subject to an exception for foreign emoluments).

At first sight section 77(2) might suggest that, in order for the Chapter to apply, the directorship or employment must be actually held at the time of the acquisition by the director or employee. However, this reading is inconsistent with section 87(1) of FA 1988, which provides for references to directors or employees to include people who are to be, or have been, directors or employees.

In addition, section 77(2) does not expressly provide that, in a case where one is concerned with an acquisition by a connected person that is to be treated as an

acquisition by a director or employee (see *Change 114),* the test of chargeability to tax applies in relation to the director or employee rather than the connected person. But section 77(2) cannot be sensibly read in any other way, given that section 83(1) of FA 1988, which deals with connected persons, makes no reference to the holding of directorships or employments in relation to such persons.

Section 77(2) has been rewritten in a way that does not suggest that acquisition and chargeability must coincide, or that the test of chargeability applies to a connected person: see section 448(1) of the Act.

Note 48: Share-related income: post-acquisition benefits from shares: cases outside charge on removal of restrictions etc.: section 452
This relates to the exclusion of shares in dependent subsidiaries from the charge to tax on the removal of restrictions, or the occurrence of other events, relating to shares.

Section 78(1) of FA 1988 makes a director or employee who has acquired shares (or an interest in shares) by reason of his office or employment chargeable to tax if a chargeable event (such as the removal of restrictions) occurs in relation to the shares at a time when he has not ceased to have a beneficial interest in them. But section 78(1)(b) limits the charge to tax to shares in a company which was not a dependent subsidiary at the time of the acquisition and is not a dependent subsidiary at the time of the chargeable event. (Shares in dependent subsidiaries may give rise to a charge to tax under section 79 of the Act.)

It is thought that section 78(1)(b) cannot have been intended to mean that a company which *becomes* a dependent subsidiary as part of the transaction which gives rise to the chargeable event is to be regarded as a company which *is* a dependent subsidiary *at the time of* the chargeable event. The accepted interpretation is therefore that the company is not a dependent subsidiary *at* that time. But it would be easier to discern the intention that such a company should fall within section 78(1)(b) if the test were whether the company was or was not a dependent subsidiary *immediately before* that time.

In rewriting section 78(1)(b) in section 452(4) of the Act the words "at the time of the chargeable event" have therefore been replaced by "immediately before the time of the chargeable event".

Note 49: Share-related income: share options: application to share options granted to former employees and directors by reason of their offices or employments: section 473(2)
This relates to the application of Chapter 5 of Part 7 to share options granted to former employees and directors by reason of their offices or employments.

Section 140(1) of ICTA provides–

> "For the purposes of section 135, 136, 138 or 139, a right to acquire shares is obtained by a person as a director or employee (within the meaning of the section in question) of a body corporate–
>
> (a) if it is granted to him by reason of his office or employment as such a director or employee who is chargeable to tax in respect of that office or employment under Case I of Schedule E; or
>
> (b) if the right is assigned to him and was granted by reason of any such office or employment of his to some other person;
>
> and paragraph (a) above shall apply to a right granted by reason of a person's office or employment after he has ceased to hold it if it would apply to a right so granted in the last chargeable period in which he did hold it."

Section 136(5)(b) of ICTA provides that "director" includes a person who is to be or has been a director. Section 136(5)(c) of ICTA provides that "employee" includes a person who is to be or has been an employee. The effect of paragraphs (a) and (b) of section 140(1) of ICTA read with these definitions is that the share option must be granted by reason of a past, present or future office or employment in respect of which the director or employee is chargeable to tax under Case I of Schedule E.

It is thought that the full-out words at the end of section 140(1) of ICTA provide a rule for the application of this employment test to a past office or employment. Their effect is to exclude share options granted by reason of a past office or employment if the director or employee was not chargeable to tax in respect of the office or employment under Case I of Schedule E for the last chargeable period when the office or employment was held.

There is a question whether the rule in the full-out words in section 140(1) of ICTA applies in the case described in paragraph (b) of that section as well as in the case described in paragraph (a). The fact that the full-out words only refer to paragraph (a) suggest that it does not.

But it seems inconceivable that the rule should have been intended to apply only where the share option was granted to the director or employee and not where it was granted to his wife, for example. The rule is needed in both situations where the office or employment is no longer held. Under paragraph (b) of section 140(1) of ICTA a right to acquire shares is obtained by a person as a director or employee if it was assigned to that person and was granted "by reason of any such office or employment of his". This refers back to paragraph (a). The effect of the full-out words is that paragraph (a) applies in relation to a past office or employment only if the employee or director was chargeable to tax in respect of the office or employment under Case I of Schedule E for the last chargeable period when the office or employment was held. Accordingly, it is thought that paragraph (b) applies in relation to the same offices and employments, including the same past ones. This argument is thought to be the better and is in line with practice.

Section 473(2) of the Act therefore applies regardless of whether the share option was granted to the employee or director or to somebody else.

Note 50: Share-related income: CSOP schemes: no charge in respect of post-acquisition benefits: section 525

This relates to the scope of the exemption from charges on post-acquisition benefits from shares which applies where a share option obtained under an approved share option scheme (other than a savings-related scheme) is exercised in accordance with the scheme.

Section 185(3)(a) of ICTA confers exemptions from income tax if a person–

- exercises a right to acquire shares obtained, in accordance with an approved share option scheme, by reason of his office or employment, and

- does so in accordance with the provisions of the scheme at a time when the scheme is approved under Schedule 9 to the Act.

It says that tax shall not be chargeable under any provision of the Tax Acts *in respect of the exercise* nor under section 78 or 79 of FA 1988 (charge on post-acquisition benefits) *in respect of the shares*.

Section 185(3)(a) is stated to be subject to section 185(5), which relates to schemes other than savings-related schemes ("CSOP schemes"). Section 185(5) says that section 185(3) *shall not apply in relation to the exercise by any person of a right* in accordance with a CSOP scheme if its exercise infringes the time limits set out in section 185(5)(a) and (b). As to these limits, see also *Change 129*.

Clearly the exemption from tax *in respect of the exercise of an option* is not available if its exercise infringes those time limits. The question then to be considered is whether the exemption from tax under section 78 or 79 of FA1988 *in respect of shares acquired by its exercise* is also lost if its exercise infringes those limits.

At first blush it might appear that section 185(3)(a) identifies two possible kinds of things that might attract a charge to tax, namely the exercise of an option and the shares acquired as a result of its exercise, and that section 185(5) only refers to the first of these. However, it is considered that the words "shall not apply *in relation to* the exercise by any person of a right" are potentially sufficiently wide to disapply section 185(3)(a) in relation to shares acquired as a result of the exercise of the right if the time limits are infringed. Furthermore, it would make no sense for Parliament to have intended to subject the exemption in respect of the exercise of an option to strict time limits but not the exemption in respect of shares acquired as a result of the exercise. Indeed it becomes abundantly clear that Parliament did not so intend when one looks at the original wording of the provisions in question in section 38(3) and (4)

of FA 1984: the time limits clearly applied to both exemptions. In practice section 185(5) is interpreted as subjecting both of these exemptions to the time limits.

In rewriting section 185(5) in section 525 of the Act it has therefore been made clear that the exemption from the charges to tax under sections 449 and 453 of the Act (which rewrite sections 78 and 79 of FA 1988) is subject to compliance with the time limits in section 524(2) of the Act.

Note 51: Share-related income: the EMI code: disqualifying events: definition of "control": section 534
This relates to the meaning of "control" in provisions relating to disqualifying events in connection with enterprise management incentives.

Part 6 of Schedule 14 to FA 2000 gives relief from income tax in respect of the exercise of a share option that is a qualifying option for the purposes of the Schedule. The relief may be reduced where a disqualifying event listed in paragraph 47 of the Schedule occurs.

One situation in which a disqualifying event occurs is where the company whose shares are subject to the option comes "under the control of another company (or of another company and any person connected with that other company), without being a 51% subsidiary of that other company": see paragraph 47(1)(a)(ii). The word "control" is not defined for the purposes of that provision.

However, that provision repeats, word for word, the formulation used in paragraph 13(1)(b) of the Schedule (the independence requirement) where "control" is defined. Paragraph 13(3) says that in paragraph 13 "control" has the meaning given by section 840 of ICTA. In these circumstances it is considered that "control" must have been intended to have the same meaning where it appears in paragraph 47(1)(a)(ii).

Paragraph 47(1)(a)(ii) has been rewritten in section 534 of the Act and the general definition of "control" in section 719 of the Act, which attracts the definition in section 840 of ICTA, has accordingly been allowed to apply for the purposes of section 534.

Note 52: Share-related exemptions: priority share allocations: exemption where different offers made to public and employees: section 544(3)
This relates to one of the conditions that must be met for the exemption in section 544 (exemption where different offers made to public and employees) to apply.

Section 68 of FA 1988 provides for an exemption in respect of the benefit derived by a director or employee from having a priority allocation of shares. Subsections (1ZA)

and (1ZB) of that section deal with the case where there is a public offer of shares and an employee offer. Subsection (1ZB) provides that the public offer and the employee offer are to be regarded as together constituting a single offer of shares to the public and that in the following provisions of the section references to "the offer" are to be construed accordingly.

Section 68(2) of FA 1988 contains conditions which must be met if the exemption in that section is to apply. The condition in paragraph (a) of that subsection is, "that the aggregate number of shares subject to the offer that may be allocated as mentioned in subsection (1)(b) above does not exceed the limit specified in subsection (2A) below or, as the case may be, either of the limits specified in subsection (2B) below". Subsection (2A) provides that, "Except where subsection (2B) below applies, the limit relevant for the purposes of subsection (2)(a) above is 10% of the shares subject to the offer ….". Subsection (2B) sets limits where the offer is part of arrangements which include one or more other offers to the public of shares of the same class.

Section 68(2C) of FA 1988 adapts the condition in section 68(2)(a) in a case falling within subsection (1ZA). The condition in section 68(2)(a) is to be taken to be satisfied if, and only if, it is separately satisfied with respect to the shares in each one of the companies which are subject to the offer. As the effect of subsection (1ZB) is that "the offer" means the single offer constituted by the public offer and the employee offer, this means that the condition in subsection 68(2)(a) has to be separately satisfied with respect to each company whose shares are subject to the public offer or the employee offer. There may be a company whose shares are only subject to the public offer. The effect of section 68(1ZB)(a) and (c) and (2C) is that the case of such a company must be considered. In such a case, the limit imposed by section 68(2)(a) on the number of shares allocated to employees and directors will never be exceeded because employees and directors are entitled to a priority allocation under the employee offer, not the public offer.

Section 544(3) of the Act is based on section 68(2)(a) of FA 1988, read with section 68(2C). It requires the case of each company whose shares are subject to the employee offer to be considered but does not require the case of a company whose shares are only subject to the public offer to be considered. This has no practical effect because in such a case the condition in section 544(3) of the Act will always be met.

Note 53: Share-related exemptions: priority share allocations: registrant discount: section 547(4)

This relates to the phrase "members of the public other than employees and directors" used in section 68(5A)(b) of FA 1988 (meaning of "registrant discount").

Section 68(1) of FA 1988 distinguishes between members of the public and directors or employees who are entitled by reason of their office or employment to an

allocation of shares in priority to members of the public. The directors and employees may be directors and employees of the company whose shares are subject to the offer or of any other company or person. Members of the public may well be directors or employees of some company or person, but the distinction in section 68(1) is between people who are directors and employees and are entitled by reason of their office or employment to a priority allocation and other people. Section 68(1) provides that the benefit derived from the entitlement is not to be treated as an emolument of the office or employment.

Section 68(1A) of FA 1988 provides that, disregarding the amount or value of any registrant discount made to the director or employee, section 68(1) does not apply to the benefit represented by the difference between the price payable for the shares allocated to him under the offer and the fixed price or lowest price successfully tendered.

Section 68(5A) of FA 1988 specifies where there is a "registrant discount" in respect of the shares of a company for the purposes of section 68. Three conditions have to be met. The second is set out in paragraph (b), which provides: "at least 40 % of the shares of that company which are allocated to *members of the public other than employees and directors* are allocated to individuals who are or become entitled either to that discount or to some other benefit of similar value for which they may elect as an alternative to the discount". The question is what the phrase "members of the public other than employees and directors" means.

It is considered that, as the definition of "registrant discount" is needed for the purposes of section 68(1A), "employees and directors" in section 68(5A)(b) must have the same meaning as in section 68(1A). In that subsection it means a director or employee who is entitled to a priority allocation of shares under the offer.

Subsections (1ZA) and (1ZB) of section 68 of FA 1988 contain a second case, in relation to which the definition of "registrant discount" also applies. In this case there must be a public offer and an employee offer and some of the directors or employees to whom the employee offer is made must be entitled by reason of their office or employment to a priority allocation of shares. The employee offer is made to directors or employees (and possibly other persons) and again the directors and employees may be directors or employees of any of the companies whose shares are on offer or of another company or person. Where subsection (1A) applies in this case, the "director or employee" referred to in that subsection will be a director or employee who is entitled by reason of their office or employment to a priority allocation under the employee offer. The construction suggested above makes sense in this context too.

Other meanings of "employees and directors" have been considered. One possibility is that "employees and directors" might mean anybody who was an employee or director of any company or person. This would be nonsensical in the context because it would exclude very many members of the public. Moreover it is not a distinction made elsewhere in section 68 of FA 1988.

Another possibility is that the phrase is referring to employees and directors of the company whose shares are being allocated. But this is not a distinction made in subsections (1) and (1A) of section 68, where the definition is needed. The only place where section 68 does make a distinction between directors and employees of the company whose shares are subject to the offer and directors and employees of other companies or persons is in subsection (3A) of that section and it does so clearly. This is not therefore thought to be the proper construction.

In a case where there is a public offer and an employee offer, another possibility is that the phrase is referring to employees and directors to whom the employee offer is made. But there is no equivalent category in the case in section 68(1) of FA 1988 where an offer is made to both public and employees and directors. Under section 68(1) of FA 1988 if a person happens to be an employee or director of a company or person but is not entitled to a priority allocation of shares by reason of his office or employment, he will count as a member of the public. This is therefore not thought to be the proper construction.

Accordingly, it is thought that the proper interpretation of the phrase "other than employees and directors" used in section 68(5A) of FA 1988 is "other than an employee or director of a company or person who is entitled to a priority allocation of the shares by reason of their office or employment". Subsection (4) of section 547 of the Act reflects this.

Note 54: Share-related income: employee benefit trusts: meaning of "associate": section 549

This relates to the meaning of "associate" in provisions relating to employee benefit trusts.

Paragraph 7 of Schedule 8 to ICTA contains the conditions that must be satisfied by a trust if it is to be an employee benefit trust. As mentioned in *Change 133*, paragraph 7 has been repealed for most purposes by FA 1997. But some of the provisions of the paragraph still apply for the purposes of the "no material interest" requirements that must be satisfied by an individual wishing to participate in one of the share schemes or other arrangements established under–

- Schedule 9 to ICTA (savings-related and other share option schemes),
- Schedule 8 to FA 2000 (share incentive plans), or
- Schedule 14 to FA 2000 (enterprise management incentives).

The cases in which those provisions so apply are cases where an individual has an interest in shares or obligations of a company. The provisions apply as if references in them to employees were to individuals.

A number of the provisions of paragraph 7 that still so apply contain references to an individual's "associate". Paragraph 7(12) provides that "associate", in relation to an individual, does not include the trustees of an employee benefit trust by reason only that the individual has *an interest in shares or obligations of the trust*.

Since, as mentioned above, the cases where the surviving provisions of paragraph 7 apply are cases where an individual has an interest in shares or obligations of a particular company, it seems that this reference to an interest in shares or obligations of the trust must, in the context, be a reference to *an interest in shares or obligations of the company which are subject to the trust*.

In rewriting paragraph 7(12) in section 549(4)(b) of the Act, these underlined words have therefore been added in order to clarify the meaning of that provision.

Note 55: PAYE: use of the term "PAYE income" to replace "income assessable under Schedule E": section 683

This relates to the use of the term "PAYE income" to replace "income assessable under Schedule E".

The term "PAYE income" takes the place of "income assessable under Schedule E" which is used in section 203 of ICTA. It is both necessary and helpful to define a new term.

It is necessary to define a new term because Schedule E will cease to exist as a statutory concept. The Act defines specific classes of income – taxable earnings, pension income and so on. But it remains crucial to identify what was income assessable under Schedule E because–

- it is *tax on all such income* (and only such income) which the Inland Revenue *must* try to collect through PAYE; and

- it is only *payments of such income* which are (potentially) subject to deductions under PAYE.

It is helpful to define a new term because it is not easy to identify in ICTA and related legislation just what is "income assessable under Schedule E". Schedule E income is not defined as such in ICTA. Schedule E is more in the nature of a label used for a mix of things. The only way to find out what things is to work through the legislation and see what it says is chargeable (or assessable) under Schedule E. And that is done not in one place in the legislation (e.g. section 19) or a few places but provision by provision throughout ICTA and other Acts. In contrast the Act defines what it is charging; and with new labels.

But a replacement for income assessable under Schedule E cannot be defined simply as what the Act makes liable to income tax. The Act deals with income which is not chargeable under Schedule E in ICTA – for example, some pension income in Part 9. In addition the net amount of income which is taxed is not the same as the amount which is *assessable*. Deductions may reduce (or remove) liability on assessable income.

That is why section 683 of the Act sets out precisely what makes up "PAYE income" by reference to terms defined in the Act and to specific sections charging pensions and social security income.

This might be thought to be different from "income assessable under Schedule E". But on close examination it has the same meaning. When PAYE was introduced section 1(1) of the Income Tax (Employments) Act 1943 provided for income tax to be assessed and charged on the emoluments specified in subsection (2); and for deductions in accordance with regulations made by the Board "on the making of any payment of, or on account of, any such emoluments".

The Income Tax (Offices and Employments) Act 1944 extended the scope of PAYE beyond manual and weekly paid workers to cover all emoluments for all employees and office holders except the armed forces. Section 1(1) provided that the 1943 Act

> "shall extend to all emoluments **assessable** *(emphasis added)* to income tax under Schedule E"

and amended section 1(1) the 1943 Act accordingly in the same terms.

The introduction of the limitation of PAYE to "assessable" emoluments may have been on the basis that widening the scope of PAYE to salaried employees and office holders brought within view payments which were not then liable to income tax. That said, the explanatory notes which accompanied the Bill might just possibly suggest that the use of the term "assessable" had not been the subject of great attention as they started–

> "Clause 1 extends to all emoluments **chargeable** *(emphasis added)* under Schedule E, other than the pay of the Armed Forces, the principle of "pay as you earn"…".

In any event, the phrase "emoluments assessable to income tax under Schedule E" was not defined. Its natural meaning would then appear to be the emoluments which are capable of being included in an assessment to income tax for any year of assessment, whether or not any income tax is payable as a result. That would exclude exempt emoluments. It would not exclude emoluments subject to deductions or reliefs which fall to be made in the return after arriving at the assessable income.

That would have been consistent with, for example, section 33 of FA 1920 which provided–

> "The expression "assessable income" in the case of any income other than earned income means the amount of that income as estimated in accordance with the provisions of the Income Tax Acts."

The exclusion from this provision of earned income related to earned income relief. This required a separate definition of earned income. Assessable income and earned income together made up total income.

By 1943 earned income relief was given by section 15 of FA 1925 (as amended as regards the figures by section 6 of FA 1941)–

> "(1) An individual who makes in the manner prescribed by the Income Tax Acts a claim in that behalf and who makes a return in the prescribed form of his total income shall, for the purposes of ascertaining the amount of his assessable income for the purposes of income tax, be allowed a deduction from the amount of his earned income of a sum equal to one-tenth of the amount of that income, but not exceeding in the case of any individual one hundred and fifty pounds."

This is also consistent with the meaning of assessable income suggested above. A person could not make a return of income until after the end of the year. So a payment could not be reduced by earned income relief when paid during the year. PAYE operated on payments before earned income relief. That is why the PAYE tables built in earned income relief.

The way the tables did so was authorised by section 2(2) of the 1943 Act (now section 203(7) of ICTA). This requires the *income tax* for the year which PAYE must try to collect to be estimated subject to provisional deductions for allowances and reliefs. But it neither requires nor permits adjustment of the *income*.

Hence this is a change in terminology but not in the law.

Note 56: PAYE: the Act does not rewrite section 139(4) of FA 1994 (enactments relating to the payment of incapacity benefit to have effect subject to PAYE regulations): section 684

This involves the omission from the Act of section 139(4) of FA 1994, which deals with the charge to tax under Schedule E on incapacity benefit.

Section 139 (4) provides–

> "Enactments relating to the payment of incapacity benefit shall have effect subject to such provision as may be contained for the purposes of this section in regulations under section 203 of the Taxes Act 1988 (PAYE regulations)".

The purpose and effect of this provision is unclear.

It is not necessary, and is not used, in order to make PAYE regulations for incapacity benefit. The powers in section 203 of ICTA (section 684 of the Act) are sufficient for

the Income Tax (Employments) Regulations 1993 (see especially regulations 98A to 98H).

It might be thought that statutory payments require some additional authority for deductions to be made. But PAYE has been deducted from other statutory payments since the inception of the system. It applied in 1944 to statutory payments to employees, office holders and pensioners. Neither then nor subsequently has the obligation to deduct been called into question because a payment was required by statute.

Accordingly section 139(4) is unnecessary and is omitted from the Act.

Note 57: PAYE: omission of any reference to the fact that PAYE applies before any assessment: section 684

This relates to the omission of any reference to the fact that PAYE applies before any assessment.

Section 203(1) of ICTA provides that deductions are to be made from payments "notwithstanding that when payment is made no assessment has been made in respect of the income". That provision is unnecessary. In 1943 it helpfully emphasised the difference between PAYE and the previous systems of deductions from pay to collect tax which had already assessed in respect of past income. But there is now no need for that emphasis.

Note 58: PAYE: intermediary to both deduct tax and account for it in accordance with PAYE regulations if the employer is not to be required to do so: sections 687, 689 and 691

This makes it clear that an intermediary must both deduct tax and account for it in accordance with PAYE regulations if the employer is not to be required to do so.

Subsection (2) of section 687 of the Act provides that subsection (1) is not to apply if the intermediary accounts for and pays tax in accordance with PAYE regulations. It derives from section 203B(2) of ICTA. But the wording of subsection (2) is modified to make it clearer that the deduction of tax and the accounting for it by the intermediary both have to be done in accordance with PAYE regulations.

Similar ambiguities have been removed from sections 689(1)(d) and 691(1)(c) of the Act, which derive from sections 203C(1)(d) and 203E(1)(c) of ICTA.

Note 59: PAYE: omission of the reference in section 203F(6) of ICTA to the European currency unit: section 702(6)

Section 702(6) of the Act contains definitions for the purposes of section 702, which gives the meaning of "readily convertible asset" for the purposes of Chapter 4 of Part 11. It is based on section 203F(6) of ICTA. The definition of "money" differs from that in section 203F(6) because it omits from the Act the reference in section 203F(6) of ICTA to the European currency unit.

Section 203F(6) of ICTA defines "money" as being any currency other than sterling or the European currency unit (ECU). Having regard to the introduction of the Euro, and the consequences of Council Regulation (EC) No 1103/97 of 17th June 1997, this is no longer necessary. Accordingly section 702(6) of the Act omits the reference to the ECU.

Note 60: PAYE: repayments not to apply in relation to unemployment benefit or income support: section 708

This involves the omission from the Act of paragraphs (a), (b) and (c) of section 204 of ICTA.

Section 204(a) and (c) of ICTA relies on the rules for claiming unemployment benefit. When jobseeker's allowance replaced unemployment benefit, section 41(5) of and Schedule 3 to the Jobseekers Act 1995 repealed the provisions of the Social Security Contributions and Benefits Act 1992 providing for unemployment benefit. Those repeals were brought into force on 7th October 1996 by the Jobseekers Act 1995 (Commencement No. 4) Order 1996 (S.I. 1996/2208). So the last tax year in respect of which unemployment benefit can have been claimed is 1996/97. This means that section 204(a) and (c), and regulations relying on them, can have no effect for tax years to which the Act applies. Accordingly section 204(a) and (c) is not rewritten.

Section 204(b) of ICTA relies on the rules for income support that are subject to a condition about availability for employment. When jobseeker's allowance replaced income support, paragraph 30(4) Schedule 2 to the Jobseekers Act 1995 substituted a new section 124(1)(d) of Social Security Contributions and Benefits Act 1992 without a condition as to availability for employment. That substitution was effective from 7th October 1996 (see section 41 of the Jobseekers Act 1995 and Regulation 2(b) of the Jobseekers Act 1995 (Commencement No. 4) Order 1996 (S.I. 1996/2208)). So the last tax year in respect of which income support can have been claimed subject to a condition about availability for employment is 1996/97. This means that section 204(b), and regulations relying on it, can have no effect for tax years to which the Act applies. Accordingly section 204(b) is not rewritten.

Note 61: PAYE: the Act makes explicit that the introduction of self-assessment for income tax did not affect income falling within section 206 of ICTA and that section does not apply to other income: section 709.
This makes it clear that the introduction of self-assessment for income tax did not affect income falling within section 206 of ICTA and that section does not apply to other income.

Note 62 relates to most of section 205 of ICTA not being rewritten. It explains that despite section 111 of FA 1995 substituting a new section 205 of ICTA (anticipating self-assessment for income tax), the changes brought about by self-assessment removed the need for most of section 205.

Section 111 of FA 1995 amended section 206 of ICTA at the same time as it substituted the new section 205. The amendment removed the words "under Schedule E" after the opening words "Where an assessment". This was recognition that under self-assessment there would normally just be a single assessment covering all of an individual's income. But that limited amendment to section 206 has arguably introduced some uncertainties.

Before self-assessment, the Inland Revenue could make an assessment which related just to Schedule E income falling within section 206(a) and (b). Under self-assessment, an assessment will normally relate to the whole of an individual's income. It seems clear that this feature of self-assessment was not intended to alter the operation of section 206. Section 709 of the Act makes explicit that an assessment can be subject to section 206 even if the assessment includes income not within section 206(a) and (b).

But the fact that such an assessment may include some other income not within section 206(a) and (b) leaves uncertain the issue of whether that other income should also be assessed in accordance with generally prevailing practice (if any). Again it seems clear that the minor change, dealing with the general disappearance of Schedule E assessments, was not intended to affect the assessment of income not within section 206(a) and (b). Section 709 of the Act makes explicit that income not within section 206(a) and (b) is unaffected by it.

Note 62: PAYE: the Act does not rewrite section 205(1) to (3) and (5) of ICTA (assessments need not be made in certain cases): section 711
This involves the omission from the Act of section 205 of ICTA other than subsection (4).

Section 205(1) to (3) of ICTA provides that an income tax assessment of income need not be made in certain cases. That only makes sense if there is a general provision requiring an assessment in other cases.

Before self-assessment for income tax was introduced, section 29(1) of TMA 1970 ("old section 29(1)") contained such a general provision. Old section 29(1) required an assessment to be made, unless otherwise provided, if the inspector was satisfied that a return under the Taxes Acts gave correct and complete information concerning profits chargeable to tax. And section 205 as it stood before self-assessment ("old section 205") was an instance of it being "otherwise provided" for the purposes of old section 29(1).

A new section 29(1) of TMA 1970 substituted by section 191(1) of FA 1994 ("new section 29(1)") had had general effect for income from the tax year 1996/97 onwards. New section 29(1) does not require the Inland Revenue to make assessments whenever a return under the Taxes Acts gives correct and complete information concerning profits chargeable to tax.

A new section 205 ICTA was substituted by section 111(1) FA 1995 for the tax year 1996/97 onwards. The new section 205 dealt with one detailed issue under income tax self-assessment – the Inland Revenue ceasing routinely to make schedular assessments. But it appears that a broader issue was overlooked. There is no longer a general requirement on the Inland Revenue to make assessments (as there had been in the old section 29(1)).

It follows that section 205(1) to (3) is not needed for tax years covered by the Act and has not been rewritten. Nor has section 205(5), which defines terms used in those subsections.

Note 63: Interpretation: legal equality of illegitimate children: section 721(6)
This concerns the disapplication of provisions that affect the interpretation of references to a child or children in England and Wales, Scotland and Northern Ireland so as to preserve the effect of the corresponding references in ICTA.

(A) England and Wales: Section 1 of the Family Law Reform Act 1987 ("the English Act") affects the interpretation of references in enactments to family relationships (however expressed). It applies to enactments passed on or after 4th April 1988 (the date of commencement of the section) so far as they have effect in England and Wales.

Section 831(4) of ICTA provides for section 1 of the English Act to be disregarded in construing references in ICTA to a child or children. (In fact, section 1 would not have applied to ICTA anyway, because ICTA was enacted on 9th February 1988, before the commencement of section 1. But it is likely that this provision was included in ICTA because, when the Act for ICTA was introduced into Parliament, the date of commencement of section 1 was not known and was not expected to become known until it was too late to amend the Act.)

(B) Scotland: Section 1(2) of the Law Reform (Parent and Child) (Scotland) Act 1986 ("the Scottish Act") makes similar provision to that made in section 1 of the English Act. It applies to enactments passed on or after 8th December 1986 (the date of commencement of the section) so far as they have effect in Scotland.

However, section 831(4) of ICTA refers not to section 1(2) of the Scottish Act, but to section 1(3). Since section 1(3) merely lists exceptions to the general rule contained in section 1, the reference to it in section 831(4) of ICTA is clearly a mistake. If read literally, the provision makes no sense.

The purpose of the reference in section 831(4) of ICTA to section 1 of the English Act is clear; and the provision gives effect to that purpose for England and Wales. It is also clear both-

- from the context of section 831(4) itself, and
- because tax legislation should be read so far as possible as having a meaning that is uniform throughout the United Kingdom,

that the reference in section 831(4) to the Scottish Act should be read as having a corresponding effect for Scotland. Accordingly, the reference is rewritten in section 721(6)(c) of the Act as a reference section 1(2) of the Scottish Act (since it is this provision that achieves for Scotland what section 1 of the English Act achieves for England and Wales).

(C) Northern Ireland: Article 155 of the Children (Northern Ireland) Order 1995 (S.I. 1995/755 (N.I. 2)) makes provision corresponding to section 1 of the English Act. It has effect for any statutory provision (which includes any statute for the time being in force in Northern Ireland) passed on or after 1st July 1995.

Accordingly, that Article does not apply for the purposes of the interpretation of ICTA but would, unless excluded, apply in relation to the Act. By including a reference to this Order in section 721(6)(d) of the Act, the present position for Northern Ireland is preserved (in conformity with the position for the other parts of the United Kingdom).

Note 64: Share-related income: share incentive plans: requirement to set consistent performance targets: paragraph 42 of Schedule 2
This relates to the requirement to set consistent performance targets in connection with an award of shares where a share incentive plan provides for "method two" performance allowances in relation to the award.

Paragraph 118 of Schedule 8 to FA 2000 (withdrawal of approval) allows the Inland Revenue to withdraw approval of a share incentive plan (a "SIP") with effect from the time when a "disqualifying event" occurs in relation to the plan. One of the disqualifying events listed in paragraph 118(2) relates to a plan that provides for a particular kind of performance allowances ("method two" allowances) in connection

with an award of shares; in such a case the award will be dependent on performance targets being met. A disqualifying event occurs in relation to such a plan if performance targets are set that, at the time they are set, cannot reasonably be viewed as being comparable: see paragraph 118(2)(c). Paragraph 118(4) then explains that performance targets are comparable if they are comparable in terms of the likelihood of their being met by the performance units to which they apply.

It is clear from these provisions that there is in effect an implied requirement for such a plan to set performance targets that can reasonably be viewed as being comparable within the meaning given by paragraph 118(4), because a failure to set such targets is liable to lead to approval of the plan being withdrawn. However, it is considered that it would be more helpful, and consistent with the general approach of setting out all the requirements that have to be met by a SIP, if this requirement were spelt out rather than being left to be implied from the provisions relating to withdrawal of approval.

In rewriting paragraph 118 in Schedule 2 to the Act, the implied requirement has therefore been spelt out in a part of the Schedule that deals with the requirements that have to be met by a SIP that provides for "method two" allowances: see paragraph 42(3) of Schedule 2 to the Act. As a matter of drafting the obligation has been reproduced as an obligation to set "consistent targets". The meaning of this expression is then explained (in line with paragraph 118(4) of Schedule 2 to FA 2000) in paragraph 42(6) of Schedule 2.

Note 65: Share-related income: share incentive plans: extension of definitions: paragraphs 43, 45, 78 and 84 of Schedule 2
This relates to the extension of certain definitions for the purposes of provisions relating to share incentive plans.

(A) Paragraph 48 of Schedule 8 to FA 2000 (meaning of "salary") contains a definition of "salary" that in terms applies only for the purposes of Part 5 of that Schedule (partnership shares).

However, "salary" is used in a number of places in that Schedule which fall outside Part 5: see, for example, paragraph 1(1). Since it is inconceivable that "salary" was intended to have a different meaning in those places from the one that applies for the purposes of Part 5, the Part 5 definition has been rewritten in Schedule 2 to the Act in a way that means that it will apply for the purposes of the Schedule generally: see paragraph 43(4) of Schedule 2.

(B) Similarly, paragraph 35 of Schedule 8 to FA 2000 (deductions from salary) contains a definition of "partnership share money" that applies only for the purposes of Part 5 of the Schedule.

Again it is considered that the meaning given by that definition must be taken to apply for the purposes of provisions of Schedule 8 that fall outside Part 5, for example paragraph 14(3). So that definition has been rewritten in Schedule 2 to the Act in a way that means that it will apply for the purposes of the Schedule generally: see paragraph 45(2) of Schedule 2.

(C) Paragraph 76 of Schedule 8 to FA 2000 (acquisition of shares by trustees from employee share ownership trust) sets out how the trustees of a share incentive plan are to deal with a qualifying transfer of shares. For this purpose there is a qualifying transfer of shares to the trustees if–

- relevant shares are transferred to them by the trustees of an employee share ownership trust, and

- the transfer is a qualifying transfer within section 69(3AA) of FA 1989 (transfer of shares in, or shares purchased from money in, an employee share ownership trust immediately before 21st March 2000).

There is no explanation of the reference to "relevant shares". But it is thought that the reference to section 69(3AA) of FA 1989, which itself refers to relevant shares, means that the reference must be taken to be to relevant shares within the meaning of section 69(3AA). Section 69(3AC) defines "relevant shares" for the purposes of section 69(3AA).

In rewriting paragraph 76 of Schedule 8 to FA 2000 in paragraph 78 of Schedule 2 to the Act, it has therefore been made clear that the reference is to relevant shares as defined by section 69(3AC) of FA 1989.

(D) Paragraph 118(3) of Schedule 8 to FA 2000 defines "key feature" for the purposes of sub-paragraph (2)(b) of paragraph 118 (withdrawal of approval).

Sub-paragraph (6)(a) of paragraph 118 also refers to a key feature but without there being any explanation of what this means. In fact, of course, it can only have the same meaning as it has in sub-paragraph (2)(b) by virtue of sub-paragraph (3). This has been reflected in rewriting paragraph 118 in Schedule 2 to the Act: see paragraph 84(6) of Schedule 2.

Note 66: Share-related income: share incentive plans: general requirements as to dividend shares: paragraph 65 of Schedule 2
This relates to the clarification of one of the general requirements relating to dividend shares acquired under a share incentive plan.

Part 7 of Schedule 8 to FA 2000 applies where cash dividends are paid in respect of shares held by participants in a share incentive plan (a "SIP"). It provides for such

dividends to be used to acquire further shares for the participants. These further shares are referred to as "dividend shares". Paragraph 55(a) of the Schedule says that a SIP must provide that dividend shares are shares of the same class, and carrying the same rights, as the shares in respect of which the dividend is paid.

Although paragraph 55(a) does not expressly require dividend shares to be shares *in the same company as* the shares in respect of which the dividend is paid, it is thought that this would be implied if the issue ever arose. In rewriting paragraph 55(a) in paragraph 65 of Schedule 2 to the Act, a requirement that the shares should be in the same company has been added in order to clarify this point.

Note 67: Share-related income: share incentive plans: company reconstructions: paragraph 86 of Schedule 2

This concerns the transactions that count as company reconstructions for the purposes of provisions relating to share incentive plans.

Paragraph 115 of Schedule 8 to FA 2000 provides for certain transactions affecting shares of a participant in a share incentive plan (a "SIP") to count as "company reconstructions". A company reconstruction has the tax and other consequences set out in the paragraph.

Paragraph 115(1) provides for two kinds of transactions "other than a transaction within sub-paragraph (2)" to count as company reconstructions. The test is whether these transactions result (or would but for certain circumstances result) in a new holding of shares being equated for capital gains tax purposes with shares originally held by a participant.

Paragraph 115(2) provides that where certain kinds of shares are issued *as part of a company reconstruction* the shares in question are to be treated as not forming part of the new holding. But (despite the words "other than a transaction within sub-paragraph (2)" in paragraph 115(1)) it does not expressly say that a transaction which consists *entirely* in the issue of shares of any of those kinds is not to count as a company reconstruction. However, this must be the practical effect of paragraph 115(2): since all of the shares to which the transaction relates are to be treated as not forming part of the new holding, there is nothing that can qualify as a "new holding" for the purposes of the test in paragraph 115(1) and the transaction therefore falls outside the scope of that provision.

In rewriting paragraph 115(1) and (2) in paragraph 86 of Schedule 2 to the Act, it has therefore been made clear that what has been called "an excluded issue of shares" does not by itself count as a company reconstruction: see paragraph 86(3)(a) of Schedule 2.

Note 68: Share-related income: SAYE option schemes: the employment requirement: paragraph 10 of Schedule 3

This deals with the exceptions to the requirement that a person may not exercise and obtain options under a savings-related share option scheme unless he is a director or employee of the company that established the scheme or (in the case of a group scheme) a participating company.

Paragraph 26(3) of Schedule 9 to ICTA contains a requirement that, subject to certain specified exceptions, a person may not exercise and obtain options under a savings-related share option scheme (an "SAYE option scheme") unless he is a director or employee of–

- the company that established the scheme, or
- (in the case of a group scheme) a participating company.

These exceptions cover provisions of the scheme made in accordance with paragraph 19 (retirement or redundancy etc.) or paragraph 21(1)(e) or (f) (circumstances relating to status of employer company).

But the stated exceptions to the requirement do not cover provisions made in accordance with paragraph 18 of the Schedule, which requires an SAYE option scheme to make provision about the exercise of options where the director or employee has died. However, in view of this express requirement, there can be no doubt that the rule in paragraph 26(3) must be regarded as being impliedly subject to paragraph 18. The Inland Revenue have always accepted that this is so.

In rewriting paragraph 26(3) of Schedule 9 to ICTA in paragraph 10 of Schedule 3 to the Act, the scope of the exceptions to the requirement has accordingly been widened so as to cover provisions made in accordance with paragraph 32 of the Schedule (paragraph 32 rewrites paragraph 18 of Schedule 9 to ICTA). In fact rather than construct a list of provisions, paragraph 10(2) of Schedule 3 opts for the simpler alternative of saying that the requirement of that paragraph is not infringed by a provision of the scheme *required or authorised by a provision of this Schedule.*

Note 69: Share-related income: the EMI code: definitions relating to groups of companies: paragraph 58 of Schedule 5

This deals with the meaning of expressions relating to groups of companies in provisions relating to enterprise management incentives.

Paragraph 71(1) of Schedule 14 to FA 2000 (enterprise management incentives) defines two expressions relating to groups of companies–

- "group", in relation to a parent company, means that company and its 51% subsidiaries;

- "group company", in relation to a parent company, means that company or any of its 51% subsidiaries.

A "parent company" is a company that has one or more 51% subsidiaries.

There are a number of places in Schedule 14 where there are references to a "group" which do not occur "in relation to a parent company" (see, for example, paragraph 10(4) to (6) of the Schedule). Strictly speaking, the definition of "group" set out above does not apply in these contexts. However, it is obvious from that definition that, for the purposes of the Schedule, a "group" was intended to consist of a parent company and its 51% subsidiaries, and that references to a member of a group were intended to refer to any one of those companies.

In rewriting Schedule 14 to FA 2000 in Schedule 5 to the Act these undefined references to a "group" have been reproduced in a way that clarifies this intended meaning. This has involved creating a new expression "group of companies", which is defined in paragraph 58 of Schedule 5 as meaning a parent company and its 51% subsidiaries.

The expression "group", which is defined by paragraph 71(1) of Schedule 14 to FA 2000 as mentioned above, has been rewritten as "the group". The concept of a "group company" is no longer used (or defined) on a general basis in Schedule 5 to the Act, although it does appear (as a defined term) in paragraph 14 of that Schedule.

Note 70: Share incentive plans: meaning of "investment company" in Schedule 8 to FA 2000: paragraph 109 of Schedule 6
This involves applying an express definition of "investment company" in the context of share incentive plans, where the term is undefined at present.

Part 12 of Schedule 8 to FA 2000 (employee share ownership plans) allows certain deductions to be made by a company in calculating trading profits for corporation tax purposes (under Schedule D). Paragraph 114 of that Schedule provides for that Part of that Schedule to apply in relation to investment companies subject to certain modifications, including providing for the deductions allowed to be treated as "expenses of management" for the purposes of calculating the trading profits of such companies. "Investment company" is not defined in that Schedule.

Section 75 of ICTA provides for how expenses of management are to be treated in calculating the trading profits of investment companies, as defined in section 130 of ICTA, which defines "investment company" for the purposes of Part 4 of ICTA (provisions relating to the Schedule D charge).

Paragraph 109 of Schedule 6 to the Act will replace Part 12 of Schedule 8 to FA 2000 with new Schedule 4AA to ICTA. The new Schedule 4AA is introduced by new section 85B of ICTA (see paragraph 12 of Schedule 6 to the Act) which falls within Part 4 of ICTA. The new Schedule 4AA will accordingly fall to be construed as part of Part 4 of ICTA so that the definition of "investment company" in section 130 of ICTA will apply for the purposes of Schedule 4AA.

But since–

- it is clear from paragraph 105 of Schedule 8 to FA 2000 that Part 12 of that Schedule applies in relation to corporation tax computations, and

- treating an amount as an expense of management, as paragraph 114 of Schedule 8 to FA 2000 does, has any effect only in relation to investment companies about which section 75 makes provision, namely investment companies within the meaning given in section 130 of ICTA,

there can be no room for doubt that the references to "investment company" in paragraph 114 of Schedule 8 to FA 2000 already have the meaning set out in section 130 of ICTA.

Note 71: Returns of emoluments derived from duties performed in the United Kingdom: paragraph 147 of Schedule 6
This explains the choice of wording substituted in section 24 of FA 1974.

Section 24 of FA 1974 extends the Inland Revenue's right under to call for a return of the emoluments derived from duties performed in the United Kingdom. Amongst its provisions is one that a notice given to a person under section 8 of TMA 1970

> "may require a return of his income to include particulars of *any emoluments paid to him, whether or not tax is chargeable on them*".

Paragraph 147 of Schedule 6 to the Act substitutes new wording for the italicised words. This change is necessary to take account of the fact that the terminology used in the Act differs from the terminology used previously. With the new wording, the quote above becomes

> "may require a return of his income to include particulars of <u>any general earnings (as defined by section 8(2) of [the Act]) paid to him</u>",

the underlined words replacing the italicised ones.

The new wording clarifies the following things–

- The provision is not concerned with exempt income, because this does not form part of a person's general earnings (see section 8(2) and (4) of the Act).

- The provision is concerned with the wider "general earnings" (i.e. earnings on which tax may or may not be charged) rather than the narrower "net taxable earnings" (i.e. general earnings on which tax is actually charged).

Note 72: Capital gains: allowance made on disposal of shares for income tax charge resulting from shares having been acquired by a director or employee : paragraph 210(2) of Schedule 6

Section 84 of FA 1988 duplicates section 120(1) of TCGA 1992 and is therefore not rewritten. In the replacement for section 120(1) (see paragraph 210(2*)* of Schedule 6 to the Act), the reference to section 83 of FA 1988 is rewritten as if it were a reference to subsection (1) of section 83 only.

Section 120(1) of TCGA 1992 provides–

> "Where an amount is chargeable to tax under Chapter II of Part III of the Finance Act 1988 on a person who acquires shares or an interest in shares, then on the first disposal of the shares (whether by him or by another person) after his acquisition, section 38(1)(a) shall apply as if a sum equal to the amount chargeable had formed part of the consideration given by the person making the disposal for his acquisition of the shares; and this subsection shall apply with the appropriate modifications in a case to which section 83 of that Act applies.
>
> This subsection shall be construed as if it were contained in Chapter II of Part III of the Finance Act 1988."

Section 38 of TCGA 1992 provides for the consideration given for the acquisition of shares to be treated as increased in certain circumstances, thereby reducing the amount of the chargeable gain on a disposal.

Section 83(2) of FA 1988 provides –

> " (2) For the purposes of this Chapter, where a person who acquires shares or an interest in shares disposes of the shares or interest otherwise than by a bargain at arm's length with a person who is not connected with him, he shall be deemed to continue to have a beneficial interest in the shares until there is a disposal of the shares or interest by such a bargain."

Any tax charged under Chapter 2 of Part 3 of FA 1988 is charged on the person who acquires the shares or interest in shares in question who can continue to suffer tax charges under that Chapter so long as that person continues to have a beneficial interest in the shares. The effect of section 83(2) is to extend the period during which a person is treated as having a beneficial interest for the purposes of that Chapter so that it does not end when the person transfers shares to a connected person.

Section 83(2) is not thought to affect the time of a disposal of the shares for capital gains tax purposes. Thus, where an employee (A) acquires shares in a company as mentioned in Chapter 2 of Part 3 of FA 1988 and disposes of them to a connected person (B), A might continue to suffer charges under that Chapter relating to the shares but the amount chargeable will increase A's acquisition cost for the purpose of calculating the chargeable gain at the time of the disposal to B.

That this is the better view of section 83(2) can be seen clearly from the facts that–

- it applies for the purposes of Chapter 2 of Part 3 of FA 1988 and is not expressed to apply for capital gains tax purposes,

- it does not in terms purport to affect a disposal, and

- an interpretation of the provision that treated the transfer to a connected person as not being a disposal for capital gains tax purposes would result in relief under section 120(1) of 1992 being given to the connected person when he finally disposed of the shares, not to the employee who originally acquired the shares and suffered the income tax charges which give rise to the relief.

Thus, no modification is needed of section 120 for a case within section 83(2) of FA 1988, and accordingly no reference to section 463 (the rewritten version of this provision) is made in the replacement for section 120(1) of TCGA 1992.

ANNEX 3: DESTINATION OF REWRITTEN EXTRA-STATUTORY CONCESSIONS

ESC Number	Description	Rewritten provision
A1	Flat rate allowances for cost of tools and special clothing	Section 367
A2	Meal vouchers	Section 89
A6	Miners: free coal and allowances in lieu	Section 306
A22	Long service awards	Section 323
A24	Foreign social security benefits	Sections 645 and 681
A25	Crown servants engaged overseas	Section 28
A57	Suggestion schemes	Sections 321 and 322
A58	Travelling and subsistence allowance when public transport disrupted	Section 245
A59	Disabled persons' home to work travel	Sections 246 and 247
A62	Pensions to employees disabled at work	Section 644
A65	Workers on offshore oil and gas rigs or platforms: free transfers to or from mainland	Section 305
A66	Payments for employees' journeys home: late night travel and breakdown in car sharing arrangements	Section 248
A70	Small gifts to employees by third parties and staff Christmas parties	Sections 264, 270 and 324
A71	Company cars: family members and shared use	Sections 148 and 169

ESC Number	**Description**	**Rewritten provision**
A72	Pension schemes and accident insurance policies	Section 307
A74	Meals provided for employees	Sections 266 and 317
A84	Allowances paid to detached national experts	Section 304
A85	Transfers of assets by employees and directors to employers and others	Section 326
A91(a)	Living accommodation provided by reason of employment	Section 108

B27	Approved employee share schemes: jointly owned companies	Paragraph 46 of Schedule 3 and Paragraph 34 of Schedule 4

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