Chapter 4

Establishment of Schemes

INTRODUCTION

4.1 There are a number of reasons why companies establish employees' share schemes rather than enter into separate agreements with each individual employee. The first is convenience, since a scheme removes the need to set out the full rights of participants in a separate agreement on each occasion an option is granted. Second, there are considerable company law advantages. Third, certain of the tax advantages under the Income Tax (Earnings and Pensions) Act 2003 (ITEPA 2003), Pt 7 are only available in respect of 'schemes' or 'plans'. Fourth, for listed companies the use of a scheme avoids the need to obtain shareholders' specific approval of each grant of an option to a director.

COMPANIES ACT 2006

Meaning of 'employees' share scheme'

4.2 An employees' share scheme is defined by the Companies Act 2006 (CA 2006), s 1166 as follows:

> 'a scheme for encouraging or facilitating the holding of shares or debentures in a company by or for the benefit of –
>
> (a) the bona fide employees or former employees of –
>
> (i) the company,
>
> (ii) any subsidiary of the company, or
>
> (iii) the company's holding company or any subsidiary of the company's holding company; or
>
> (b) the spouses, civil partners, surviving spouses, surviving civil partners, or minor children or step-children of such employees or former employees'.

4.3 There are a number of difficulties which arise in relation to the construction of this definition. First, the legislation refers to 'the … employees …' and 'the spouses …' and this could mean all such persons. However, one meaning for the word 'the' when used with a noun in the plural is 'those who are' and this seems the better construction. In other words, the

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definition of 'employees' share schemes' sets out the categories of persons who may be included in an employees' share scheme, but it does not lay down that all persons within these categories must be included. However, it is unlikely that an arrangement intended to benefit only directors would amount to an employees' share scheme unless it is the intention that participation will be widened subsequently.

4.4 Another difficulty arises where a particular scheme allows participation by persons outside the permitted categories in CA 2006, s 1166, for instance, non-executive directors, self-employed consultants and the employees of joint venture companies or other non-subsidiaries. There is no authority on this, but the widely accepted view is that a distinction should be made between allocations to qualifying and non-qualifying persons, and the allocations to qualifying persons should be treated as made under an employees' share scheme. Allocations to non-qualifying persons should be treated as separate arrangements and, therefore, should not enjoy the company law benefits normally available in respect of allocations under employees' share schemes (see **4.5** and **4.6** below). However, the statutory tax-advantaged scheme codes now provide for employees of joint venture companies to be able to participate in one or other of the schemes of a joint owner and, to this extent, non-subsidiaries would be involved (ITEPA 2003, Sch 2, para 91; Sch 3, para 46; and Sch 4, para 34).

Directors' authority to allot shares

4.5 CA 2006, s 549 provides that directors shall not exercise any power of the company to allot shares or grant options over shares unless the company is a private company with only one class of share capital or, otherwise, they are authorised by a resolution in general meeting or under the articles of association. However, there is no prohibition on an allotment of shares in pursuance of an 'employees' share scheme' within the meaning of CA 2006, s 1166. An 'allotment' of shares includes not only the issue of new shares, but also the grant of an option over such shares (CA 2006, s 549(2)(a)).

Disapplication of pre-emption provisions

4.6 CA 2006, s 561 gives the shareholders of a company a right to be offered any proposed allotment of 'equity securities' in priority to third parties. However, by CA 2006, s 566 such pre-emption rights do not apply to an offer of equity securities under an employees' share scheme.

Prohibition of financial assistance by a public company in the purchase of own shares (CA 2006, ss 677–683)

4.7 CA 2006, s 678 provides that it is unlawful for a company to give financial assistance directly or indirectly to a person for the acquisition of its shares (where the company is a public company), or shares in any public holding

company. Amongst the exceptions to this is 'the provision by a company, in good faith in the interests of the company, of financial assistance for the purposes of an employees' share scheme' (see CA 2006, s 682(2)(b)). 'Financial assistance' will be tainted if the purpose is to establish an impediment to a possible takeover (*Hogg v Cramphorn [1967] Ch 254*). 'Financial assistance' includes any loan, guarantee or other financial assistance given to 'another person', such as an Employee Benefit Trust (EBT) trustee, for the acquisition of shares. In addition, the giving of financial assistance by a public company is only allowed if the company has net assets which are not thereby reduced or, to the extent that the assets are thereby reduced, if the assistance is provided out of distributable profits. Financial assistance by private companies in the purchase of private company shares is permitted.

Memorandum and articles of association

4.8 It is common for a company's articles of association to incorporate a power enabling the company to establish employees' share schemes. A typical form of words for such a power is as follows:

> 'To establish, maintain, manage, support and contribute to any schemes for the acquisition of shares in the Company or its holding company by or for the benefit of any individuals who are or were at any time in the employment of, or directors or officers of:
>
> (i) the Company; or
>
> (ii) any company which is or was its holding company or is or was a subsidiary of the Company or any such holding company; or
>
> (iii) any other company or former company connected or associated in any way with the Company or with the whole or any part of its undertaking,
>
> and to lend money to any such individuals or to trustees on behalf of such individuals to enable them to acquire shares in the Company or in its holding company and to establish, maintain, manage and support (financially or otherwise) any schemes for sharing profits of the Company or any other such company as aforesaid with any such individuals.'

4.9 However, the absence of any such express power will not be fatal. CA 2006, s 31 provides that where a company's articles association do not restrict the object of the company, then the objects are unrestricted, and so unless there is an express prohibition of employees' share schemes, they will be a permitted object of the company.

Directors' fiduciary duties

4.10 Under company law, there are various provisions intended to ensure that a director acts in the best interests of the company and avoids conflicts

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of interest. CA 2006, s 177 imposes a duty on a director to declare his interest in contracts in which he is interested. In most companies, the articles of association restrict a director voting at meetings of directors on matters in which he is personally interested (see Article 14 of the Model Articles comprised in the Companies (Model Articles) Regulations 2008). In principle, every director is potentially interested in an employees' share scheme and, therefore, voting restrictions usually need to be relaxed where an employees' share scheme is to be considered at a meeting of the directors. For this reason, the resolution to establish an employees' share scheme will often include such a relaxation. Strictly speaking, any such resolution should be passed as a special resolution if it is intended to override the provisions of the articles of association.

Prohibition of the allotment of shares at a discount to the nominal value

4.11 CA 2006, s 580 provides that no shares may be allotted at a discount. In a share option scheme, this will mean that the subscription price of new shares must be fixed at a price which is not less than the nominal value.

4.12 Whilst options may not be granted at a discount to the nominal value, many share option schemes provide for the adjustment of options in the event of certain variations of share capital such as a rights issue. This will normally involve a reduction in the price of the shares under option as well as an increase in the number of shares. The question arises whether any adjustment can be made if the adjusted option price would be less than the nominal value of a share. In order to overcome the prohibition under CA 2006, s 580, where shares are to be subscribed, the difference between the adjusted option price and the nominal value would need to be paid up out of a capitalisation of reserves. The Model Articles (Article 36) only allow for capitalisation issues in favour of 'the persons who would have been entitled 'which does not extend to optionholders and so the company's articles of association may need to be altered to allow a specific power to capitalise reserves in favour of optionholders. An appropriate power is as follows:

> 'Where, pursuant to an employees' share scheme (within the meaning of section 1166 of the Companies Act 2006) the Company has granted options to subscribe for ordinary shares on terms which provide (inter alia) for adjustments to the subscription price payable on the exercise of such options or to the number of shares to be allotted upon such exercise in the event of any increase or reduction in or other reorganisation of the Company's issued share capital and an otherwise appropriate adjustment would result in the subscription price for any share being less than its nominal value, then, subject to the provisions of the articles of association, the Directors may on the exercise of any of the options concerned and payment of the subscription price which would have applied had such adjustment been made, capitalise any profits or reserves (including share premium account and capital redemption reserve) to the extent necessary to pay up the unpaid balance of the nominal value of the

shares which fall to be allotted on the exercise of such options and to apply such amount in paying up such balance and to allot shares fully paid accordingly'.

Disclosure of directors' dealings

4.13 Under rule 3.1.2 of the Disclosure and Transparency Rules (DTRs) published by the Financial Conduct Authority (FCA), a person discharging managerial responsibility of a listed company is under an obligation to notify the company in writing of the occurrence of all transactions conducted on his own (or a connected person's) account or any financial involvements relating to those shares. Such a transaction will include the grant of an option and the receipt of an award under an LTIP. The acquisition or disposal of shares by the trustees of an EBT in which the director is a beneficiary is not a transaction by a connected person provided the EBT is an employees' share scheme within CA 2006, s 1166 and not a personal trust for the benefit of the individual concerned. As soon as possible, and no later than the end of the next business day, the company must notify an approved Regulatory Information Service ('RIS') (a list of which is maintained by the FCA) of the information disclosed pursuant to DTR, r 3.1.2.

4.14 There is no obligation under the Companies Act 2006 on a director to report share dealings to the company. However, a record will need to be maintained by listed companies to satisfy the objectives in **4.13** above.

Disclosure of notifiable interests (DTR 5.1.2)

4.15 The trustees of a SIP or other EBT holding shares in a listed company have a notifiable interest under the provisions of rule 5.1.2 of the Disclosure and Transparency Rules if their holdings of shares exceeds three per cent (or any greater percentage) of the share capital. There is no obligation of disclosure under the Companies Act 2006.

PROSPECTUS RULES

4.16 The Prospectus Rules provide that it is unlawful to offer transferable securities to the public in the UK unless an approved prospectus has been made available. Transferable securities include, for example, securities capable of being dealt in on a regulated stock exchange (even if not actually so dealt with). They will be offered to the public as a result of any communication in any form and by any means presenting sufficient information on the terms of the offer and the securities to enable an investor in any EU country to purchase or subscribe. The Prospectus Rules are derived from the EU Prospectus Directive which is based on the principle that there should be a common form of prospectus throughout the EU so that approval by the 'competent authority' in one EU country will be sufficient for an offer made in another country, subject only to registration of the document with the competent authority in

the other EU country. The 'single passporting' of prospectuses throughout the EU means that companies based in non-EU countries may be faced with the preparation of a full prospectus before making an offer of shares to employees within the UK, although an extension to the employee offer exemption (see below), allows for companies not listed in the EEA to take advantage of the exemption if they are incorporated outside the EU but have securities admitted to trading on a third country market, provided that the European Commission has determined that the relevant market offers equivalent protections to those which exist in relation to EU regulated markets. Currently, the European Commission has not made any such determination, but it is anticipated that exchanges such as the New York Stock Exchange, the Tokyo Stock Exchange and the Australian Stock Exchange will qualify for equivalence.

As far as UK companies are concerned, the UKLA does not treat offers of non-transferable options as within the scope of the Prospectus Rules. In addition, as there is no consideration paid for the receipt of free shares (for example under an LTIP or SIP), these also fall outside of the Prospectus Rules. It is, therefore, probably the case that only offers of partnership shares under a SIP and share purchase offers are caught (although this may not be the case in relation to the interpretation of the Prospectus Directive in other jurisdictions). In addition, there are a number of exceptions from the prospectus requirements which can be helpful to companies wishing to make an offer of shares where the offer is made wholly or mainly to employees. In particular, these include:

(a) the employee offer exemption – securities offered to existing or former directors or employees by their employer (being with a company either having its head office or registered office in the EU, having a listing on an EU market, or otherwise where the extension referred to above applies), provided an information memorandum is made available containing:

   (i) the name of the issuer and where additional information on the issuer can be found, e.g. the website;

   (ii) the reasons for the offer, i.e. to give employees the opportunity to participate in the growth in value of the company;

   (iii) the price of the securities;

   (iv) eligibility conditions;

   (v) minimum and maximum numbers of shares offered;

   (vi) details of any scaling back provisions;

   (vii) whether shares are offered by purchase or subscription;

   (viii) the opening and closing dates of the offer;

   (ix) the method of payment; and

   (x) a summary of rights eg dividend and voting rights.

   The above information will normally be included in the employee guides prepared by most companies so it will normally be fairly easy

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for most companies to satisfy the conditions of the employee exemption offer. Where the employee offers exemption is not available, there is the possibility for issuers without an EU listing to file a 'short-form' prospectus which excludes certain information not considered to be relevant for employee offers. This does not, however, extend to private companies.

(b) Small offers – an offer to 150 or fewer persons is exempt and so is an offer where the total consideration payable is less than €5m.

FINANCIAL SERVICES AND MARKETS ACT 2000

4.17 The Financial Services and Markets Act 2000 (FSMA 2000) regulates investment business and includes provisions relating to employees' share schemes.

Carrying on regulated activities – exemption for employees' share schemes

4.18 A company which establishes an employees' share scheme, and any EBT to be operated in conjunction with the scheme, is likely to be carrying on a 'regulated activity' in the UK. A regulated activity is one of the activities which may be specified in secondary legislation from time to time and carried on as a business activity. By the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (SI 2001/544), these will include:

(a) dealing in investments (which includes dealing in shares as principal or agent);

(b) arranging deals in investments;

(c) managing investments;

(d) safeguarding and administering investments; and

(e) establishing and operating, etc a collective investment scheme.

It is an offence for a person to carry on a regulated activity in the UK, or purport to do so, unless he is either an authorised or exempt person (FSMA 2000, s 19(1)).

4.19 However, article 71 of the Order includes an exemption for group companies or relevant trustees carrying on activities by entering into, as principal, transactions for the purpose of enabling or facilitating transactions in acquiring or holding shares or debentures in connection with employees, or former employees, of that or another group company (or their spouses or dependants). This covers most activities carried on by a company in connection with issuing and allotting shares under employees' share schemes. It also covers most activities carried on by trustees, including the operation of EBTs and SIPs.

Prohibition of financial promotion: exemption for employees' share schemes

4.20 FSMA 2000, s 21 provides that a person must not, in the course of business, 'communicate an invitation or inducement to engage in investment activity' unless he is an authorised person, or the content of the communication is approved by an authorised person (FSMA 2000, s 21). However, this prohibition does not extend to any communication which is made by a person, a member of a group of companies or a relevant trustee for the purpose of an employees' share scheme and relates to shares, debentures, options or certificates in respect of securities (Financial Services and Markets Act 2000 (Financial Promotion) Order 2001 (SI 2001/1335), art 60).

LISTING RULES

4.21 The Listing Rules apply to all companies admitted to the Official List of the Financial Conduct Authority (and so does not apply to AIM companies or companies admitted to the High Growth segment of the London Stock Exchange, each of which are subject to their own rulebooks), although the provisions relating to employees' share schemes and long-term incentive schemes do not apply to overseas companies admitted to listing.

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Terms used in the Listing Rules

4.22 In the Listing Rules, the terms 'deferred bonus' and 'long-term incentive scheme' have the following meanings:

(a) Deferred bonus – any arrangement pursuant to the terms of which the participant(s) may receive an award of any asset (including cash or any security) in respect of service and/or performance in a period not exceeding the length of the relevant financial year notwithstanding that any such asset may, subject only to the participant(s) remaining a director or employee of the group, be receivable by the participant(s) after the end of the period to which the award relates.

(b) Long-term incentive scheme – any arrangement (other than a retirement benefit plan, a deferred bonus or any other arrangement that is an element of an executive director's remuneration package which may involve the receipt of any asset (including cash or any security) by a director or employee of the group:

- which includes one or more conditions in respect of service and/or performance to be satisfied over more than one financial year; and
- pursuant to which the group may incur (other than in relation to the establishment and administration of the arrangement) either cost or liability, whether actual or contingent.

(c) either:

(i) where the company reports half-yearly, the period from the end of the financial period up to, and including, the announcement; or

(ii) where the company reports quarterly, the period of 30 days immediately preceding a quarterly announcement (or from the end of the period to the announcement, if shorter), except in the case of the announcement of annual results.

These restrictions apply to listed companies, regardless of anything to the contrary contained in the scheme, and apply not only to the grant and exercise of options, but also to the surrender of options (as well as other sales and acquisitions of shares).

PROCEDURE

Offer and acceptance/grants under deed

5.40 As for any other legal contract, an option will only be enforceable if consideration is given for its grant or the option is executed as a deed.

5.41 Options may be granted by the company sending out invitations to eligible employees and requiring consideration to be paid for the option grant. Generally speaking, the alternative procedure of granting an option under deed is much simpler. The grant of options under deed saves time and effort since it is not necessary to wait for the optionholder to respond to the invitation by applying for the option, or even requiring him to pay the consideration (which is often a nominal amount of, say, £1). In particular, it does not matter if the proposed optionholder is absent on business or holiday. For these reasons, most companies now grant options under deed involving a pre-printed certificate, countersigned by a director and secretary as may be required by the company's articles of association, although normally the signatures will be pre-printed as well. Options may, alternatively, be granted under a single (global) deed of grant which sets out a list of the options being granted in a schedule. In this case, optionholders need only receive a certificate which does not need to be executed.

5.42 Any payment for the grant of an option will be deducted in calculating any gain for income tax purposes accruing on the exercise of an unapproved option or approved option exercised within three years (ITEPA 2003, s 478).

PRICE

CSOP options

5.43 ITEPA 2003, Sch 4, para 22 provides that the price at which shares may be acquired on the exercise of an approved option must be stated at

the time of grant. The exercise price may be stated in a currency other than sterling and may be expressed as 'X or such higher market value as is agreed with Shares and Assets Valuation at HMRC', which allows options to be granted over unlisted shares without waiting for Shares and Assets Valuation to agree the market value of the shares. The acquisition price of the shares is so fundamental to a legally binding contract that it is difficult to envisage any grant of an option without stating the exercise price.

5.44 Although unusual, a CSOP can be drafted to allow for a variable exercise price during the life of the option. For instance, the exercise price may be increased on each anniversary of the date of grant by an amount representing the increase in the retail prices index over the previous year, or the price may increase from time-to-time to reflect the carrying costs of the option shares during the option period (ie interest costs on a notional loan to purchase the shares less the amount of dividends payable on that number of shares). So long as the exercise price of a CSOP option is determinable at any time, the requirement for the exercise price to be stated at the time of grant would be satisfied.

5.45 CSOP options must be granted at a price which is not manifestly less than the market value of shares of the same class at the time of grant. Options may be granted at a higher price than the market value. CSOP options granted at a discount are subject to income tax (ITEPA 2003, s 526).

5.46 The value of shares which are included in the London Stock Exchange Daily Official List (but not AIM shares) will normally be derived from the quoted prices for the relevant day (or an average over the relevant days). The market value is taken from TCGA 1992, s 272, which currently provides for the lower of:

(a) the quarter-up price (the lower of the two prices shown for the relevant day plus 25 per cent of the difference); or

(b) the mean bargain price (halfway between the highest and lowest prices) recorded on the relevant day (unless there have been any special circumstances).

At the time of writing, a draft regulation (The Market Value of Shares, Securities and Strips Regulations 2014) has been published for consultation which would result in a simplified calculation – see **4.81** above.

5.47 Non-quoted shares are valued at the price which such shares might reasonably be expected to fetch on a sale in the open market (ITEPA 2003, Sch 4, para 36(1) and TCGA 1992, s 272(1)). Although the market value of shares quoted on overseas stock exchanges currently needs to be agreed with Shares and Assets Valuation, the prices on the New York Stock Exchange or the American Stock Exchange (but not NASDAQ) as derived from the Wall Street Journal will normally be accepted as market value. This requirement will likely change as a result of the proposed regulation referred to at **4.82** and **4.83** above.

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5.48 Problems often arise in valuing shares for the purposes of the statutory tax advantaged schemes where the company proposes to float. Any grant of a CSOP option taking effect on or after the date on which shares are floated should be based on market prices derived from the Daily Official List (see **5.47** above), which will not necessarily be the flotation price. Where options are granted on the day of flotation the issue arises in that there will be no readily available market value determined by this methodology. Where options are granted not later than the day of any offer for sale, then Shares and Assets Valuation may be prepared to treat the offer for sale price as the market value, provided there is a fixed price and the grant takes effect unconditionally no later than the day of the flotation. If HMRC are consulted in advance and will not accept the offer for sale price as market value on the day of flotation, for example because of significant 'grey market' trading, then the grant of options may need to occur in advance of flotation. It is often the case that the shareholders of a company proposing a flotation do not wish to see unconditional grants of options prior to flotation and, in such cases, the scheme rules may provide for the lapse of options if the proposed flotation does not take place within a specified number of days after grant.

5.49 Where the scheme provides for an invitation of applications, HMRC will normally not permit the exercise price to be ascertained by reference to the market value of the shares on a day earlier than 30 days prior to the date of grant. Where options are granted under deed, unilaterally, by the company, HMRC will not normally agree to value the shares by reference to the market value over more than five dealing days prior to the grant. Similarly, where applications for the grant of options are invited, HMRC will not normally agree to value the shares by reference to the average market value over more than five dealing days before the date of invitation. Any such five-day period must, in any event, fall within the 30-day period.

5.50 CSOP options must be granted at a price which is not 'manifestly' less than the market value of the shares at the material time. 'Manifestly' is strictly interpreted by HMRC and so, where fractions of a share are involved, the fractional amount should be rounded up. HMRC emphasise that if an exercise price is not determined exactly in accordance with the rules of the approved scheme, the option will not qualify for income tax relief. HMRC specifically seeks information, through the annual return, of the basis on which the market value of the shares was determined, including, in the case of unquoted shares and, currently, shares quoted on any overseas recognised stock exchange, the date Shares and Assets Valuation agreed to the market value.

5.51 By virtue of ITEPA 2003, s 526, any undervalue on the grant of approved options is taxable as income of the tax year in which the option is granted. Any amount charged to income tax under ITEPA 2003, s 526 is deducted in calculating the income tax charge which may arise on the exercise of the option and is taken into account for capital gains tax purposes in determining the cost of the shares on any subsequent disposal. It appears that if a CSOP option is granted at less than the market value of the shares, then the option will inevitably have been granted otherwise than in accordance with

the CSOP legislative requirements (and any gains on exercise will, therefore, be subject to income tax).

Unapproved options

5.52 In unapproved share option schemes, the grant of an option at less than the market value will not be chargeable to income tax (ITEPA 2003, s 475(1)).

5.53 Prior to 15 April 2003, an unapproved option was only relieved from income tax in respect of gains arising on grant if it was capable of exercise for no more than ten years from grant. Most schemes continue to limit the lifespan of an option to ten years as a result of ABI Guidelines (ABI Guidelines, paragraph 2.viii).

Board resolution to grant options

5.54 Under most schemes, the authority to grant options is given to the board of directors or, more specifically in listed companies, the Remuneration Committee. An appropriate form of board resolution for the grant of share options is as follows:

'Directors' resolution

IT WAS RESOLVED THAT [CSOP]/[Part B (unapproved)] options be hereby granted under the [ ] Share Option Scheme to the following employees:

Name and address of optionholders	*Number of shares*	*Exercise price*	*Terms or performance targets*
[Details]	[Details]	[Details]	[Details]

The Secretary be hereby instructed to prepare and issue the option certificates and to make all necessary regulatory notifications accordingly.'

5.55 Boards of directors and Remuneration Committees often agree the options to be granted in advance of the actual date of grant. In such cases, the exercise price cannot be ascertained at the time the directors, or the Remuneration Committee, meets, but there is no reason why options cannot be determined in advance based on an aggregate acquisition price. An appropriate form of board resolution is as follows:

'Directors' resolution

IT WAS RESOLVED THAT with effect from [date], [CSOP]/[Part B (unapproved)] options be hereby granted at a price equal to the [market value]/[mid-market closing price] on [specified date of grant] under the [ ] Share Option Scheme to the following employees:

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Name and address of optionholders	*Number of shares*	*Exercise price*	*Terms or performance targets*
[Details]	[Details]	[Details]	[Details]

PROVIDED THAT the number of shares above shall be limited, where appropriate, to such lesser number of shares as shall not exceed any limit on the number of shares available to that individual under the Scheme rules.'

Option certificate

5.56 ITEPA 2003, Sch 4, para 21A requires optionholders to receive certain specified information on grant (as denoted by * in **5.57** below), which will usually form part of an option certificate or statement to be given to optionholders.

5.57 Any form of option certificate should contain the following:

- the identity of the optionholder;
- the name of the company;
- the name of the scheme;
- the maximum number of shares under option*;
- the exercise price (per share)*;
- a description of the shares which may be acquired*;
- details of any restrictions which apply to the shares to be acquired*;
- the period during which the option may be exercised*;
- the circumstances in which the option may lapse*;
- a statement that the option is not transferable, and that the option rights will lapse upon the occasion of any assignment, charge, disposal or other dealing with the rights conveyed by it or in any other circumstances; and
- any performance targets or special conditions of exercise (if these were not included in any invitation)*.

HMRC accepts that the option certificate need not set out in detail all of the above information but may cross-refer to the provisions of the scheme rules.

5.58 HMRC's Model Scheme, which is included on the HMRC website, includes provisions for options to be granted under deed or as a result of an invitation of applications and payment of nominal consideration for the grant of the option. Most schemes now provide for the grant of options solely under deed.

5.59 The manner in which a company may execute a document must be ascertained from the articles of association.

5.60 A recommended form of option certificate for options granted under seal is as follows.

[Certificate No]

'SHARE OPTION CERTIFICATE

[ ] plc/Limited

SHARE OPTION SCHEME

Date of grant	Normal first exercise date	Exercise price per share	Number of shares
[Details]	[Details]	[Details]	[Details]

This is to certify that: .... of ....has been granted an Option to acquire the number of ordinary shares of [ ]p each fully paid in the Company at the exercise price shown above under the Rules of the [.................................] Share Option Scheme.

The option may not be exercised later than the tenth anniversary of the date of grant.

Executed as a deed)
by [a person] on behalf)
of [a company])
in the presence of:)

[Director]

[Secretary]

NOTES:

(1) The Option is not transferable, and will lapse upon any assignment, charge, disposal or other dealing.

(2) The option may be exercised and may lapse in other circumstances as set out in the scheme rules.

(3) A copy of the Scheme rules is available for inspection upon request to [ ].

THIS CERTIFICATE IS IMPORTANT AND SHOULD BE KEPT IN A SAFE PLACE'

5.61 Many schemes allow the company to issue a balance certificate where an option is exercised in part; the option certificate may be called in for endorsement or cancellation and replacement in appropriate circumstances, for example, where the number and price of option shares has been adjusted following any variation of share capital (see Chapter 14).

Disclaimer of options

5.62 Many public company schemes provide for an optionholder, who so wishes, to disclaim an option granted to him within a specified period following

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new grant may be made within three years of the date of the last grant as a qualifying option (ITEPA 2003, Sch 5, para 6). It is possible, however, for a new EMI grant to be made within three years of the last EMI grant, provided that the previous grants were over shares with a value of £249,999 or less. EMI options, therefore qualify for relief if, at the time of grant, there has been no previous qualifying option granted in excess of the £250,000 limit in the previous three years.

6.8 In determining the £250,000 limit, unexercised CSOP options are treated as unexercised EMI options. This means that if the maximum £30,000 CSOP options are subsisting, only up to £220,000 worth of EMI options may be granted.

No limits on the number of participants

6.9 There is no limit on the number of employees who may hold qualifying options in respect of shares in the relevant company but there is an overall limit of £3m worth of subsisting EMI options (ITEPA 2003, Sch 5, para 7).

Qualifying companies

6.10 Part 3 of ITEPA 2003, Sch 5 lays down restrictions on the types of company which may grant EMI options and these restrictions mark out EMI options relief as more 'targeted' than CSOP options.

Independence test

6.11 ITEPA 2003, Sch 5, para 9 provides that companies must not be:

(a) a 51 per cent subsidiary of another company (ie a company in which another holds 51 per cent of the shares);

(b) under the control (within ITA 2007, s 995) of another company; or

(c) under the control of another company and any other person connected with it (without being a 51 per cent subsidiary).

There must also be no arrangements in existence by virtue of which the company could become a 51 per cent subsidiary or come under the control of another company (other than as a result of a 'qualifying exchange of shares' within ITEPA 2003, Sch 5 – see **6.46** below). Where an investment has been made by one or more venture capital investors and others then a shareholder agreement will usually be entered into in order to lay down how the business will be run. Technically, any such agreement might amount to the company being under the control of another company and any connected persons. It is understood that HMRC do not intend to apply this test aggressively, but care will always need to be taken when there is any form of shareholders' agreement in existence.

Qualifying subsidiaries test

6.12 Where a company ('the parent') has subsidiaries, all those subsidiaries must be 'qualifying subsidiaries': ITEPA 2003, Sch 5, para 10. A subsidiary is a company which is under the control within the meaning of CTA 2010, ss 450 and 451 of another company (and any connected persons).

6.13 A company is a 'qualifying subsidiary' of another company ('the parent') if all the following conditions are met:

(a) that the subsidiary is a 51 per cent subsidiary of its holding company;

(b) no person (other than the parent or its subsidiaries) has control of the company; and

(c) there are no arrangements in existence as a result of which any of the above conditions would cease.

There are provisions which make it clear that the above conditions will not be treated as having ceased to apply where either a winding up or disposal of a subsidiary (whereby it will cease to be a qualifying subsidiary) is carried out for bona fide commercial reasons, ie not for the purposes of tax avoidance (ITEPA 2003, Sch 5, para 11(4)–(7)), or where anything is done as a consequence of the company being in administration or receivership (ITEPA 2003, Sch 5, para 11(8)–(10)).

A subsidiary which is a property managing subsidiary, ie one whose business consists wholly or mainly in the holding of managing of land, buildings or interest in land, will not, however, be a qualifying subsidiary if the parent does not satisfy various 90 per cent tests – it must hold at least 90 per cent of the issued share capital, 90 per cent of the votes, 90 per cent of the assets available for distribution on a winding up and 90 per cent of the profits available for distribution (ITEPA 2003, Sch 5, para 11A(1)).

Gross assets and employees tests

6.14 ITEPA 2003, Sch 5, para 12 provides for a gross assets test in respect of the company (or group of companies) granting EMI options. The limit is gross assets of £30m. Where there is more than one member of the group of companies, the £30m test applies to the consolidated value of the group, disregarding any interests in other group companies. ITEPA 2003, Sch 5, para 12A was introduced in 2008 to limit the availability of EMI options to companies and groups with less than 250 full-time equivalent employees: in calculating the number of full-time equivalent employees, part-time employees are counted on a pro rated basis, but employees on maternity/paternity leave and students on vocational training are excluded. HMRC regard a full-time employee as someone whose standard working week (excluding lunch breaks and overtime) is at least 35 hours, although any employee who works in excess of 35 hours would still only count as one full-time employee. The purpose of these two tests is to limit EMI options to small companies.

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UK permanent establishment and trading activities tests

6.15 ITEPA 2003, Sch 5, para 14A provides that, in relation to a single company, that in order to be able to grant EMI options the company must have a permanent establishment in the UK. For a group, this requirement is met is any other member of the group has a permanent establishment in the UK. In either case, the trading activities test must be met by the company with the permanent establishment in the UK.

ITEPA 2003, Sch 5, paras 13 and 14 set out alternative tests on trading activities depending on whether a single company or a parent company of a group is involved.

6.16 In the case of a single company, the company must exist wholly for the purpose of carrying on one or more qualifying trades (see **6.18** below) and is so carrying on such a trade, or preparing to do so, ignoring any incidental activities (e.g. holding property for one or more qualifying trades carried on by it).

6.17 In the case of a group of companies, at least one group member must satisfy the tests in **6.16** above. In addition, disregarding any incidental activities, the business of the group taken as a whole must not consist wholly, or as to a substantial part, in the carrying on of non-qualifying activities, other than incidental activities, e.g. the holding of shares in a subsidiary, making loans to another group company, or holding property used in qualifying trades carried on by a group company (see **6.19** below). Non-qualifying activities means all excluded activities or activities carried on otherwise than in the course of a trade. HMRC generally consider that activities amounting to more than 20 per cent of the trade form a substantial part of the whole.

6.18 By virtue of ITEPA 2003, Sch 5, para 15(1), a trade is a qualifying trade if it:

(a) is conducted on a commercial basis with a view to the realisation of profits; and

(b) does not consist wholly or mainly (or as to a substantial part) in the carrying on of excluded activities (see **6.19** below).

Research and development by the company (or a company in the group) prior to commencement of a qualifying trade, which it is intended to carry on, is treated as carrying on the qualifying trade. However, preparation for carrying on such research and development is not the carrying on of a qualifying trade.

6.19 A number of activities are treated as excluded activities so that companies carrying them out cannot grant qualifying options. These activities are:

(a) Dealing in land, in commodities and futures or in shares, securities or other financial instruments.

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(b) Dealing in goods otherwise than in the course of an ordinary trade of wholesale or retail distribution.

'Wholesale distribution' means a trade where goods are offered for sale or for resale (or processing and resale) to members of the public for their use and consumption. 'Retail distribution' means a trade where goods are offered for sale to members of the general public for their use and consumption (ITEPA 2003, Sch 5, para 17).

A trade is not 'an ordinary trade of wholesale or retail distribution' if it consists, to a substantial extent, in dealing in goods of a kind which are collected or held as an investment (or a mix of that and some other excluded activity), or if goods are held for a significantly longer period than would reasonably be expected.

It is an indication of the carrying on of 'an ordinary trade of wholesale or retail distribution' if the goods are bought in quantities larger than they are sold, or if the goods are bought and sold by the dealer in different markets, or if the person employs staff and incurs expenses in the trade in addition to the cost of the goods and (in the case of a trade carried on by a company) any remuneration paid to any person connected with it. It is an indication that the activities are not 'an ordinary trade of wholesale or retail distribution' if there are purchases of sales from and to a person who are connected with the trader, or if the purchases are matched with forward sales or vice versa, or if the goods are held by that person for longer than is normal for goods of the kind in question, or if the trade is carried on otherwise than at a place or places commonly used for wholesale or retail trade, or if the person does not take physical possession of the goods.

(c) Banking, insurance, moneylending, debt-factoring, hire purchase financing or other financial activities.

(d) Leasing (including letting ships on charter or other assets on hire).

Letting of ships – ITEPA 2003, Sch 5, para 18 provides supplementary information on the letting of ships (but does not apply to offshore installations or pleasure craft). A trade shall not be excluded from being a qualifying trade by reason only of its consisting in letting ships on charter if the following requirements are met:

- every ship let on charter is beneficially owned by the company;
- every ship beneficially owned by the company is registered in the UK;
- the company is solely responsible for arranging the marketing of the services of its ships; and
- the following conditions are satisfied:
  - the letting is for a period not exceeding 12 months and there is no provision for extending it (other than at the option of the charterer);

- during the letting there is no provision for a new letting (other than at the option of the charterer) which will end more than 12 months after the provision is made;
- the letting is by way of a bargain made at arm's length between the company and a person who is not connected with it;
- under the charter, the company is responsible as principal for managing the ship and defraying expenses in connection with the ship (other than those of a particular voyage); and
- no arrangements exist for someone to be appointed as manager of the ship.

(e) Receiving royalties or licence fees.

Receipt of royalties and licence fees – ITEPA 2003, Sch 5, para 19 provides supplementary information on royalties and licence fees. A trade shall not be excluded from being a qualifying trade by reason only that it consists to a substantial extent in the receiving of royalties or licence fees if the royalties and licence fees (or substantially all) are attributable to the exploitation of intangible assets (in accordance with normal accountancy practice), the whole or greater part of the value of which has been created by the company or a qualifying subsidiary, including most forms of intellectual property which have been created by the company (alone or with others).

(f) Providing legal or accountancy services.

(g) Property development.

ITEPA 2003, Sch 5, para 20 provides supplementary information in relation to property development which is defined as the development of land by a company which has (or at any time has had) an interest in land, with the sole or main object of realising a gain from the disposal of an interest in the land when it is developed. Interests in land include any estate, interest or right including options over such estate, interest or right but do not include the interests of creditors or mortgages.

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(h) Farming or market gardening.

(i) Holding, managing or occupying woodlands, any other forestry activities or timber production.

(j) Operating or managing hotels or comparable establishments, or managing property used as a hotel or comparable establishment.

ITEPA 2003, Sch 5, para 21 provides supplementary information on hotels and comparable establishments which is defined as a guest house, hostel or other establishment the main purpose of maintaining which is the provision of facilities for overnight accommodation (with or without catering services). The activities will only be excluded if the person has an estate or interest, or is in occupation of, the hotel or comparable establishment in question.

(k) Operating or managing nursing homes or residential care homes, or managing property used as a nursing home or residential care home.

ITEPA 2003, Sch 5, para 22 provides supplementary information on nursing homes and residential care homes. Nursing homes are defined as establishments which exist wholly or mainly for the provision of nursing care for persons suffering from sickness, injury or infirmity or for women in maternity wards. Residential care homes are defined as establishments that exist wholly or mainly for the provision of residential accommodation (with board and personal care) for persons in need of personal care by reason of old age, mental or physical disability, alcoholic or drug dependence, any past illness, past or present mental disorder. Any such activities are excluded activities if the company has an estate or interest in, or is in occupation of, the nursing home or residential care home in question.

(l) Providing services or facilities for another person carrying on an excluded activity.

ITEPA 2003, Sch 5, para 23 provides that the provision of services or facilities for a business carried on by another person is excluded if it consists, to a substantial extent, of excluded activities and a controlling interest in the business is held by a person who also has a controlling interest in the business carried on by the company providing the services or facilities. Control of the business is extended in the case of a close company to cases where the person and his associates (being a director of the company) beneficially own 30 per cent of the ordinary share capital or are able directly or indirectly to control more than 30 per cent of that share capital or not less than one half of the business could, for the purposes of CTA 2010, s 942, be regarded as belonging to them for the purposes of CTA 2010, s 941 (company reconstructions without a change of control).

(m) Shipbuilding (for options granted from 21 July 2008).

The definition of shipbuilding is set out in ITEPA 2003, Sch 5, para 20A by reference to European legislation on state aid.

(n) Producing coal (for options granted from 21 July 2008).

ITEPA 2003, Sch 5, para 20B provides that coal is defined in accordance with European legislation on state aid, and includes the extraction of coal.

(o) Producing steel (for options granted from 21 July 2008).

ITEPA 2003, Sch 5, para 20C provides that the definition of steel includes any of the steel products listed in Annex 1 to the European guidelines on national regional aid (OJ [2006] C54/08) published in the Official Journal on 4 March 2006.

It is possible to seek comfort from HMRC before options are granted as to whether it considers that a company will qualify for the grant of EMI options by writing to the Small Company Enterprise Centre (SCEC) at:

Local Compliance
Small Company Enterprise Centre Admin Team
S0777
PO Box 3900
Glasgow
G70 6AA

The SCEC will only give its view on the qualifying requirements, and not in relation to other aspects of an EMI option, such as whether an individual is an eligible employee.

Eligible employees

6.20 Part 4 of ITEPA 2003, Sch 5 lays down three eligibility tests relating to individuals which must be satisfied. These three eligibility tests are a requirement that the individual is employed with the relevant company, a requirement in relation to his commitment of working time and a requirement that he has no material interest.

The requirement of employment with the relevant company

6.21 ITEPA 2003, Sch 5, para 25 provides that an individual will only be eligible if he is an employee of the company whose shares are the subject of the option or of a qualifying subsidiary (see **6.13** above) of that company.

Commitment of working time test

6.22 ITEPA 2003, Sch 5, para 26 provides that an employee will only be eligible if they satisfy one of the two tests in respect of the time they are required to spend on their duties ('committed time'). These alternative tests are that their committed time amounts to:

(a) at least 25 hours a week; or

(b) if less, 75 per cent of their working time (all gainful work including self-employment).

Committed or working time includes any time which the employee would have been required to spend on their duties in relevant employment (ITEPA 2003, Sch 5, para 26(2)–(4)) but for injury, disability, pregnancy, childbirth, maternity or paternity leave or parental leave, reasonable holiday entitlement or any garden leave. Relevant employment means employment with the relevant company or (if the relevant company is a parent company) employment with any group company.

The 'no material interest' requirement

6.23 ITEPA 2003, Sch 5, para 28 excludes participation by individuals who have a material interest (see **6.24** below) in the company (or any 51

per cent subsidiary). An individual has a material interest if they (with or without their associates) or any associate (with or without their associates) has a material interest. An associate means, in relation to an individual, their relatives (lineal predecessors or descendants) or partner, trustees of any settlement set up by them (or any relative of theirs) and the trustees of any settlement (except certain employee benefit trusts) under which they are excluded as a beneficiary or the personal representatives of any estate (in either case, where the individual is a beneficiary) which is interested in shares of the company (ITEPA 2003, Sch 5, paras 31–33).

6.24 By virtue of ITEPA 2003, Sch 5, para 29, a material interest in a company means:

(a) beneficial ownership of (or the ability to control) directly or indirectly, more than 30 per cent of the ordinary share capital;

(b) (where the company is a close company) the possession of, or entitlement to acquire such rights as would, upon the winding up of the company or in other circumstances, give a right to 30 per cent of the assets available for distribution. A close company includes a company that would be a close company, but for its non-UK residence under CTA 2010, s 442(a) or its exclusion under CTA 2010, ss 446 and 447 (exclusion of certain quoted companies). For these purposes, a person has the ability to control shares if he has a right to subscribe for them (ie the shares are unissued).

6.25 In determining whether any person has a material interest, shares under EMI options and unappropriated shares held under a SIP are disregarded. Thus the 30 per cent test will be applied to a smaller number of shares.

Terms of options

6.26 Part 5 of ITEPA 2003, Sch 5 lays down requirements as to the terms of the options which must be satisfied. These terms relate to the types of shares that may be acquired when the option is capable of being exercised, the terms to be agreed in writing and the non-assignability of the option.

Type of shares that may be acquired

6.27 By virtue of ITEPA 2003, Sch 5, para 35 options must be over shares which:

(a) form part of the ordinary share capital of the relevant company (see **6.21** above);

(b) are fully paid up; and

(c) are not redeemable.

Option capable of exercise within ten years

6.28 An option must be capable of being exercised within 10 years of the date of grant (ITEPA 2003, Sch 5, para 36). This does not mean that an EMI

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MISCELLANEOUS

Company reconstructions and rights issues

8.93 ITEPA 2003, Sch 2, paras 87 and 88 contain provisions which allow a new holding of shares received on a company reconstruction (e.g. a share exchange on a takeover, or upon a scheme of arrangement, or a bonus or rights issue) to be treated as if it were the original holding and therefore provides relief from income tax and capital gains tax on any gains arising on the disposal of the original holding involved in the transaction. The relief is available where the new holding is equated with the original holding for capital gains tax purposes, including a transaction where the new holding consists of, or includes, a qualifying corporate bond (within the meaning given by TCGA 1992, s 117). However, the relief is not available where the new holding consists of redeemable shares, a bonus issue which follows an earlier repayment of share capital, or a stock dividend taxable as income under ICTA 1988, s 249.

8.94 Where in respect of plan shares the trustees subscribe for new shares on the same terms as all other shareholders under a rights issue then the rights shares taken up will be treated as part of a new holding under a company reconstruction (see **8.93** above) for capital gains tax purposes unless funds are provided to exercise the rights otherwise than under the tail-swallowing powers of the trustees under ITEPA 2003, Sch 2, para 77. In addition, if any rights are offered specifically to participants in the plan (or on special terms), the shares acquired will be outside the relief for company reconstructions and will be treated as a part disposal for capital gains tax purposes.

Relief from stamp duty

8.95 Where partnership or dividend shares are transferred by the trustees of a SIP to a participant, no stamp duty or stamp duty reserve tax is due on the stock transfer or in relation to the agreement to transfer (FA 2001, s 95). Stamp duty issues are not in point on the acquisition of shares for nil consideration, as with free and matching shares.

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HMRC's power to require information

8.96 ITEPA 2003, Sch 2, para 93 enables HMRC to obtain such information as it may from time to time require for the performance of its functions from any person who may have the information (or can reasonably be expected to provide it). In particular, HMRC can obtain information to enable it:

(a) to check anything contained in a notification of the SIP or any annual return; or

(b) to determine the liability to tax (including capital gains tax) of any participant in the plan or any other person who may have such a liability in connection with the SIP.

It can also seek information about the administration of the plan and any proposed alteration. HMRC must give at least three months' notice of any information sought and there are penalties for non-compliance.

Plan returns

8.97 ITEPA 2003, Sch 2, para 81B provides that the company operating the SIP must file an annual return with HMRC by 6 July immediately following the end of the relevant tax year. This return must be in such form, and contain such information, as HMRC shall require and, under ITEPA 2003, Sch 2, para 81D must be filed electronically through the HMR online system. This return should also indicate whether, during the relevant tax year, any alterations to a 'key feature' of the plan have been made. Penalties may apply in the case of a late or missed filing.

8.98 If at any time HMRC has reason to believe that the requirements of ITEPA 2003, Sch 2 are not, or have not been, met, HMRC may open an enquiry into the SIP. Where, following such enquiry, HMRC consider that the legislative requirements have not been met, HMRC may require amendments to be made to the SIP terms, or may issue a closure notice specifying that the SIP shall not maintain tax-advantaged status from the date of the notice, or such earlier date as HMRC may specify. Such a determination will not affect the tax advantages enjoyed by participants, but may result in a penalty being imposed on the company operating the SIP calculated by reference to the tax savings being made by participants (see **4.55** above).

8.99 The company may appeal to the Tax Tribunal within 30 days against a decision of HMRC to:

(a) impose penalties on the company;

(b) withdraw corporation tax relief (see **9.21–9.23** and **10.19**); or

(c) require amendments to a SIP.

Termination of plan

8.100 The plan may provide for the company by notice to terminate a plan early (ITEPA 2003, Sch 2, para 89(1)). The company may include in the plan such circumstances of early termination as it may determine. These may relate to the expiry of a specified period, a change of control of the company or at the exercise of a discretion on the part of the directors. Any plan termination notice must be served on the following without delay:

(a) the trustees; and

(b) all participants (including any individual who has entered into a partnership share agreement even though he may not yet have any shares).

8.101 The effect of service of a plan termination notice is that no further awards of shares can be made and the trustees must remove the shares from the plan as soon as practicable after the later of:

(a) three months from service of notice; and

(b) the first date on which shares may be removed from the plan without any income tax charge on the participants (which may, of course, be up to five years).

However, the shares may be removed with the consent of the participant at an earlier date. Partnership share money and any cash dividends which have not been reinvested must also be paid over to the participants.

HMRC does not object to the SIP trust deed providing for, or being amended to provide for, the distribution of surplus assets during the period between the service of a plan termination notice and the plan shares being removed from the trust.

Corporation tax deduction for the costs of setting up the plan

8.102 The costs of setting up a SIP are deductible for corporation tax purposes provided the scheme is not operated before approval (CTA 2009, s 987, previously ICTA 1988, Sch 4AA, para 7). In addition, the trustees' running expenses (including interest costs) in operating the plan are deductible for corporation tax purposes (CTA 2009, s 988, previously ICTA 1988, Sch 4AA, para 8).

OPERATING THE PLAN

8.103 There is nothing in the legislation which requires invitations to be issued at any particular time, although where the company operates the plan on a rolling monthly basis, new employees must be invited as soon as they satisfy any eligibility criteria. Listed companies offering free shares, or partnership shares on an annual basis, will generally follow the ABI Guidelines and provide for a participation 'window' following the announcement of results (see **3.28** above).

Model Code under the Listing Rules

8.104 The UKLA Model Code for Dealings in securities of listed companies generally restricts the acquisition of shares by persons discharging managerial responsibilities (PDMRs) during the period of 60 days prior to the preliminary announcement of annual results by a listed company, or during the shorter specified period in relation to the announcement of other periodic results. These restrictions do not apply, however, where shares are awarded or acquired under a SIP which is offered on similar terms to all or most employees of the participating companies (paragraph 2(i)).

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Chapter 9

SIPs – Free Shares

INTRODUCTION

9.1 A Share Incentive Plan (SIP) can provide for the award of free shares. Income Tax (Earnings and Pensions) Act 2003 (ITEPA 2003), Sch 2 provides tax reliefs for the participant (see **9.14–9.20** below) and tax deductions for the company (see **9.21** and **9.22** below).

MAXIMUM ANNUAL AWARD

9.2 The maximum value of shares which can be awarded as free shares under a SIP each tax year is £3,600 (ITEPA 2003, Sch 2, para 35), increased from £3,000 from 6 April 2014. This is based on the market value of the shares on the date they are awarded. For this purpose, any restrictions (including forfeiture provisions) are disregarded in valuing the shares.

The market value of shares quoted on a recognised stock exchange will depend on whether those shares are acquired on the market, in which case HMRC will allow the market value to be determined by reference to the average acquisition costs of the shares over the period of up to five consecutive dealing days ending on the date of the award, or whether the shares are new issue (or already held in the trust), in which case HMRC will allow the market value to be determined by reference to the quoted price on the date of the award or on the previous dealing date, or as the average quoted prices over a period specified in the rules of up to five days immediately preceding the award. The market value of unquoted shares must be agreed with Shares and Assets Valuation at HMRC who have issued a form of application (Form VAL 230) for valuations which may be used by the employer company.

PERFORMANCE ALLOWANCES

9.3 It is possible for the plan to provide for free shares to be allocated on the basis of performance allowances (conditions). Performance allowances may determine whether or not free shares will be awarded to an individual and the number or value of the free shares to be awarded. It should be noted that this flexibility relates only to pre-allocation targets: the performance allowances cannot be imposed as conditions for the release of shares

(i.e. once the trustee is holding shares for an employee those shares cannot be forfeited based on performance). This means that performance allowances will normally relate to one financial year and the awards will be made in the next financial year, thus effectively extending the plan term by the length of the performance period, as notifications of potential allocations will be sent to employees 12 months in advance of the allocation date). It remains open to companies, however, to operate group-wide targets which must be satisfied in order that the plan is operated in any year. In such cases the requirements in relation to performance allowances will not apply as employees need not be informed of the conditions for operating the plan in advance of the allocations being made.

9.4 ITEPA 2003, Sch 2, para 38 provides that if performance allowances are imposed in relation to an award, they must apply to all qualifying employees.

Performance allowances – measures and targets

9.5 ITEPA 2003, Sch 2, para 39 provides that any performance allowances used must:

(a) be based on business results and other objective criteria; and

(b) be fair and objective measures of the performance of the units to which they apply.

There is, therefore, no scope for the exercise of discretion in determining whether performance allowances are satisfied.

9.6 Performance allowances must be set by reference to performance units comprising one or more employees. In that case it will be easy to identify a performance unit – a group of companies, a company, a division or any business unit (even a single person) – provided objective (though not necessarily audited) information is available about the performance of that business unit. It is the policy of HMRC to rely largely on companies determining whether the business unit identified by the company satisfies the requirements and only intends to challenge unreasonable cases. However, an employee must not be a member of more than one business unit.

9.7 ITEPA 2003, Sch 2, para 40 requires each qualifying employee who has accepted an invitation to participate in an award of free shares to be notified of the performance measures and targets which will be used to determine the number and value of free shares to be awarded to him. In addition, a general description of the performance measures applying to employees generally must be given to all qualifying employees. It is necessary to give this information as soon as practicable. This does not necessarily mean the information must be provided before the start of the financial period to which the target applies; in many cases companies will only determine the performance target well after the financial year has started and it is only necessary in these cases to give the information as soon as reasonably practicable thereafter. The company is

entitled to exclude from the notice information which the company reasonably considers commercially confidential (ITEPA 2003, Sch 2, para 40(3)).

Performance allowances – Methods 1 and 2

9.8 There are two methods of setting performance allowances. In practice, Method 2 gives greater flexibility and will usually be satisfied (even if Method 1 is also coincidentally satisfied).

Method 1

9.9 Under Method 1:

(a) at least 20 per cent of the total number of shares to be awarded to employees must be awarded without reference to performance but on the 'same' terms. The shares awarded on non-performance terms under the award will be on the 'same' terms as required by ITEPA 2003, Sch 2, para 9 (see **8.40** and **8.41** above);

(b) the remaining shares must be awarded by reference to performance; and

(c) no individual may receive more than four times as many performance shares as any individual gets non-performance shares (some, of course, may not receive any performance shares). If more than one class of share is awarded, the performance allowance rules apply to each class of share separately. In practice, it would be unusual to award more than one class of share at a time (ITEPA 2003, Sch 2, para 41).

Method 2

9.10 Under Method 2:

(a) some or all of the shares must be awarded by reference to performance; and

(b) the awarding of shares to qualifying employees who are members of the same employment unit must be on the same terms (ITEPA 2003, Sch 2, para 42).

Many plans will satisfy both Method 1 and Method 2 but there are differences which may be important:

(a) either method allows for an element of non-performance shares – in the case of Method 1 there must be a minimum of 20 per cent of the shares covered by the award but in the case of Method 2 the company has a discretion to award any proportion of non-performance shares (but not 100 per cent);

(b) under Method 1, no individual may receive more than four times the number of performance shares than non-performance shares, but no such ratio applies under Method 2; and

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(c) under Method 2, which provides for allocations to different employment units, awards of performance shares must be on the same terms (equally or pro rata salary, length of service or hours worked) as between members of the same employment unit (but not as between members of different employment units).

THE HOLDING PERIOD FOR FREE (AND MATCHING) SHARES

9.11 ITEPA 2003, Sch 2, para 36 provides that the company may set a holding period for each award of free (and matching) shares, ie it does not need to be permanently fixed under the plan rules but will be contained in the free shares agreement (see **9.12** below). The period may be between three and five years and must apply to all participants in the same award. The company may from time to time vary the length of the holding period for future awards but only within these parameters. As it has been possible, as a result of changes made by FA 2013, for SIP shares to be subject to restrictions, it would be possible for the company to impose an additional 'no sale' period once the shares cease to be subject to the SIP, which would effectively replicate, or extend, any holding period imposed. This could be used, for example, in place of a holding period where participants leave employment and the SIP holding period comes to an end early (see **9.13** below), although where tax charges arise on shares leaving the SIP, a sale of shares to cover tax may need to be permitted.

9.12 During the holding period, the participant must permit his shares to remain in the hands of the trustees and must not assign, charge or otherwise dispose of the beneficial interest in the shares. The plan must provide for the participant to be bound in contract with the company. A form of undertaking (the free shares agreement) must be entered into before any award of free shares is made to a participant. HMRC accept that, in relation to awards of free shares, companies may, rather than asking employees to enter into 'Free Share Agreements', operate an opt-out process whereby employees receive invitations to participate in a free share award and will be deemed to have accepted the award unless they opt out within a period specified in the invitation. Whilst HMRC require only a 14-day period to be open to employees for the acceptance of invitations, if the opt out method is used a period of not less than 25 days is required.

9.13 The holding period will terminate early if the participant ceases to have relevant employment (see **8.47–8.52** above). The obligation on the participant to leave his shares with the trustees is subject to the power of the trustees:

(a) to act on directions from the participant in respect of general offers affecting the shares;

(b) to sell shares to meet its PAYE obligations under ITEPA 2003, Sch 2, para 79; and

(c) to remove shares with the consent of the participant on early termination of the plan.

The trustee may act on directions from the participant under (a) above in respect of:

(a) a share for share takeover or offer of non-qualifying corporate bonds on a takeover;

(b) an offer of qualifying corporate bonds (with or without other assets or cash) on a takeover;

(c) a cash offer (with or without other assets) on a takeover; and

(d) a company reorganisation.

INCOME TAX CHARGE ON FREE (AND MATCHING) SHARES

Ceasing to be subject to the plan

9.14 ITEPA 2003, s 505 provides that when free (and matching) shares cease to be subject to the plan, income tax may be chargeable depending on the period that has elapsed between the date of award and the date on which the shares cease to be subject to the plan. There is no tax payable on shares withdrawn from the plan after five years.

9.15 If the period since the award is less than three years, the amount which counts as employment income, and therefore the amount on which the participant is charged income tax, is the market value of the shares when they cease to be subject to the plan.

9.16 If the period since the award is three or more years (but less than five years) then the amount which counts as employment income is the lesser of:

(a) the market value of the shares on the date of award; and

(b) the market value on the date they cease to be subject to the plan.

9.17 If there has been a capital receipt since the date of award then the amount of tax to be paid is reduced by the tax paid on the capital receipt.

9.18 Forfeited shares are not subject to income tax on forfeiture. Only free and matching shares can be forfeited.

No relief where the beneficial interest in shares is disposed of during the holding period

9.19 ITEPA 2003, s 507 provides that where the beneficial interest in free (and matching) shares is disposed of during the holding period (in breach of the participant's obligations) then the amount which counts as employment income, and so the amount on which the participant is subject to income tax, is the full

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market value of the shares when they cease to be subject to the plan, regardless of the period which has elapsed since award. The amount of tax payable is reduced by the tax paid on any earlier capital receipt in respect of these shares.

Exemption from tax for good leavers and on takeover

9.20 ITEPA 2003, s 498 provides that there will be no charge to income tax on shares ceasing to be subject to the plan where the participant ceases relevant employment (see **8.47–8.55** above) as a 'good leaver' on account of:

(a) injury or disability;

(b) dismissal by reason of statutory redundancy;

(c) a TUPE transfer;

(d) a change of control (or other circumstances ending the associated company status) of the employer company;

(e) retirement (see **8.65** above); or

(f) his death.

There will also be no charge to income tax on shares ceasing to be subject to the plan in connection with a scheme of arrangement, takeover by way of general offer or compulsory acquisition of shares under the provisions of the Companies Act 2006 provided that the participant receives, for the SIP shares, cash consideration (and no other asset) and the participant did not have the opportunity of accepting replacement assets which could have remained in the SIP trust. This exemption will also not be available in connection with SIP shares awarded where HMRC consider that the award would not have been made but for the ability to take advantage of the transaction-related tax exemption.

CORPORATION TAX DEDUCTIONS FOR FREE (AND MATCHING) SHARES

9.21 CTA 2009, s 994 (previously ICTA 1988, Sch 4AA, para 2) provides a deduction for corporation tax on an amount equal to the market value of any free (and matching) shares awarded to employees. The deduction is given for the period of account in which the shares are awarded to employees in accordance with the plan. It is to be noted that the deduction may be given in a later year to which the shares are acquired by the trustees. Shares are identified for this purpose strictly in the order of acquisition by the trustees. There is in fact nothing in the legislation which requires actual expenditure to be incurred and indeed any amounts for the actual cost of the shares are specifically disallowed.

Group plans – allocation of deductible amounts

9.22 Where shares are awarded under a group plan, the amount to be deducted for corporation tax purposes (ie the market value of the shares)

must be allocated between the various group companies whose employees participate in the award. The allocation to different group companies should be made strictly in proportion to the number of shares awarded to its employees.

Non-employee taxpayers

9.23 No deduction is allowed in respect of shares awarded to an individual who is not chargeable to tax under ITEPA 2003, Pt 2, Chs 4 or 5 in respect of general earnings from his employment.

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will be entitled to elect for any particular form of consideration which was originally available to shareholders under the offer (CA 2006, s 981(3)).

Rollovers of options – tax-advantaged options

13.15 A rollover of tax-advantaged (CSOP, SAYE and EMI) options involves an offer by an acquiring company to grant replacement options upon the release of the existing options in the target company. The replacement options must continue to satisfy the relevant legislation, including as to the type of share which may be used. Subject to this, repleacement options may be granted over shares in any company in the acquiring company's group (although, for EMI options, only shares in the acquirer may be used) and may be over issued or unissued share capital. It follows, of course, that unincorporated offerors cannot offer a rollover facility. An offeror which is under the control of a private company can only offer to replace the existing options by replacement options over its ultimate parent if the ultimate parent is so willing.

13.16 There are three principal reasons for a company offering a rollover facility. First, where a company with an SAYE scheme or CSOP is taken over by a private company then the scheme shares in that company will cease to satisfy the requirements of ITEPA 2003, Sch 3, para 19 (SAYE options) or ITEPA 2003, Sch 4, para 17 (CSOP options) upon the cessation of listing, with the result that, unless exercised within 20 days under a rule permitted by ITEPA 2003, Sch 3, para 37(6B), or Sch 4, para 25A(7B), income tax is chargeable on any option gains arising. The solution is to allow a rollover of options into the shares of a company in the acquiring group assuming those shares satisfy the provisions of ITEPA 2003, Sch 3, paras 18–20 and 22 or ITEPA 2003, Sch 4, paras 15–18 and 20, as appropriate. This is, therefore, the only way in which rights of exercise can be preserved with income tax relief in a takeover by a private company. The second reason for rollovers in SAYE and CSOP schemes is to avoid the premature income tax charge which may arise, depending on the consideration being offered on the takeover, where options are exercised within three years of the date of grant (see **5.25** above). The third reason for rollovers relates specifically to SAYE schemes. As noted above, in such schemes, optionholders are restricted on an early exercise of options to acquiring only such number of shares as may be purchased with their accumulated savings and interest at the date of exercise. An early exercise of options, therefore, has the effect that optionholders will lose the opportunity to realise the accrued gains on the shares to the extent the savings contract is incomplete (this may also be the case in relation to other share plans where time apportionment applies). The point of a rollover of options, therefore, is to allow the optionholder to continue saving until the bonus date and, therefore, eventually realise the gains on all the shares assuming, of course, that the shares under option retain their value between the date of the rollover and the eventual bonus date.

13.17 The facility for a rollover of tax-advantaged options only applies where:

(a) the acquiring company obtains control of the company whose shares are held in the scheme as a result of making a general offer to acquire either all the issued ordinary share capital of the company which is made on a condition such that if it is satisfied the offeror will have control of all the shares of the same class as the shares used in the scheme;

(b) the acquiring company obtains control of a company whose shares are scheme shares in pursuance of a compromise or arrangement sanctioned by the court under CA 2006, s 899;

(c) the acquiring company becomes bound or entitled under CA 2006, ss 979–982 to acquire shares in a company whose shares are used under the scheme.

For EMI options, a rollover may also be offered where there is a 'qualifying exchange of shares', effectively where there is any other arrangement under which the consideration receivable by shareholders in the original company cosists wholly of the issue of shares in a new company.

13.18 The maximum period during which the offer to rollover tax-advantaged options may be made available by the offeror is:

(a) where a general offer has become unconditional, six months;

(b) where the court sanctions a scheme of arrangement under CA 2006, s 899, six months;

(c) where the offeror's rights of acquisition under CA 2006, ss 979–982 are invoked, during the period the offeror is bound or entitled to acquire the shares of the dissenting shareholders.

13.19 The shares offered under the replacement option must satisfy the conditions of ITEPA 2003, Sch 3, paras 17–20 and 22 (SAYE options) or Sch 4, paras 15–18 and 20 (CSOP) and, for EMI options, the provisions of Sch 5, para 43 must be met. The replacement option is governed by the rules of the target company scheme – it is, therefore, immaterial whether the offeror has its own share option scheme. The replacement option must be 'equivalent' to the existing option. The total amount payable on exercise of the replacement option must be the same as the total amount payable under the existing option. The total market value of the shares under the replacement option must be equivalent to the total market value of the shares under the existing option immediately before the time of release. Where the shares in the offeror and the target company are both quoted on a recognised stock exchange and the offer is in the form of a share for share offer, then the basis of exchange of shares available to shareholders will be accepted by HMRC as 'equivalent' value and the offeror company need only notify HMRC of the exchange. In all other cases, the basis of exchange must be considered by Shares and Assets Valuation on the basis of the market values of the shares. An appropriate basis of exchange will be agreed for a limited period which will usually be a maximum of 21 days. When applying to HMRC for approval of any basis of exchange HMRC will normally require the following:

(a) a copy of the proposed rollover calculation;

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(b) the offer documentation; and

(c) a copy of the articles of association of the company whose shares will be used in the scheme, unless company is, or is to be, listed on a recognised stock exchange.

To avoid HMRC having to be approached on multiple occasions it may be possible to ensure that all options are rolled over on the same day.

Shares and Assets Valuation will agree that a rollover may be effected as follows: the original option price is adjusted by the market value of a share in the offeror on the day agreed with HMRC divided by the market value of share in the offeree on the same day; and the number of shares under individual options is adjusted by its reciprocal, ie the market value of a share in the offeree divided by the market value of share in the offeror.

Example 1

The optionholder has an option over 1,000 shares with an exercise price of 150p per share. An offer is made for the company at 500p per share. At the time that the rollover is made, a share in the offeror is worth 800p per share. The rollover calculation is as follows:

(a) The exercise price of the replacement option is:

$$\frac{150p \times 800p}{500p} \quad \begin{matrix}\text{(offeror share price)} \\ \text{(offeree share price)}\end{matrix}$$

= 240p

(b) The number of shares under the replacement option is:

$$\frac{1{,}000 \times 500p}{800p} \quad \text{(the reciprocal of (a) above)}$$

= 625 shares

The replacement option over 625 shares has an aggregate exercise price of £1,500 (240p × 625), being equal to the original aggregate exercise price (150p × 1,000). The aggregate gain on exercise of the new option is £3,500, calculated as 625 shares x (800 – 240), which is equal to the aggregate gain on the old option at the time of rollover, calculated as 1,000 shares × (500 – 150).

It is often the case that, where the rollover is to be effected immediately following the change of control, the market value of the two shares to be used in the calculation is taken on the last day of trading in the offeree's shares. Once the takeover has become effective, the offer consideration will likely be substituted for the market value of an offeree share as there will no longer be a readily ascertainable value for those shares, and the offer price will have been fixed.

13.20 The tax treatment of any rollover under a tax-advantaged share option scheme is as follows:

(a) Income tax – The replacement option is treated as granted at the same time as the old option was granted, with the result that income tax will only be payable on the exercise of the replacement option in the same circumstances as applied to the old option. In practical terms, this means that exercise rights and lapse provisions will be measured not from the date of the replacement option, but the date of the original option. Even if there were no express statutory provisions in ITEPA 2003, Sch 3, para 39(5) and Sch 4, para 27(5) about the effect of the SAYE and CSOP rollover provisions including overriding any income tax charges at the time of the rollover of options, ITEPA 2003, s 483 would still have the same effect.

(b) Capital gains tax – The release of the old option in consideration of the grant of a replacement option at a lower price is, in principle, a disposal of a chargeable asset (the old option) for the purposes of capital gains tax. This is because the surrender of rights is treated as a disposal for the purpose of TCGA 1992, s 22(1)(c). The proceeds of the disposal is the value which accrues to the optionholder as a result of his receiving an option to buy shares at a price which is less than their current market value. However, relief is provided in TCGA 1992, s 237A which provides for a rollover in respect of the option so that the replacement option is treated as the same asset as the old option.

There will be no National Insurance contributions liability on the rollover, and on the eventual exercise of the option National Insurance would only apply to the extent that it would have applied to the original option had that option been exercised at the same time.

Rollover of unapproved options and restricted share awards

13.21 The tax treatment of any rollover under an unapproved share option scheme (including an unapproved rollover of a tax-advantaged option, ie outside the scheme rules) is as follows:

(a) Income tax – the replacement option is treated as granted at the same time as the old option was granted with the result that income tax will be payable on exercise of the replacement option under ITEPA 2003, s 483. If the shares are readily convertible assets at the date of exercise then the income tax on any gains will be collected through PAYE (ITEPA 2003, s 700(2)).

(b) Capital gains tax – the capital gains tax treatment of the rollover of an unapproved option is identical to the treatment of the rollover of an approved option (TCGA 1992, s 237A): see **13.20** above.

(c) National Insurance contributions (NICs) – relief from NICs is available on the rollover of unapproved options where the total discount to the market value of the shares under the replacement option is not

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substantially greater than the total discount on the original option at the time of rollover (Social Security (Contributions) Regulations 2001, Sch 3, Pt IX, para 15).

The tax treatment of a rollover under a share scheme which provides for restricted (including forfeitable) shares is as follows:

(a) Income tax – provided that the unrestricted market value of the replacement shares is no greater than that of the original shares immediately prior to the exchange, there will be no income tax in relation to the disposal of the original shares or the acquisition of the replacement shares, and the disposal is not a chargeable event (ITEPA 2003, s 430A(5)). Provided that the restrictions applying to the replacement shares mirror those attaching to the original shares, tax charges in relation to the replacement shares will follow those which would have applied to the original shares.

(b) Capital gains tax – the capital gains tax treatment of a rollover of restricted shares will follow the normal rules for a share-for-share exchange under TCGA 1992, s 135.

(c) National Insurance contributions (NICs) – relief from NICs is available on the acquisition of the replacement shares were no income tax charge arises (Social Security (Contributions) Regulations 2001, Sch 3, Pt IX, para 9). As there is no income tax charge on the disposal of the original shares, no NIC charge arises under Social Security (Contributions) Regulations 2001, reg 22(7).

Surrender of an option for a cash consideration

13.22 The offers made to optionholders on a takeover may include an offer to surrender their options in consideration of the payment of cash equal to any accrued gain.

13.23 The offer must be made by or on behalf of the offeror, not the target company, in respect of tax-advantaged options. The reason for this is that, where the payment is made by the target company, HMRC will regard this as a feature of the scheme which is not made available in accordance with ITEPA Sch 3 or Sch 4, as appropriate, and so would be contrary to ITEPA 2003, Sch 3, para 5 (SAYE) or ITEPA 2003, Sch 4, para 5 (CSOP).

13.24 In a letter to professional advisers dated 6 February 1991, HMRC accepted that a target company will often wish to advise and make recommendations to its optionholders about the various offers made by an offeror company and has indicated that it will not treat the provision of such advice and recommendations as unacceptable in connection with an SAYE or CSOP scheme. In practice, HMRC will normally accept the target company making the offers to its optionholders on behalf of the offeror. HMRC will treat any payments made by the trustees of an employee benefit trust which

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has a close relationship with the target company in the same way as if they were made by the company which established the scheme.

Taxation

13.25 Any sum received by an optionholder for the surrender of his option will be chargeable to income tax by virtue of ITEPA 2003, s 477(3)(b). The tax charge is based on the whole of the sum received less any sum paid for the grant of the option or for its surrender. The surrender of the option is also treated as a disposal of a chargeable asset (the option) for capital gains tax, but as the amount brought into charge to income tax will be taken into account in computing the amount of any chargeable gain, no gain will in practice arise. The surrender of an option for a cash payment will be subject to PAYE.

13.26 Following the introduction of the statutory corporation tax deduction in FA 2003 (now CTA 2009), the surrender of options for cash is likely to be unattractive as there will be a loss of the corporation tax deduction which would have been available had the options been exercised.
Private company offerors often propose a surrender for cash for administrative purposes as the statutory corporation tax deduction would, before changes introduced by FA 2014, have been lost in any event as a result of the shares which would otherwise have been acquired ceasing to satisfy the legislative consitions in CTA 2009, s 1016, namely that the shares acquired must either be in a company not under the control of another company, listed on a recognised stock exchange or in company under the control of a company listed on such an exchange. CTA 2009, s 1016(1A) now provides that where the shares are acquired within 90 days of the takeover, the legislative conditions will be deemed to still be met if they were met immediately prior to the takeover.

Share incentive plans

13.27 The basic point in relation to SIPs is that the plan shares are retained by trustees subject to certain restrictions on disposal. Where there is a takeover offer or reconstruction which is treated as a 'reorganisation' for capital gains tax purposes (ie the shareholders are entitled to a rollover) then the legislation treats the new holding as substituted for the original shares and held accordingly under the terms of the SIP. To the extent any such transaction is not treated as a reorganisation, it will usually be treated as a disposal of plan shares (for instance, a cash offer for the shares), or possibly a capital receipt if the original shares have been retained and the receipt represents a capital distribution not subject to income tax, e.g. an exempt demerger distribution of shares.

Takeover offers – relaxation of the trustees' obligations

13.28 In relation to free, matching and dividend shares under a SIP, ITEPA 2003, Sch 2, paras 36(1), 61 and 67 provide that each participant must agree

that (amongst other things) during the relevant holding period, he will leave the shares with the trustees (para 36(1)(a)) and not assign, charge or otherwise dispose of the beneficial interest in the shares (para 36(1)(b)).

13.29 ITEPA 2003, Sch 2, para 37, provides that the above obligations shall not prevent the participant from directing the trustees in respect of his plan shares:

(a) to accept an offer of a new holding (shares or loan notes) provided the transaction is treated as a 'reorganisation' for capital gains tax purposes (para 37(2)) – see **13.32–13.39**;

(b) to direct the trustees to agree to a transaction affecting the shares pursuant to a scheme of arrangement (para 37(3));

(c) to accept a cash offer with or without any offer of shares, loan notes or other securities, if the offer forms part of a general offer which is made to the holders of the relevant class of share such that, if it is satisfied, the offeror will obtain control of the company (para 37(4)(a));

(d) to accept an offer of qualifying corporate bonds, whether alone or with cash or other assets or both, if the offer forms part of a general offer (para 37(4)(b)).

In relation to partnership shares under a SIP, the participant is free to direct the trustee in relation to those shares at any time as there is no applicable holding period.

Trustees' circular

13.30 As a matter of general trust law, the trustees should seek the directions of the participants in relation to any takeover offer or proposed scheme of arrangement and most trust deeds provide accordingly. This will normally involve the trustees sending copies of any offer or proposal document to shareholders or participants, together with an explanatory note, seeking their directions in writing by a date shortly before the closing date of the offer or proposal.

Cash offer

13.31 If the trustees accept a cash offer for the participant's plan shares under a SIP, the participant is treated as making a disposal of those shares. The participant may be chargeable to income tax if the shares are disposed of within five years of the appropriation. For further information on the income tax treatment of disposals of plan shares, see **13.9** above. No capital gains tax liability arises in relation to a disposal from a SIP.

Where forfeiture provisions apply to matching shares where the linked partnership shares are disposed of within the forfeiture period, the plan rules may not specifically deal with whether this would apply where the partnership

shares are disposed of in connection with a takeover. HMRC accept that, if considered necessary, the plan may be amended to confirm the position. Where shares are acquired by the offeror as a result of a compulsory acquisition process (or through a scheme of arrangement – see **13.40** below), and the forfeiture provisions are drafted in terms of the participant 'withdrawing' partnership shares, then it would seem clear that in these circumstances there should not be a forfeiture of the matching shares (which would also be acquired under the compulsory acquisition process or scheme).

Share consideration

13.32 Where a takeover offer is made involving share consideration for the shares acquired, the transaction will be treated as a 'reorganisation' for capital gains tax purposes if the conditions of TCGA 1992, s 135 apply, namely:

(a) the issuer holds, or in consequence of the exchange will hold, more than 25 per cent of the ordinary share capital of the target company; or

(b) the issuer issues the shares pursuant to a general offer for the whole of the issued share capital of the company (or all the shares of the relevant class) which is made in the first instance on a condition that, if it were satisfied, the issuer would have control of the target company; or

(c) the issuer holds, or will in consequence of the exchange hold, the greater part of the voting power in the target company. Given that any takeover offer will normally involve the acquisition of at least 51 per cent of the ordinary share capital of the company, there will not usually be any difficulty in establishing that any takeover offer will be treated as a 'reorganisation' for capital gains tax purposes.

13.33 Assuming the takeover offer is treated as a 'reorganisation' for capital gains tax purposes, the trustee of a SIP will be treated, after the time of such reorganisation, as holding the 'new holding' on the basis that:

(a) there was no disposal of the original holding as a result of the exchange (ITEPA 2003, Sch 2, para 87(2)(a));

(b) the new holding is treated as if it were appropriated under the scheme at the time of the original holding (ITEPA 2003, Sch 2, para 87(2)(b));

(c) the conditions related to scheme shares under ITEPA 2003, Sch 2, Pt 4, are treated as satisfied with respect to the new shares as if they were (or were treated as) satisfied with respect to the original holding (ITEPA 2003, Sch 2, para 87(2)(c));

(d) the provisions relating to the taxation of SIP shares apply to the new holding as they did to the original holding (ITEPA 2003, Sch 2, para 87(2)(d)).

13.34 Following any 'reorganisation' it is necessary, unless the new shares are a 'mirror image' of the old shares, to apportion the base value of the old holding amongst the new holding after the reconstruction.

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