

INCOME TAX (EARNINGS AND PENSIONS) ACT 2003

EXPLANATORY NOTES

COMMENTARY ON SECTIONS

Example 3

Ne = £5,000; Da = 183; De = 183; Smg = 0

so limit is $(10\% \times £5,000 \times 183/183) - 0 = £500$

1329. *Subsection (5)* is a method statement to calculate the amount of net earnings to be used in subsection (4).

Section 316: Accommodation, supplies and services used in employment duties

1330. This section derives from section 155ZA of ICTA which excludes from section 154 of ICTA the charge on benefits arising from the provision of accommodation, supplies and services mainly used to perform an employee's duties of the employment, but also used to a minor degree for other purposes.

Section 317: Subsidised meals

1331. This section derives from section 155(5) of ICTA which provides an exemption for canteen meals and from ESC A74. The ESC provides an exemption for the provision of any free or subsidised meals on the employer's premises, but not elsewhere, provided that all the employer's employees are able to obtain such meals or have vouchers or tokens enabling them to obtain such meals, regardless of where those meals are obtained. To the extent that this section legislates ESC A74 it is a minor change to the law. See *Change 77* in Annex 1.

1332. Section 155(5) of ICTA and the concession requires meals to be available to the staff "generally". It was not clear how that test applies when employees work at different locations. In practice the rule is applied sensibly and the new section provides clarification by focusing on the employees at a particular location.

1333. Section 155(5) of ICTA and ESC A74 only provide an exemption from the benefits charge. This section goes further and provides a complete exemption from income tax. This is a minor change to the law. See *Change 77* in Annex 1.

Section 318: Care for children

1334. This section provides there is no liability to tax on the benefit of "workplace nursery" facilities provided for the children of employees. It derives from section 155A of ICTA.

1335. *Subsection (1)* provides exemption for the benefit which arises by virtue of Chapter 10 of Part 3 (taxable benefits: residual liability to charge), where the provision of care for a child meets the conditions in subsections (3), (4) and (6).

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- 1336. *Subsection (2)* set out the limited exemption where only part of the provision meets those conditions.
- 1337. *Subsection (3)* contains conditions applying to the child for whom care is provided.
- 1338. Section 155A of ICTA used the term “parental responsibility”, which is defined by cross-reference to the Children Act 1989. The definition in the latter Act is used directly in subsection (3)(c).
- 1339. *Subsection (4)* contains conditions applying to the premises at which care is provided for the child.
- 1340. The cross-references required for the definition in *subsection (5)* of the term “registration requirement” (used in subsection (4)) have been updated.
- 1341. *Subsections (6) and (7)* contain conditions applying to the employer’s involvement in providing the premises at which care is provided.
- 1342. *Subsection (8)* defines “care” for the purposes of the exemption.

Section 319: Mobile telephones

- 1343. This section derives from section 155AA of ICTA, which excludes from section 154 of ICTA the benefit arising from the provision of a mobile telephone. It is no longer necessary to make any special mention of mobile phones provided in connection with a taxable car, van or exempt heavy goods vehicle, as benefits provided in connection with such vehicles are adequately covered by section 239. Accordingly section 155AA(3) has not been rewritten. See *Note 35* in Annex 2.

Section 320: Limited exemption for computer equipment

- 1344. This section derives from section 156A of ICTA, which provides a limited exemption in respect of computer equipment provided to employees or members of their families or households.
- 1345. The exemption only applies where the employer provides the computer equipment for the use of the employee (or members of his or her family etc) rather than transferring it to him or her. In a case where the computer is given to the employee to keep, the benefit arising is still chargeable to tax in the normal way.
- 1346. The exemption is not available in cases where the arrangements to provide computer equipment particularly favour directors. This does not mean that where an employer has provided computer equipment only for directors or their families, because only they have taken up an offer available to all employees, that the exemption cannot apply. The employer’s provision of computer equipment has to be deliberately restricted to directors and their families for the exemption to be withheld. This is covered in section 156A(2) of ICTA, rewritten in this section as *subsection (6)*.
- 1347. The definition of director in *subsection (7)(b)* derives from section 168 of ICTA. It is necessary to bring the definition into this section because this provision is not in the benefits code.

Section 321: Suggestion awards

- 1348. This section provides that no liability to income tax arises where awards which do not exceed the limits set by section 322 are made under a suggestions scheme.
- 1349. It derives from ESC A57. See *Change 78* in Annex 1.
- 1350. *Subsection (1)* sets out the type of scheme to which the section applies.

1351. *Subsection (2)* provides that no liability to tax arises on an encouragement award or a financial benefit award (defined in subsection (6)) which meets the three conditions in subsections (3) to (5), to the extent that it does not exceed the limits set by section 322.

1352. *Subsection (6)* defines “encouragement award” and “financial benefit award”.

Section 322: Suggestion awards: “the permitted maximum”

1353. This section provides the level, “the permitted maximum”, at or below which a suggestion award is not liable to tax.

1354. It derives from ESC A57. See *Change 78* in Annex 1.

1355. *Subsection (1)* gives the permitted maximum for an encouragement award.

1356. *Subsection (2)* provides that the permitted maximum for a financial benefit award where no previous award has been made for that suggestion is the suggestion maximum or, where the award is made to more than one person, the appropriate proportion of that maximum award. The suggestion maximum is given at *subsection (4)* and “the appropriate proportion” is defined at *subsection (6)*.

1357. *Subsection (3)* provides that the permitted maximum for a financial benefit award where an award has already been made for that suggestion is the residue of the suggestion maximum or, if more than one such award has been made previously, the appropriate proportion of that residue. “The residue of the suggestion maximum” is defined at subsection (6).

1358. *Subsection (4)* gives the suggestion maximum for financial benefit awards. This is the maximum of £5,000 or the financial benefit share (defined at *subsection (5)*). The power to alter the limit in this provision is contained in section 716.

1359. *Subsection (5)* defines the “financial benefit share” as the greater of half the financial benefit likely to arise within the first year of the adoption of the suggestion or one-tenth of the financial benefit for the first five years after its adoption.

1360. *Subsection (6)* defines “the appropriate proportion” and “the residue of the permitted maximum” which are used at subsections (2) and (3). It also defines “the total previous exemption” used in the definition of “the residue of the permitted maximum”.

Section 323: Long service awards

1361. This section derives from ESC A22 which concerns awards made to mark long service. Where the conditions are met the concession provides an exemption from income tax. Legislating the concession is a minor change to the law. See *Change 79* in Annex 1.

1362. The concession was introduced in the mid-1970s when employers had begun to give employees long service gifts other than the traditional clock or watch. It was restricted to tangible articles or shares of a defined kind to prevent cash payments that would properly be charged as earnings being dressed up as long service awards. In practice, the concession is applied more liberally than a strict interpretation of it would permit. For example, the provision by the employer of a holiday or a life membership to the National Trust as a long service award would be treated as covered by the concession. The scope of this section as set out in *subsection (3)* should cover all the types of award currently treated as being within the concession.

1363. When an ESC contains monetary limits, any change in those limits may be made by press release or by republishing the ESC with different amounts. This is not possible for legislation. There are a number of exemptions in the source legislation in which an amount is fixed by Treasury order and the power to alter the limit in this provision is contained in section 716.

1364. The concession does not restrict qualifying service to “the same employer” in the same way as the definition of a long service award in *subsection (2)*. However, in practice the concession is applied so that the service must be with the same employer unless there has been a change of employer of the kind described in *subsection (5)*.

1365. The definition of “group” adopted means that the minimum possible group relationship will enable the exemption to apply.

Section 324: Small gifts from third parties

1366. This section derives from ESC A70A. It provides an exemption from income tax in respect of certain small gifts from third parties. Legislating the concession is a minor change to the law. See *Change 59* in Annex 1.

1367. The conditions for the exemption are in similar terms to the entertainment exemption in section 265. The reasons for it are the same, namely to remove the compliance problems if the conditions in *subsections (2) to (6)* are met. Those conditions include a limit on value of the gifts which may be varied by the Treasury power in section 716.

1368. The concession also extends to non-cash vouchers and credit-tokens. That aspect is dealt with in section 270.

Section 325: Overseas medical treatment

1369. This section derives from section 155(6) of ICTA. It originated as an ESC which was enacted in FA 1981. The exemption relates to the provision of medical treatment and the provision of insurance against the cost of medical treatment.

1370. As far as the first aspect is concerned, the exemption only applies where the provision of the medical treatment falls within benefits code. There is no exemption if the payment for the treatment is handled in such a way that chargeability arises as earnings.

1371. The same applies to the provision of insurance. It is only direct provision which is exempt, so it does not cover reimbursement of the employee’s premium for overseas medical insurance.

1372. The reference to in-patient treatment is applicable to the whole section. This is to clarify that the insurance may also provide cover for in-patient treatment.

Section 326: Expenses incidental to transfer of a kind not normally met by transferor

1373. This section exempts from income tax certain paid or reimbursed expenses which arise in connection with an asset transferred by reason of the employment. This exemption will most commonly apply where an employee, benefiting from a relocation package, transfers his or her house to an employer who pays the acquisition costs.

1374. It derives from ESC A85. See *Change 80* in Annex 1.

1375. *Subsection (1)* provides that no liability to tax arises where expenses incidental to an “employment-related asset transfer” (defined at *subsection (2)*) are paid or reimbursed. The expenses must be wholly and exclusively incurred as a result of that transfer and not of a type normally met by the transferor. Thus the disposal costs of a house sold to an employer under a relocation package are not within the exemption as the vendor would normally be the one to meet these costs.

1376. *Subsection (2)* defines “employment-related asset transfer” as the transfer of an asset to an employer or person nominated by the employer and which arose by reason of the employment.

1377. *Subsection (3)* explains what is meant by “transfer”.

Part 5: Employment income: deductions allowed from earnings

Background

1378. This Part provides for deductions allowed from earnings.
1379. The charge to tax on employment income is a charge to tax on two different categories of employment income: “general earnings” and “specific employment income” (see section 6(1)); and, in the case of “general earnings”, (a term defined in section 7(3)), the amount charged to income tax is the “net taxable earnings” from the employment in the tax year (see section 9(2)). Section 11 then provides that the net taxable earnings from an employment in a tax year consist of the total amount of the taxable earnings from the employment less the total amount of any deductions allowed from those earnings (as listed in section 327(3) to (5)). And it is with this final component of “net taxable earnings” that this Part of this Act is concerned.
1380. In ICTA, the deductions provisions are very difficult to unravel. Some individual provisions are straightforward. But there are many connections between provisions. They interact in ways which are not always easy to follow. Several fictions have been adopted to make the provisions work.
1381. One major source of complexity is that the expenses of an employee may be met in several possible ways, taxed under different sections of ICTA. The mechanism for making a deduction may vary according to the circumstances.
1382. For example, consider the position of a director making a train journey to attend a meeting. The table below shows some of the various ways in which the employer might fund the trip, how the director would be taxed and how the director might obtain a deduction in respect of the expenses of the train ticket. (References to sections are to sections of ICTA.)

<i>Employer funds trip by</i>	<i>Charging provision</i>	<i>Deduction allowable under</i>
round sum allowance	section 19(1)1	section 198
specific expense payment	section 153	section 198
buying the ticket	section 141	section 198 via section 141(3)
providing credit card for employee to use on ticket	section 142	section 198 via section 142(3)

1383. There are other possibilities. For example, if the same director travelled to the same meeting using private transport provided by the employer, the provision of the transport would be taxed under section 154 of ICTA, with a deduction allowable under section 198 via section 156(8). And if the business journey involved foreign travel, there are further deduction provisions that may apply.
1384. Another major source of complexity is that the central provision relating to deductions, section 198 of ICTA, is used by other provisions of ICTA and is used in different ways. For example:
- under section 156(8) of ICTA, the cost of a benefit provided is allowed as a deduction under section 198, or other provisions, if it would be allowed as a deduction if paid out of emoluments;
 - under section 193(3) of ICTA, certain travel expenses are treated as having been necessarily incurred in the performance of the duties of an overseas employment for the purposes of section 198(1);

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- under section 193(7) of ICTA, references to section 198, and to deductions under section 198, are treated as including references to section 193(3), and to deductions under that subsection; and
- under section 200A(1) of ICTA, incidental overnight expenses are not regarded as emoluments if they would not be deductible under section 198.

1385. In this Act the number of provisions that cross-refer to other deductions provisions has been much reduced. The view has been taken that it is more helpful, in the case of each deduction provision, to set out in full the conditions that must be met. In setting out those conditions, Inland Revenue practice has been followed. As a result of this approach, sections 194(10) and 195(11) of ICTA, which provide for provisions to be construed with other provisions, have no direct successors in this Act.

Overview

1386. In this Part, in order to make each individual deduction provision as simple as possible, Chapter 1 states some general propositions about deductions. This saves those propositions having to be repeated in the individual provisions, so the deductions sections can then concentrate on the rules applying for the particular deduction in question.

1387. The provisions relating to deductions are then grouped in different chapters according to the type of deduction. So there are separate chapters for:

- deductions for employee's expenses (Chapter 2);
- deductions from benefit code earnings for costs which would have been deductible if they had been paid by the employee (Chapter 3);
- deductions for employee's expenses covered by fixed allowances (Chapter 4);
- deductions for earnings which represent expenses borne by the employer (Chapter 5); and
- deductions from seafarers' earnings (Chapter 6).

1388. Within Chapters 2 and 5, the provisions are then grouped according to the type of expense involved. For example, in Chapter 2, sections 337 to 342 deal with travel expenses.

1389. Within this Part, very many of the sections that allow deductions are drafted in accordance with the general formula that a deduction from earnings is allowed for an amount whose characteristics are then specified.

Chapter 1: Deductions allowed from earnings: general rules

Overview

1390. This is the first of six chapters dealing with deductions allowed in charging earnings to income tax.

1391. After the introductory section 327, this Chapter sets out some general propositions which are applicable to most of the deductions dealt with in the next five chapters. Those propositions relate to:

- the income from which deductions may be made (section 328);
- the general prohibition on deductions exceeding earnings (section 329);
- the prevention of double deductions (section 330); and
- the order in which deductions are to be made (section 331).

1392. This Chapter concludes with section 332, which lists “the deductibility provisions”.

Section 327: Deductions from earnings: general

1393. This section sets the scene. It gives information about the contents of this Part, and places this Part within a wider context.

1394. The section is new, although it draws on material contained in section 131(1) of ICTA.

1395. *Subsection (1)* provides the essential link between this Part of this Act and section 11(1), which is in Part 2. The subsection states that this Part provides for deductions that are allowed from the taxable earnings from an employment in a tax year for the purpose of calculating the “net taxable earnings” from the employment in the tax year for the purposes of Part 2 of this Act.

1396. *Subsection (2)* sets out how two key expressions are used in this Part. References to the earnings from which deductions are allowed are references to the taxable earnings mentioned in subsection (1), and references to the tax year are references to the tax year mentioned there.

1397. *Subsection (3)* states that the deductions for which this Part provides are those allowed under Chapters 2 to 6; and the contents of those Chapters are indicated.

1398. *Subsection (4)* lists other provisions, not in this Part, which make further provision about deductions; and *subsection (5)* lists other provisions, not in this Part, which make further provision about deductions from income including employment income.

Section 328: The income from which deductions may be made

1399. This section is the first of four which sets out a general proposition relating to deductions from earnings. It deals with the income from which deductions may be made.

1400. The most important single source for this section is section 198(1) of ICTA, which includes the proposition that an amount paid “out of the emoluments of the office or employment ... may be deducted from the emoluments to be assessed”. This section also draws on a considerable number of other passages in Part 5 of ICTA and in section 50 of FA 1989.

1401. *Subsection (1)* sets out the general rule that deductions under this Part are allowed from any earnings from the employment in question, but not from earnings from any other employment.

1402. An example of how this rule operates in practice is given in Inland Revenue guidance in SE 31658:

An individual is employed as a teacher and separately employed as coach to a local youth football team. As coach she is paid £100 a year but she incurs expenses of £1,000 a year in travelling to away matches. She pays the expenses herself and is not reimbursed by her employer.

She is only allowed a deduction of £100 for her travelling expenses under section 198(1) of ICTA. She cannot claim a loss for the remaining £900 and nor can she deduct that amount from her teaching income.

1403. The general rule is subject to a number of qualifications. These are dealt with in the rest of this section.

1404. *Subsection (2)* deals with one case where the general rule is not wide enough. Expenses of a minister of religion (see section 351) are allowed from earnings from any employment as a minister of a religious denomination.

1405. *Subsections (3) to (5)* deal with cases where the general rule is too wide: for example there are some cases where the deductions are allowed only from earnings with

particular characteristics – either relating to the source of the earnings or to the manner in which the earnings are charged to tax.

1406. Subsection (3) provides that deductions under section 368 are only allowed from earnings payable out of the public revenue.
1407. Subsections (4) and (5) deal with “deductions limited to specified earnings”: for, in the cases of some provisions, deductions are allowed from earnings from the employment which qualify as taxable earnings under certain of the charging provisions of Chapters 4 and 5 of Part 2, but not from other earnings from the employment.

Section 329: Deductions from earnings not to exceed earnings

1408. This section is the second of four which sets out a general proposition relating to deductions from earnings. It deals with the proposition that deductions from earnings may not exceed earnings.
1409. As in the case of section 328 the most important single source for this section is section 198(1) of ICTA, which allows a deduction for an amount if “the holder of an office or employment is obliged to incur and defray [that amount] out of the emoluments of the office or employment”. This section also draws on a considerable number of other passages in Part 5 of ICTA and in section 50 of FA 1989.
1410. *Subsection (1)* sets out the general rule that deductions may not exceed the earnings from which they are deductible. That general rule is then elaborated in *subsections (2) to (4)*.
1411. Inland Revenue guidance makes it clear that the employee does not generally have to demonstrate that an expense has literally been paid out of the emoluments rather than out of some other source of money. It is generally sufficient that the emoluments charged to tax in a particular tax year are equal to, or greater than, the deductions to be made from those emoluments. As the Inland Revenue does not generally trace the source of funds used by the employee to pay expenses, the requirement that the employee must pay the expenses out of the emoluments of the employment is not stated in general terms in this Act. See *Change 81* in Annex 1.
1412. *Subsection (5)* deals with a matter which follows on from the fact that this Act does not reproduce any general requirement that expenses must be paid out of the emoluments of the employment. This Act rewrites numerous provisions that refer to expenses that would be allowable if the employee paid them out of the emoluments of the employment. Those provisions (“the deductibility provisions”) are listed in section 332. Since the general requirement in *subsection (1)* that deductions from earnings are not to exceed earnings is assumed to be met in the deductibility provisions (because of the references in them to the employee being assumed to have paid the amounts or expenses out of emoluments), this subsection provides that this section is to be disregarded for the purposes of the deductibility provisions.
1413. *Subsection (6)* provides a signpost to section 380 of ICTA, a section drafted on the basis that there may be Schedule E losses which may be set against other income of the tax year, or carried back to earlier tax years.

Section 330: Prevention of double deductions

1414. This section is the third of four which sets out a general proposition relating to deductions from earnings. It deals with the prevention of double deductions.
1415. The proposition in this section is not articulated in general terms in ICTA, although it seems true as a matter of income tax law. There are statements of this proposition in particular contexts in sections 194(9), 195(12) and 198(3) of ICTA.

1416. *Subsection (1)* sets out the general rule: a deduction from earnings under this Part is not allowed more than once in respect of the same costs or expenses.
1417. *Subsection (1)* is expressed to apply to “costs and expenses”. These words are intended to cover all potential deductions under this Part, even though the amount of the deduction may not be computed by reference to an actual amount of expenditure – as is the case under Chapter 4 of this Part, which deals with fixed allowances for employee’s expenses.
1418. *Subsection (2)* deals with the case where a cost or expense qualifies both for an allowance under Chapter 4 of this Part and for a deduction under some other provision. In such a case only one of the deductions is allowed. This provision codifies Inland Revenue practice on these topics. See *Change 82* in Annex 1.

Section 331: Order for making deductions

1419. This section is the last of four which sets out a general proposition relating to deductions from earnings. It deals with the order in which deductions may be made.
1420. *Subsection (1)* sets out the general rule that section 835 of ICTA, which provides for deductions to be allowed in the order which results in the greatest reduction of liability to income tax, applies in the present context.
1421. *Subsection (2)* qualifies the general rule. The subsection specifies two provisions which impose a requirement to consider deduction provisions in a particular order.

Section 332: Meaning of “the deductibility provisions”

1422. This Act rewrites numerous provisions that refer to amounts or expenses whose deduction would be allowed if the employee incurred and paid them out of the emoluments of the employment (or in some cases just incurred or just paid them). See *Change 81* in Annex 1.
1423. The provisions of the Act that rewrite these provisions are listed in this section, where they are defined as “the deductibility provisions”.
1424. The requirement that amounts or expenses be incurred and paid out of emoluments of the employment is not, in general, being rewritten: so the deductibility provisions do not rewrite the words “out of the emoluments”. Instead, they refer to amounts or expenses that would be allowed as a deduction if the employee had incurred and paid them.
1425. Since the general requirement in section 329(1) that deductions from earnings are not to exceed earnings is assumed to be met in the deductibility provisions (because of the references in them to the employee being assumed to have paid the amounts or expenses out of emoluments), section 329(5) provides that section 329 is to be disregarded for the purposes of the deductibility provisions.
1426. In the case of the deduction under section 353, where the requirement for payment out of earnings has survived, it is provided that, for the purposes of the deductibility provisions, the expenses are to be assumed to have been paid out of the earnings in question. (See section 353(4).)

Chapter 2: Deductions for employee’s expenses

Overview

1427. This Chapter deals with the most familiar situation in which deductions from earnings are allowed – where the employee has paid an expense of the employment. The Chapter also deals with the situation where someone else (usually the employer) pays the expense on the employee’s behalf. The Chapter therefore deals with section 198 of ICTA, with the related provisions in Schedule 12A of that Act, and with a number

of other provisions, such as sections 201, 201AA and 201A of ICTA, which allow deductions for particular expenses paid by the employee.

1428. The Chapter may be divided into the following components:

- introductory provisions (sections 333 to 335);
- the general rule governing the deduction of expenses (section 336);
- further rules allowing the deduction of particular expenses, grouped according to the type of expense involved (sections 337 to 352);
- special rules for earnings with a foreign element (sections 353 to 355); and
- rules which prohibit or restrict deductions (sections 356 to 360).

Section 333: Scope of this Chapter: expenses paid by the employee

1429. This section sets out the distinguishing condition for the deductions allowed under this Chapter: the amount in question must have been paid by or on behalf of the employee.

1430. *Subsection (1)* sets out this basic proposition.

1431. The most important single source for this section is section 198(1) of ICTA, which allows a deduction for an amount where the holder of an office or employment is obliged to “incur and defray” that amount. There are also a number of other provisions in Part 5 of ICTA which have similar wording.

1432. There is, however, another point that arises in relation to this part of section 198(1) of ICTA and other corresponding provisions. A deduction may be allowed where the employee has incurred the expense but the actual liability is met by someone else, usually the employer. Where the employee’s pecuniary liability is met in this way it is an emolument. It is taxed under paragraph 1 of section 19(1) of ICTA. As the expense is met in a way that constitutes emoluments, it is accepted that it has been defrayed out of those emoluments. The employee, accordingly, is allowed a deduction if the liability met comes within the wording of section 198(1) of ICTA or some other corresponding provision. This, in practice, is how those provisions are operated. *Subsection (1)(b)* of this section therefore provides for a deduction to be allowed for such an amount if that amount is paid on the employee’s behalf by someone else and is included in the earnings. See *Note 36(A)* in Annex 2.

1433. The source legislation does not state explicitly that a deduction is allowed where the employee incurs the expense but the liability is met by someone else. *Subsection (2)* makes the position clearer by providing that the employee is treated as paying the expense where the actual liability is met by someone else and constitutes earnings of the employee.

1434. To be allowed a deduction under this Chapter, an employee must satisfy subsection (1), read, if necessary, with subsection (2), although there are some provisions where it is perhaps unlikely that subsection (2) will be in point. The inclusion of these propositions here means that it becomes unnecessary to say something to the same effect in each of the individual deduction provisions in this Chapter.

1435. *Subsection (3)* deals with the two exceptions to subsection (1). In the case of these two exceptions, subsection (2) is also disappplied.

1436. *Subsection (4)* consists of a signpost to the following Chapter. That Chapter deals with deductions from benefits code earnings for costs that would have been deductible if the employee had paid them. It therefore covers cases where an expense is met by the employer in the form of a taxable benefit.

Section 334: Effect of reimbursement etc.

1437. This section contains provisions dealing with the effect of reimbursement.
1438. Under the source legislation, a reimbursed amount is dealt with for income tax purposes in either of two ways:
- if the reimbursed amount constitutes part of the earnings from the employment, the deduction is allowed in full; or
 - if the reimbursed amount does not constitute part of the earnings from the employment, the deduction of the expense is not allowed to the extent that reimbursement is made. The speeches of Lord Guest and Lord Pearce in *Pook (HM Inspector of Taxes) v Owen* (1969) 45 TC 571 envisage that a reimbursed amount may be dealt with in this way.
1439. Against this background, this section has been included in this Act with the object of making explicit provision for cases where an amount is reimbursed. This section is not derived directly from the source legislation, but it reflects Inland Revenue practice in cases where amounts deductible for income tax purposes are reimbursed. See *Note 36(B)* in Annex 2.
1440. This section also includes wording to ensure that the provisions of this Chapter apply where a payment is made to the employee in respect of the expenses in question, and that payment is included in the employee's earnings. This wording guards against the argument that, in such a case, it is the person making the payment to the employee who pays the amount in question, and not the employee.
1441. *Subsection (3)* provides that this section does not apply to expenses allowed under section 351 (expenses of ministers of religion).
1442. *Subsection (4)* provides that this section is disregarded for the purposes of the deductibility provisions (as defined in section 332).

Section 335: Application of deductions provisions: "earnings charged on receipt" and "earnings charged on remittance"

1443. This section provides that the availability of certain deductions under this Chapter depends on whether or not the earnings are "earnings charged on receipt" or "earnings charged on remittance".
1444. The section is new, but it draws on material in section 198(2) of ICTA.
1445. The expressions "earnings charged on receipt" and "earnings charged on remittance" are defined in *subsection (4)* for the purposes of this Part of this Act. The ambit of the expression "earnings charged on receipt" is the same as that of Cases I and II of Schedule E in paragraph 1 of section 19(1) of ICTA; and the ambit of the expression "earnings charged on remittance" is the same as that of Case III of Schedule E in section 19(1) of that Act.

Section 336: Deductions for expenses: the general rule

1446. This section states the general rule relating to deductions allowed from earnings.
1447. The section derives from section 198(1)(b) of ICTA. This provision has been the subject of much litigation.
1448. *Subsection (1)* states the general rule: a deduction from earnings is allowed for an amount if the employee is obliged to incur and pay it as holder of the employment, and the amount is incurred wholly, exclusively and necessarily in the performance of the duties of the employment.

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1449. *Subsection (2)*, which is new, provides that the following sections in this Chapter contain additional rules allowing deductions for particular kinds of expenses, and rules preventing particular kinds of expenses from being deductible. This subsection, accordingly, emphasises the fact that deductions under the later sections in this Chapter do not depend on this section being satisfied first.
1450. *Subsection (3)* provides that no deduction is allowed under this section for an amount that is deductible under sections 337 to 342 (travel expenses).

Section 337: Travel in performance of duties

1451. This section allows a deduction from earnings for travel expenses if the expenses are necessarily incurred on travelling in the performance of the duties of the employment.
1452. The section is the first of two dealing with the proposition, contained in section 198(1)(a) of ICTA, that a deduction is allowed for “qualifying travelling expenses”. This section deals with the part of that definition in section 198(1A)(a) of ICTA.
1453. Although the label “qualifying travel expenses” appears in section 198(1)(a) of ICTA, that label is used only at the beginning of section 198(1A) of that Act. The label is not used in this Act.
1454. *Subsection (1)* provides that a deduction is allowed from earnings for the travel expenses. In *subsection (1)(b)*, the word “incurred” has replaced the word “expended”; but the practical application of this section should be precisely the same as that of the legislation it replaces: *subsection (1)(a)* provides that the travel expenses must be both incurred and paid.
1455. *Subsection (2)* provides that this section needs to be read with section 359, which prohibits a deduction if a mileage allowance is paid or if mileage allowance relief is available.

Section 338: Travel for necessary attendance

1456. This section allows a deduction from earnings for travel expenses if the expenses are attributable to the employee’s necessary attendance at any place in the performance of the duties of the employment. However, the deduction allowed by this section is not available for the expenses of “ordinary commuting” or “private travel”.
1457. The section is the second of two dealing with the proposition that a deduction is allowed for qualifying travelling expenses. This section deals with the part of that definition in section 198(1A)(b) of ICTA. That provision mentions “ordinary commuting” and “private travel” in section 198(1A)(b)(ii) but those expressions are only defined in paragraph 2 of Schedule 12A to that Act. Paragraph 3 of that Schedule contains a gloss on paragraph 2 and this section also deals with that gloss.
1458. This section derives from section 198(1)(a) and (1A)(b) of ICTA and from paragraphs 2 and 3 of Schedule 12A to that Act. The statutory material has been reorganised so that the definitions of “ordinary commuting” and “private travel” are placed near the propositions to which they apply; and the gloss upon the definitions has been incorporated in the subsections setting out the effect of “ordinary commuting” and “private travel”.
1459. *Subsection (6)* provides that this section needs to be read with section 359, which prohibits a deduction if a mileage allowance is paid or if mileage allowance relief is available.

Section 339: Meaning of “workplace” and “permanent workplace”

1460. This section defines the terms “workplace” and “permanent workplace”, which are used in the definitions of “ordinary commuting” and “private travel” in section 338.

1461. The section derives from paragraphs 2(3) and 4 to 7 of Schedule 12A to ICTA.

Section 340: Travel between group employments

1462. This section allows a deduction from earnings for travel expenses where an employee, who has employments with more than one company in the same group, travels from a place of employment with one group company to another place of employment with another group company.
1463. The section derives from section 198(1B) of ICTA, which provides that the travel expenses are treated as necessarily expended in the performance of the duties to be performed at the destination.
1464. *Subsections (2) to (5)* set out all the conditions that need to be met for the deduction to be allowed. The condition that it is the holder of the employment who is obliged to incur the expenses has not been included, because the Inland Revenue does not rely on this condition before the deduction is allowed. See *Change 83* in Annex 1.
1465. *Subsection (6)* defines the term “group” for the purposes of this section. The definition is more concise than in the legislation from which this subsection derives.
1466. *Subsection (7)* does not set out the general proposition, to be found in the source legislation, that the travel expenses are necessarily expended in the performance of the duties to be performed at the destination. Instead, the operation of the provision has been confined to the two sections (mentioned in this subsection) where this proposition may have an impact.
1467. *Subsection (8)* provides that this section needs to be read with section 359, which prohibits a deduction if a mileage allowance is paid or if mileage allowance relief is available.

Section 341: Travel at start or finish of overseas employment

1468. This section allows a deduction from earnings for starting travelling expenses and finishing travelling expenses if the duties of the employment are performed wholly outside the United Kingdom.
1469. The section derives from section 193(2) and (3) of ICTA.
1470. Section 193(3) begins with the words “For the purposes of section 198(1)”. This section sets out all the conditions that have to be met in each case, as opposed to referring to section 336, the successor provision to section 198(1).
1471. *Subsections (2) to (4)*, however, do not reproduce the condition from section 198(1) that the holder of the employment is obliged to incur and defray the expenses, because the Inland Revenue does not rely on this condition before allowing the deduction from earnings. See *Change 83* in Annex 1.
1472. *Subsection (4)* is one of the provisions that make use of the new term “foreign employer”, defined in section 721 for the purposes of this Act as a whole.
1473. *Subsections (6) and (7)* derive from section 132(2) of ICTA. These subsections ensure that a deduction under this section is still available if duties of the employment are performed in the United Kingdom which are merely incidental to the duties of the employment performed outside the United Kingdom. See also *Change 101(B)* in Annex 1.
1474. *Subsection (8)* defines the new terms “starting travel expenses” and “finishing travel expenses”, which describe travel to take up an overseas employment and travel home after it has finished. This subsection also extends the meaning of the term “employee” to include a person who is to be, or has ceased to be, an employee.

1475. *Subsection (9)* provides that this section needs to be read with section 359, which prohibits a deduction if a mileage allowance is paid or if mileage allowance relief is available.

Section 342: Travel between employments where duties performed abroad

1476. This section allows a deduction from earnings for travel expenses where an employee, who has performed duties of one employment at the place of departure, travels to perform duties of another employment at the destination, and the place of departure or the destination, or both, are outside the United Kingdom.
1477. The section derives from section 193(5) and (6) of ICTA.
1478. Section 193(6) begins with the words “For the purposes of section 198(1)”. This section sets out all the conditions that have to be met in each case, as opposed to referring to section 336, the successor provision to section 198(1).
1479. *Subsections (2) to (7)*, however, do not reproduce the condition from section 198(1) that the holder of the employment is obliged to incur and defray the expenses, because the Inland Revenue does not rely on this condition before the deduction is allowed. See *Change 83* in Annex 1.
1480. *Subsection (7)* is one of the provisions that make use of the new term “foreign employer”, defined for the purposes of this Act as a whole in section 721.
1481. *Subsection (9)* provides that this section needs to be read with section 359, which prohibits a deduction if a mileage allowance is paid or if mileage allowance relief is available.

Fees and Subscriptions

Overview

1482. The following three sections rewrite section 201 of ICTA. The sorts of fees and contributions that are covered by section 201(2) have to be paid before an employee can, lawfully, begin to practise the particular profession or occupation to which the fees relate. They do not therefore meet the “in the performance of the duties” test in section 198 of ICTA, rewritten in section 336(1)(b) of this Act. The subscriptions covered by section 201(3) are voluntary in nature, in the sense that employees do not have to join the body concerned, and so do not meet the “necessarily” test in section 198, again rewritten in section 336(1)(b).
1483. There is another distinction between the expenses allowable under those two subsections. Section 201(2) of ICTA lists the fees paid that qualify for deduction. Section 201(3) gives a general description of the sorts of bodies that are eligible to apply to the Board of Inland Revenue for approval under that subsection, by reference to their character and the activities they pursue.
1484. The names of the bodies that the Board approves are published in a booklet called “Fees and subscriptions paid to Professional Bodies and Learned Societies (List 3)”. That information is also published on the Inland Revenue’s web site. The vast majority of the bodies in List 3 have been approved under section 201(3). Where fees paid to a body qualify for deduction under section 201(2) their entry in List 3 normally records that fact.

Section 343: Deduction for professional membership fees

1485. This section provides for a deduction for fees paid by employees to enable them, lawfully, to pursue their professions or occupations. The section derives from parts of section 201(1), (2) and (5) of ICTA.

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1486. *Subsection (1)* states the basic principle that a deduction from earnings is allowed for certain specified payments. Each such payment is described as a “professional fee”. The requirement in the source legislation that, to be allowable, the payment must have been made “out of the emoluments of the employment” has not been reproduced here. Instead that general requirement is stated in the introduction to the provisions relating to deductions in Part 5 of this Act. See *Change 81* in Annex 1.
1487. *Subsection (2)* defines what is meant by “professional fee”. More fees are listed there than appeared in section 201(2) of ICTA. See *Change 84* in Annex 1.
1488. This Act presents the different types of fees payable in a table. The fees are grouped by reference to the occupational sectors to which they relate.
1489. *Subsections (3)* and *(4)* together provide a new power for the Board of Inland Revenue to make an order adding a new, qualifying fee to the Table in subsection (2). See *Change 85* in Annex 1.

Section 344: Deduction for annual subscriptions

1490. This section provides for a deduction for annual subscriptions to bodies having certain specified characteristics, established for stated objects related to the advancement of knowledge, the maintenance or improvement of standards of conduct within the profession and the protection of its members against claims. The section derives from parts of section 201(1), (3), (4), (5) and (6) of ICTA.
1491. *Subsection (1)* states the basic principle of the availability of a deduction from earnings for subscriptions paid to approved bodies. As in section 343(1), the requirement in the source legislation that, to be allowable, the payment must have been made “out of the emoluments of the employment” has not been reproduced here. See *Change 81* in Annex 1.
1492. *Subsection (2)* describes the types of bodies, by reference to their activities, whose subscriptions are eligible, subject to approval of the body by the Inland Revenue, to be deducted.
1493. *Subsection (3)* provides for the Inland Revenue to approve a body of persons. This reflects the practice on the application of section 201(3) whereby the power of the Board of Inland Revenue to approve such bodies is delegated to the technical specialist. See *Change 158* in Annex 1.
1494. The requirement in *subsection (4)* that the Inland Revenue give notice of their decision on an application simply enacts the existing Inland Revenue practice. See *Change 86* in Annex 1.
1495. *Subsections (5)* and *(6)* give the Inland Revenue the power to determine the part of a subscription that is allowable under subsection (1). That reflects the existing practice on how the power of the Board of Inland Revenue to make such a determination is exercised. See *Change 158* in Annex 1.
1496. The rule in *subsection (7)* about when a payment is treated as having been made to an approved body makes clear how the Inland Revenue have always allowed such payments. See *Change 87* in Annex 1.

Section 345: Decisions of the Inland Revenue under section 344

1497. This section provides powers for the Inland Revenue to withdraw or vary any approval given to or any determination made in respect of a body. The section derives from section 201(6) and (7) of ICTA.
1498. In *subsection (1)* the power to vary a decision on the approval or otherwise of a body for the purposes of section 344 rests with the Inland Revenue as opposed to the Board in the source legislation. See *Change 158* in Annex 1.

1499. This Act requires the Inland Revenue to give notice of their decision. See *Change 88* in Annex 1.
1500. In *subsections (2) and (3)* the move to a straightforward appeal procedure is intended to simplify matters. Section 48(2) of TMA 1970 provides that various provisions of that Act as regards proceedings before the Commissioners apply to “appeals other than appeals against assessments” and to “proceedings...to be heard and determined in the same way as an appeal”. There is therefore no real difference in law or practice in this instance between provisions that refer to an appeal and those that refer to proceedings where the Special Commissioners shall “hear and determine the matter in like manner as an appeal”. See *Changes 158 and 89* in Annex 1.

Section 346: Deduction for employee liabilities

1501. This is the first of a group of five sections that give relief for payments made against liabilities arising from an office or employment. It provides for a deduction for certain employee liabilities. The section derives from section 201AA(7), (8) and (9) and part of section 201AA(1) of ICTA.
1502. *Subsections (1) and (2)* define the payments for which a deduction may be claimed.
1503. *Subsection (3)* defines “premium” and provides some explanatory detail.

Section 347: Payments made after leaving the employment

1504. This section provides that deductions allowable under section 346 are restricted to those relating to liabilities arising in a current employment. It also gives a signpost to the corresponding provisions that deal with payments made after the employee has ceased the particular employment in relation to which the liability to make a payment arises. The section derives from part of section 201AA(1) of ICTA.

Section 348: Liabilities related to the employment

1505. This section defines the types of liability that can give rise to payments that qualify for relief. It derives from section 201AA(2) of ICTA.

Section 349: Meaning of “qualifying insurance contract”

1506. This section defines “qualifying insurance contract”. It derives from section 201AA(3) (a) to (d) and (4) of ICTA.
1507. *Subsections (2) to (5)* state the conditions that have to be met for an insurance contract to come within section 346(1).

Section 350: Connected contracts

1508. This section provides rules to determine whether insurance contracts are connected for the purposes of section 349. It derives from section 201AA (5) and (6) of ICTA.
1509. *Subsections (1) to (3)* define when insurance contracts are connected.
1510. *Subsections (4) to (7)* provide for such a connection to be ignored in certain circumstances.

Section 351: Expenses of ministers of religion

1511. This section allows a deduction for expenses from the earnings of a minister of religion. These include a proportion of the rent of a house used in the performance of the duties and, where premises are occupied in which a charity or ecclesiastical corporation holds an interest and those premises are used in the performance of the duties, a proportion of the expenses arising in connection with them.

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1512. The section derives from section 332 of ICTA.
1513. Unlike section 332 this section does not allow an expense incurred in respect of the profession of a minister to be deducted from any income from an employment or office as a minister. Deductions are restricted to one particular class of income. See *Change 90* in Annex 1.
1514. *Subsection (1)* allows a deduction from the earnings of a minister for amounts incurred wholly, exclusively and necessarily in the performance of the duties.
1515. *Subsection (2)* allows a deduction from earnings for a quarter of the rent paid where a part of the house is used mainly and substantially in carrying out the duties of a minister. Where the part of the house so used is less than one quarter of the whole house an appropriate, lower proportion of the rent paid may be deducted.
1516. Section 332(3) allows a deduction for “such part of the rent as the inspector by whom the assessment is made allows”. The inspector’s decision is subject to appeal to the Commissioners. Since this rule does not fit comfortably with Self Assessment the provision in this section makes the deduction available without reference to the inspector on a just and reasonable apportionment basis. See *Change 91* in Annex 1.
1517. *Subsection (3)* provides for a deduction from earnings for part of the expenses borne by the minister in connection with premises which are owned by a charity or ecclesiastical corporation and in which he resides for the purposes of carrying out his duties.
1518. *Subsection (4)* gives the formula for the deduction allowable under the previous subsection.
1519. *Subsection (5)* defines “charity”. The definition of “charity” is the same as that in section 506(1) of ICTA. See *Note 34* in Annex 2.
1520. *Subsection (6)* requires subsection (1) to be read with section 359 (disallowance of travel expenses: mileage allowances and reliefs) which prevents a deduction where mileage allowance payments are received.

Section 352: Limited deduction for agency fees paid by entertainers

1521. This section provides for a deduction for entertainers in respect of fees paid to their agents for finding them work. The section derives from part of section 201A of ICTA.
1522. Section 201A was introduced to allow entertainers who are in employment to get relief for the fees they pay to their agents for finding them work. Such fees are not deductible under the general rule for the deduction of expenses in section 198(1) of ICTA (rewritten in section 336 of this Act) for two reasons. First, they are paid to put the performer in the position to earn from the employment. They are not, therefore, expended “in the performance of the duties of the employment”. Secondly, as not every entertainer uses the services of an agent, the expense does not pass the “necessarily” test.
1523. *Subsection (1)* states the basic principle that a deduction is allowed, subject to certain conditions being met.
1524. In *subsection (2)* the way the limit of 17.5% of the taxable earnings is expressed differs slightly from the source legislation. See *Change 92* in Annex 1.
1525. *Subsection (4)* defines “entertainer” for the purposes of this section.
1526. *Subsection (5)* defines “agency fees”, by reference to the contract or arrangement under which the entertainer pays them. The use of the word “paid” in this subsection means that it is not sufficient for the employee only to have incurred the liability to pay the fee. The employee has to have transferred value to the agent by way of payment for the deduction to be allowed.

1527. *Subsection (6)* restricts the scope of what counts as a “co-operative society” for the purposes of the section. It also gives a signpost to the external definition of “employment agency”.
1528. Section 201A(6), which contains the commencement date, has not been reproduced because it is now spent.

Section 353: Deductions from earnings charged on remittance

1529. This section deals with deductions from earnings charged on remittance, an expression defined in section 335(4).
1530. The section derives from section 198(3) of ICTA.
1531. *Subsection (1)* provides for a deduction to be allowed from earnings charged on remittance for expenses within *subsection (2)* if the condition in *subsection (3)* is met.
1532. *Subsection (2)* specifies the expenses to which this section applies. Paragraph (a) refers both to expenses paid by the employee out of the relevant earnings and to expenses paid on the employee’s behalf by another person and included in those earnings. This wording did not appear in the source legislation, but it corresponds to the wording used in section 333 (scope of this Chapter). See *Note 36* in Annex 2.
1533. *Subsection (3)* states a condition that must be met before this section may operate: that the earnings would have been deductible under sections 336 to 342 if the earnings had been earnings charged on receipt in the tax year in which the expenses were incurred. (The expression “earnings charged on receipt” is defined in section 335(4)). The reference to “sections 336 to 342” derives from the reference to “subsection (1)” in section 198(3) of ICTA. Sections 341 and 342 do not derive directly from section 198(1) of ICTA, but these have been included in the new reference because the provisions from which they do derive (section 193(3) and (6) of ICTA) operate through section 198(1).
1534. *Subsection (4)*, which is a drafting addition, deals with the relationship between this section and the deductibility provisions (listed in section 332). In the case of deductions under this section the requirement for payment out of earnings has survived, so it is provided that, for the purposes of the deductibility provisions, the expenses are to be assumed to have been paid out of the earnings charged on remittance. See *Change 81* in Annex 1.

Section 354: Disallowance of expenses relating to earnings taxed on different basis or untaxed

1535. This section applies in certain cases where some of the earnings are taxed on one basis while the remainder are either taxed on a different basis or are not within the charge to income tax. This section prevents a deduction relating to earnings in the first category from being given against earnings in the second category in those cases. The section derives from provisions in section 198(2) of ICTA.
1536. *Subsection (1)* prohibits a deduction under sections 336 to 342 if the expenses relate to earnings from the employment which are either not liable to income tax or are taxed on the remittance basis under section 26.

Example

1537. Suppose that F, a Frenchman, is resident and ordinarily resident in France. He performs most of the duties of his employment in France where he receives the earnings for those duties. F does not remit any of those earnings to the United Kingdom, so they are not chargeable to income tax in the United Kingdom. As the holder of his employment, F is also obliged, while in France, to incur expenditure wholly, exclusively and necessarily in the performance of his duties there. However, F also performs a minority of the duties of his employment in the United Kingdom where he receives earnings for these

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other duties. These earnings are chargeable to income tax in the United Kingdom (see section 27). This section prohibits F from deducting the expenditure incurred in France from the income chargeable to tax in the United Kingdom.

1538. *Subsection (2)* applies if the earnings from an employment for a tax year include both earnings charged on remittance under section 26 and other earnings. The subsection prohibits a deduction under section 353 from the earnings charged on remittance if the expenses in question relate to the other earnings.
1539. *Subsection (3)* provides that this section is to be disregarded for the purposes of the deductibility provisions. See *Note 37* in Annex 2.

Section 355: Deduction for corresponding payments by non-domiciled employees with foreign employers

1540. This section provides for a non-domiciled employee with a foreign employer to claim a deduction if certain conditions are met.
1541. This section derives from section 192(1) and (3) of ICTA.
1542. *Subsections (2) to (5)* sets out the conditions that must be met:
- The employee must not be domiciled in the United Kingdom;
 - The employment must be with a foreign employer (a term defined in section 721(1));
 - The employee must have made a payment out of earnings from the employment; and
 - The payment did not reduce the employee's liability to United Kingdom income tax, but was made in circumstances corresponding to those in which it would do so.
1543. *Subsection (6)* provides for the deduction to be allowed.
1544. Section 192(3) of ICTA provides for a successful claim to be allowed "as a deduction in computing the amount of the emoluments"; but this section provides for the claim to be allowed "as a deduction under this Chapter". See *Change 93* in Annex 1.

Section 356: Disallowance of business entertainment and gifts expenses

1545. This section prevents a deduction from earnings of expenses incurred in providing entertainment or a gift in connection with the employer's trade, business, profession or vocation. This general prohibition is subject to the exceptions in sections 357 and 358.
1546. This section derives from section 577(1)(b), (5), (7) and (8) of ICTA and contains new drafting material.
1547. *Subsection (1)* contains the general prohibition on deducting expenses incurred in providing entertainment or a gift.
1548. This section makes it clear that the trade, business, profession or vocation to which the business entertainment expenses relate is the trade etc of the employer. See *Change 94* in Annex 1.
1549. *Subsection (2)* refers to certain exceptions from the general prohibition in subsection (1).
1550. *Subsection (3)* extends the meaning of "entertainment" and brings incidental expenses within the scope of the section.

Section 357: Business entertainment and gifts: exception where employer's expenses disallowed

1551. This section contains an exception to the general prohibition on deducting business entertainment and gifts expenses in section 356. It derives from section 577(1)(a) and (3) of ICTA and contains new drafting material.
1552. *Subsection (1)* disapplies the prohibition on deducting entertaining and gifts expenditure in section 356 where certain conditions are met and refers to further alternative conditions in subsections (2), (3) and (4).
1553. *Subsection (2)* requires that the deduction of the expense must fall to be disallowed in calculating the employer's profits because of section 577 of ICTA where the employer is carrying on a trade, profession or vocation. In practice, this condition is treated as met where the expense would have been disallowed apart from any exemption in section 505(1)(e) of ICTA (exemption from tax under Schedule D in respect of the profits of any trade carried on by a charity where the profits are applied solely to the purposes of the charity etc.) or because of another relief applying to the profits of the employer. Subsection (2) spells out this treatment.
1554. *Subsection (3)* contains an alternative requirement that the expense must fall to be disallowed in calculating the employer's expenses of management because of section 577 of ICTA. Again, it is made clear that the fact the disallowance does not operate because a relief applies is ignored.
1555. *Subsection (4)* contains the other alternative requirement that the expense would fall to be disallowed in calculating the employer's "relevant shipping profits" apart from the making by the employer of a tonnage tax election. See *Change 95* in Annex 1.
1556. *Subsection (5)* contains cross-references to Schedule 22 to FA 2000 to explain the terms used in subsection (4) relating to tonnage tax.
1557. The reference in section 577(3)(b) of ICTA to "in whole or in part" has been omitted. See *Note 38* in Annex 2.

Section 358: Business entertainment and gifts: other exceptions

1558. This section contains the other exceptions from the general prohibition on deducting business entertaining and gifts expenses in section 356. It derives from section 577(5), (7)(c) and (8) of ICTA and contains new drafting material.
1559. *Subsection (1)* provides that the general prohibition on deducting expenses in section 356 does not apply, with some exceptions, if the sums are incurred in providing entertainment or gifts for the employer's employees. But the prohibition in section 356 does still apply in the circumstances set out in paragraphs (a) and (b) of subsection (1) of section 358.
1560. *Subsection (2)* treats directors and persons engaged in the management of a company as employed by it for the purpose of this section.
1561. *Subsection (3)* provides that the general prohibition on deducting entertaining and gifts expenses in section 356 does not apply, with some exceptions, if the sums relate to the provision of a gift which incorporates a conspicuous advertisement for the employer. But the prohibition in section 356 does still apply in the circumstances set out in subsection (3)(a) or (b) of section 358.
1562. The subsection also provides that where the employer is a company, the general prohibition does not apply, with some exceptions, if the expenses are incurred in providing a gift which incorporates a conspicuous advertisement for another company which belongs to the same group as the employer. See *Change 96* in Annex 1. This exception will not apply, however, in the circumstances set out in subsection (3)(a) or (b) of this section.

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1563. This subsection also removes any doubt there might be about whether an employee is excepted from the prohibition in section 356 where the terms of the exception are met. See *Change 96* in Annex 1.
1564. The word “donor” which appears towards the end of the introduction to section 577(8) of ICTA has been changed to “employer” in subsection (3) of section 358. See *Change 96* in Annex 1.
1565. The £50 limit in subsection (3)(b) of this section is fixed at that amount by the section. However, section 716(2)(h) of this Act provides that the £50 limit may be increased by an order made by the Treasury. See *Change 96* in Annex 1.
1566. *Subsection (4)* defines “group” for the purposes of subsection (3) of this section.

Section 359: Disallowance of travel expenses: mileage allowances and reliefs

1567. This section prohibits an employee from obtaining a deduction under the travel deduction provisions (defined as sections 337 to 342, 351, 370, 371, 373 and 374) if mileage allowance payments are made to the employee or mileage allowance relief is available. The section is necessary to establish the order in which the relevant provisions are to be applied and to ensure that there is no double relief.
1568. The section derives from section 198(5) of ICTA, added by Schedule 12, Part 2, paragraph 6 to FA 2001 (in so far as this section relates to the travel deductions provisions other than section 351); and from section 332(3A) and (3B) of ICTA, added by Schedule 12, Part 2, paragraph 10 to FA 2001 (in so far as this section relates to section 351).
1569. *Subsection (4)* contains the definitions of “mileage allowance payments” and “the travel deductions provisions” and contains signposts to the definitions of “company vehicle” and “mileage allowance payments”. Mileage allowance relief is dealt with in section 231.

Section 360: Disallowance of certain accommodation expenses of MPs and other representatives

1570. This section prevents MPs and other representatives from obtaining a deduction from earnings for residential or overnight accommodation.
1571. The section derives from section 198(4) of ICTA.
1572. Section 198(4) is the counterpart to provisions contained in sections 200 and 200ZA of ICTA, from which sections 292 and 293 derive. Those sections provide that allowances for residential or overnight accommodation are exempt from income tax: and this present section accordingly provides that no deduction is allowed for the accommodation expenses in respect of which the allowances are paid.
1573. *Subsection (1)* provides that no deduction from earnings is allowed “under this Chapter”, and may, accordingly, be contrasted with section 198(4) of ICTA, which provided that no deductions should be made “under this section”. See *Change 97* in Annex 1.

Chapter 3: Deductions from benefits code earnings

Overview

1574. The sections in this Chapter allow deductions where goods or services are provided which are within the scope of the benefits code and deductions would have been allowed if the goods or services had been paid for by the employee. The sections derive from sections 141(3), 142(2), 145(3) and 156(8) of ICTA.

1575. All the sections in the Chapter refer to deductions under the whole of Chapter 2 and Chapter 5 of this Part instead of restricting them to the rewritten versions of the provisions referred to in sections 141(3), 142(2), 145(3) and 156(8) of ICTA. See *Change 99* in Annex 1.

Section 361: Scope of this Chapter: cost of benefits deductible as if paid by employee

1576. This section sets out the general proposition for a deduction to be allowed under this Chapter. A person's earnings must include an amount treated as earnings under the relevant parts of the benefits code and a deduction must have been allowable if the employee had paid the cost of the goods or services. The sections in this Chapter are a change in approach to provisions from which they are derived. The changes in sections 362, 363, 364 and 365 are explained in detail in *Changes 98* and *99* in Annex 1.

Section 362: Deductions where non-cash voucher provided

1577. This section applies where goods or services are obtained by an employee in exchange for a non-cash voucher for which an amount is treated as earnings by virtue of section 87(1). It derives from section 141(3) of ICTA. If, had the goods or services been provided by the employee, a deduction would be allowable by the provisions of Chapter 2 or 5 of this Part a deduction is allowable by virtue of this section.

1578. *Subsection (1)* sets out the conditions which must apply if a deduction from earnings is to be allowed.

1579. *Subsection (2)* quantifies the amount of the deduction. A limit is placed on the amount of the deduction allowed rather than providing the deduction is only to be set against the amount treated as earnings.

Section 363: Deductions where credit-token provided

1580. This section applies where goods or services are provided using a credit-token. A deduction may be allowed where the earnings include an amount treated as earnings under section 94(1) and the token is used to obtain goods or services. If the employee would have been allowed a deduction under Chapter 2 or Chapter 5 of this Part if he had paid for the goods or services, a deduction is allowed by this section.

1581. *Subsection (1)* sets out the conditions which must apply if a deduction from earnings is to be allowed.

1582. *Subsection (2)* quantifies the amount of the deduction, with the same limit as described for section 362.

1583. The section derives from section 142(2) of ICTA.

Section 364: Deductions where living accommodation provided

1584. This section applies where the benefit provided is living accommodation. A deduction may be allowed where the earnings include an amount treated as earnings under Chapter 5 of Part 3. If the employee would have been allowed a deduction under Chapter 2 or Chapter 5 of this Part if he had paid for the accommodation, a deduction is allowed under this section. It derives from section 145(3) and 146(9) of ICTA.

1585. A limit is placed on the deduction to be made. The deduction will be calculated on the basis that the amount paid by the employee for the accommodation is equal to the amount treated as earnings in respect of that accommodation.

1586. *Subsection (1)* sets out the conditions which must apply if a deduction from earnings is to be allowed.

1587. *Subsection (2)* quantifies the amount of the deduction.

Section 365: Deductions where employment-related benefit provided

1588. This section applies where an unspecified benefit is provided. A deduction may be due where the earnings include an amount treated as earnings under Chapter 10 of Part 3 of this Act in respect of a benefit. If the employee would have been allowed a deduction under Chapter 2 or Chapter 5 of this Part if he had paid for the cost of the benefit, a deduction is allowed under this section. It derives from section 156(8) of ICTA.
1589. *Subsection (1)* sets out the conditions which must apply if a deduction from earnings is to be allowed.
1590. *Subsection (2)* quantifies the amount of the deduction with the same limit as described for section 362.
1591. *Subsection (3)* contains an explanation of the “cost of the benefit”.

Chapter 4: Fixed allowances for employee’s expenses

Overview

1592. This Chapter contains provisions that allow deductions from an employee’s earnings for amounts fixed by the Treasury.

Section 366: Scope of this Chapter: amounts fixed by Treasury

1593. This section sets out the scope of the Chapter – to allow deductions from earnings for a sum fixed by the Treasury by reference to the employee’s employment.

Section 367: Fixed sum deductions for repairing and maintaining work equipment

1594. This section allows a deduction from the earnings of certain classes of employees for a sum fixed by the Treasury.
1595. It derives from ESC A1. See *Change 100* in Annex 1.
1596. *Subsection (1)* allows a deduction from the earnings of an employee for a sum fixed by the Treasury as representing the average annual expense in respect of the repair and maintenance of work equipment incurred by employees of the class to which the employee belongs.
1597. *Subsection (2)* sets out the terms under which the Treasury may fix a sum for a class of employees.
1598. *Subsection (3)* prevents the allowance of the fixed-sum deduction if the expense in respect of which the sum is fixed is paid or reimbursed by the employer or would be if requested.
1599. *Subsection (4)* provides that where the employer meets part of the expenses (or would do if so requested) in respect of which the fixed-sum deduction is set, the deduction is reduced by that amount.
1600. *Subsection (5)* defines “work equipment” for subsections (1) and (2).
1601. *Subsection (6)* requires the section to be read with section 330(2) (prevention of double deductions). If an expense on work equipment were deductible under Chapter 2 of Part 5, it would not be deductible under this section. See *Change 82* in Annex 1.

Section 368: Fixed sum deductions from earnings payable out of public revenue

1602. This section allows for certain descriptions of employees a deduction of a sum fixed by the Treasury from earnings paid out of public revenue.
1603. It derives from section 199 of ICTA.

1604. *Subsection (1)* allows a deduction from earnings payable out of public revenue for fixed sum expenses relating to the duties that give rise to those earnings.
1605. *Subsection (2)* defines “fixed sum expenses”.
1606. *Subsection (3)* requires the section to be read with section 330(2) (prevention of double deductions). If the expense were deductible under Chapter 2 of Part 5, it would not be deductible under this section.

Chapter 5: Deductions for earnings representing benefits or reimbursed expenses

Background

1607. This Chapter deals with cases where the employer, or a third party, bears the cost of something that is taken into account as part of the employee’s earnings, but the employee is entitled to a deduction from those earnings in respect of that cost.
1608. This Chapter derives from provisions in sections 193 to 195 of ICTA and in sections 50 to 52 of FA 1989. In the majority of cases dealt with, the amount of such a deduction is expressed as being “equal to so much of that cost or, as the case may be, those expenses as fall to be included in those emoluments”. In the present Chapter, by contrast, it is possible to define the amount in question as “the included amount”, and then to say that “the deduction is equal to the included amount”.
1609. Another common thread in the provisions dealt with in this Chapter is that the amounts included in the employee’s earnings are generally expressed in terms of provision being made “by or on behalf of the employer” (or similar). It has not been possible to establish the original policy reasons for limiting the scope of the deductions to provision made in this way. There may be circumstances where the provision is by or on behalf of someone other than the employer and the amount is still chargeable as part of the employee’s earnings. As long as all the other conditions for the deductions are met, there seems no reason why a deduction should be withheld because the provision was made by a person other than the employer or someone acting on the employer’s behalf. The words “by or on behalf of the employer” (or similar) which appear in the source legislation are therefore omitted. To the extent that this change has any practical effect, it will be in favour of the taxpayer. See *Change 101(A)* in Annex 1.
1610. This Chapter does not deal with a deduction for expenses incurred and paid by the employee without any reimbursement. That kind of deduction is dealt with in Chapter 2 of this Part.

Overview

1611. As in Chapter 2 of this Part, the sections have been grouped according to the type of expense involved. After section 369, which is introductory:
- sections 370 to 372 allow deductions for travel costs and expenses where the employee is resident and ordinarily resident in the United Kingdom, but the duties of the employment are performed abroad;
 - section 373 to 375 allow deductions for travel costs and expenses where the employee is not domiciled in the United Kingdom, but the duties of the employment are performed in the United Kingdom;
 - section 376 allows a deduction for costs and expenses in respect of accommodation or subsistence where the employee is resident and ordinarily resident in the United Kingdom, but working abroad;
 - section 377 allows a deduction for costs and expenses in respect of personal security assets and services.

Section 369: Scope of this Chapter: earnings representing benefits or reimbursed expenses

1612. This section deals with preliminary matters relevant for this Chapter.
1613. *Subsection (1)* brings together material contained in sections 193(4), 194(1) and 195(7) of ICTA and in section 50(2) and (3) of FA 1989. *Subsections (2)* and *(3)* are drafting additions.
1614. *Subsection (1)* states the general proposition that a deduction from a person's earnings is allowed under the following provisions of this Chapter where an amount has been included in the earnings in respect of provision made for the person or expenses reimbursed by another person. See *Change 101(A)* in Annex 1.
1615. *Subsection (2)* provides that the amount described in *subsection (1)* is referred to in this Chapter as "the included amount".
1616. *Subsection (3)* is concerned with the overlap between this Chapter and Chapter 3 of this Part. If the included amount is an amount treated as earnings by virtue of the benefits code, a deduction may be available under Chapter 3; and this subsection accordingly provides a signpost to that Chapter.

Travel costs and expenses where duties performed abroad

1617. The next three sections provide for deductions to be allowed from earnings for travel costs and expenses where the employee is resident and ordinarily resident in the United Kingdom but the duties of the employment are performed abroad. These sections derive from provisions in section 194 of ICTA.

Section 370: Travel costs and expenses where duties performed abroad: employee's travel

1618. This section provides that a deduction is allowed from earnings for travel costs and expenses where the journey in question is made by the employee.
1619. The section derives from provisions in section 194(1), (3), (4), (5), (6) and (8) of ICTA.
1620. *Subsection (1)* specifies the circumstances in which a deduction from earnings is allowed. See also *Change 101(A)* in Annex 1. The deduction is allowed if:
- the employee has earnings which are taxable earnings under section 15 or 21 (which apply if the employee is resident and ordinarily resident in the United Kingdom in the tax year);
 - the earnings include an amount in respect of the provision of travel facilities for a journey made by the employee, or the reimbursement of expenses incurred by the employee on such a journey; and
 - the requirements specified in one of cases A to C are met.
1621. *Subsection (2)* provides that the deduction is equal to the included amount; and cases A, B and C are set out in *subsections (3), (4)* and *(5)*.
1622. In the source legislation the provisions of section 132(2) of ICTA could affect the availability of this deduction. The application of section 132(2) would mean the disallowance of a deduction under this section where the duties performed in the United Kingdom were merely incidental to the performance of the other duties of the employment outside the United Kingdom. In practice deductions are allowed in these circumstances; and, accordingly, material deriving from section 132(2) of ICTA has not been included in this section. See *Change 101(B)* in Annex 1.

Section 371: Travel costs and expenses where duties performed abroad: visiting spouse's or child's travel

1623. This section provides that a deduction is allowed from earnings for travel costs and expenses where the journey in question is made by the employee's spouse or child.
1624. The section derives from provisions in section 194(1) and (2) of ICTA.
1625. *Subsection (1)* specifies the circumstances in which a deduction from earnings is allowed. See also *Change 101(A)* in Annex 1. The deduction is allowed if:
- the employee has earnings which are taxable earnings under section 15 or 21 (which apply if the employee is resident and ordinarily resident in the United Kingdom in the tax year);
 - the earnings include an amount in respect of the provision of travel facilities for a journey made by the employee's spouse or child, or the reimbursement of expenses incurred by the employee on such a journey; and
 - conditions A to C are met.
1626. *Subsection (2)* provides that the deduction is equal to the included amount; and conditions A, B and C are set out in *subsections (3), (4) and (5)*.

Section 372: Where seafarers' duties are performed

1627. This section provides that section 40(2) (certain duties treated as performed in the United Kingdom) does not apply for the purposes of determining whether duties performed on a vessel are performed in or outside the United Kingdom for the purposes of sections 370 and 371. It derives from section 194(7) of ICTA.

Travel costs and expenses of non-domiciled employees where duties performed in UK

1628. The next three sections provide for deductions to be allowed from earnings for travel costs and expenses where the employee is not domiciled in the United Kingdom, but the duties are performed there. These sections derive from provisions in section 195 of ICTA.

Section 373: Non-domiciled employee's travel costs and expenses where duties performed in UK

1629. This section provides that a deduction is allowed from earnings for travel costs and expenses where the journey in question is made by the employee.
1630. The section derives from provisions in section 195(1), (2), (5), (7), (8) and (9) of ICTA.
1631. *Subsection (1)* specifies the circumstances in which a deduction from earnings is allowed. See also *Change 101(A)* in Annex 1. The deduction is allowed if:
- the employee is not domiciled in the United Kingdom;
 - the employee receives earnings from an employment for duties performed in the United Kingdom; and
 - an amount is included in the earnings in respect of the provision of travel facilities for a journey made by the employee, or the reimbursement of expenses incurred by the employee on such a journey.
1632. *Subsection (2)* provides for the deduction from earnings to be allowed if:
- the earnings are earnings charged on receipt (a term defined in section 335(4)); and
 - the conditions set out in *subsections (3) and (4)* are met.

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

1633. Condition A in *subsection (3)* reflects Inland Revenue practice in linking the five year period to the date when the journey was undertaken as opposed to the date when the expenditure was incurred. See *Change 102* in Annex 1.
1634. *Subsection (5)* provides that if the journey is wholly for the purpose specified in *subsection (4)*, the deduction allowed is equal to the included amount; and *subsection (6)* provides that if the journey is only partly for that purpose, the deduction allowed is only a proportion of the included amount.
1635. In section 195 of ICTA there are references to a person's "usual place of abode" and this expression is then defined (in section 195(9)) as "the country (outside the United Kingdom) in which he normally lives". The provisions in this Act take a simpler approach, referring just to "the country outside the United Kingdom in which the employee normally lives".

Section 374: Non-domiciled employee's spouse's or child's travel costs and expenses where duties performed in UK

1636. This section provides that a deduction is allowed from earnings for travel costs and expenses where the journey in question is made by the employee's spouse or child.
1637. The section derives from provisions in section 195(1), (2) and (6) to (10) of ICTA.
1638. *Subsection (1)* specifies the circumstances in which a deduction from earnings is allowed. See also *Change 101(A)* in Annex 1. The deduction is allowed if:
- the employee is not domiciled in the United Kingdom;
 - the employee receives earnings from an employment for duties performed in the United Kingdom; and
 - an amount is included in the earnings in respect of the provision of travel facilities made by the employee's spouse or child, or the reimbursement of expenses incurred by the employee on such a journey.
1639. *Subsection (2)* provides for the deduction from earnings to be allowed if:
- the earnings are earnings charged on receipt (a term defined in section 335(4)); and
 - the conditions set out in *subsections (3) to (5)* are met.
1640. Condition A in *subsection (3)* reflects Inland Revenue practice in linking the five year period to the date when the journey was undertaken as opposed to the date when the expenditure was incurred. See *Change 102* in Annex 1.
1641. *Subsection (6)* provides that if the journey is wholly for the purpose specified in *subsection (5)*, the deduction allowed is equal to the included amount; and *subsection (7)* provides that if the journey is only partly for that purpose, the deduction allowed is only a proportion of the included amount.
1642. As in the case of section 373, references to an employee's "usual place of abode" have been replaced by references to the country outside the United Kingdom in which the employee normally lives.

Section 375: Meaning of "qualifying arrival date"

1643. This section explains the meaning of the expression "qualifying arrival date", which is used in sections 373 and 374. It derives from section 195(2), (3) and (4) of ICTA.
1644. *Subsection (4)* provides that if there are two or more dates in a tax year which are capable of being a "qualifying arrival date", the qualifying arrival date is the earliest of those dates.

Section 376: Foreign accommodation and subsistence costs and expenses (overseas employments)

1645. This section provides that a deduction is allowed for costs or expenses in respect of accommodation or subsistence while an employee is working abroad.
1646. The section derives from section 193(2) and (4) of ICTA.
1647. *Subsection (1)* specifies the circumstances in which a deduction from earnings is allowed. See also *Change 101(A)* in Annex 1. The deduction is allowed if:
- the duties of the employment are performed wholly outside the United Kingdom;
 - the employee is resident and ordinarily resident in the United Kingdom;
 - in a case where the employer is a foreign employer (see section 721(1)), the employee is domiciled in the United Kingdom; and
 - the earnings include an amount in respect of the provision of accommodation or subsistence outside the United Kingdom for the purpose of enabling the employee to perform the duties of the employment, or the earnings include an amount in respect of the reimbursement of expenses incurred by the employee on such accommodation or subsistence for that purpose.
1648. *Subsection (2)* provides that if the accommodation or subsistence is wholly for the purpose of enabling the employee to perform the duties of the employment, the deduction is equal to the included amount; and *subsection (3)* provides that if the accommodation or subsistence is only partly for that purpose, the deduction allowed is only a proportion of the included amount.
1649. The expression “board and lodging” in section 193(4) of ICTA has been replaced in this Act by the expression “accommodation or subsistence”. It is not necessary for both elements mentioned in section 193(4) to be present for the deduction to be allowed.
1650. In the detail of the wording used, this section departs from the legislation it replaces to a significant extent. Some of these changes reflect the decision to dispense with the term “foreign emoluments” and to use the term “foreign employer”.
1651. *Subsections (4) and (5)* derive from section 132(2) of ICTA. These subsections ensure that a deduction under this section is still available if duties of the employment are performed in the United Kingdom which are merely incidental to the duties of the employment performed outside the United Kingdom. See also *Change 101(B)* in Annex 1.

Section 377: Costs and expenses in respect of personal security assets and services

1652. This section provides that a deduction is allowed for costs and expenses in respect of personal security assets and services.
1653. The section derives from sections 50 to 52 of FA 1989.
1654. *Subsection (1)* specifies the circumstances in which a deduction from earnings is allowed. See also *Change 101(A)* in Annex 1. The deduction is allowed if:
- there is a special threat to the employer’s personal physical security which arises wholly or mainly because of the employee’s employment;
 - an asset or service which improves personal security is provided for or used by the employee to meet the threat;
 - the employee’s earnings include an amount in respect of the asset or service because some or all of the costs are borne by the provider; and

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- the provider's sole object in bearing the whole or part of the cost or reimbursing the expenses is meeting the threat.
1655. If the provider of an asset within subsection (1) intends that asset to be used solely for the purpose of improving personal physical security, a deduction equal to the included amount is allowed (*subsection (2)*). Use incidental to this purpose is ignored (*subsection (3)*). If the provider of the asset intends it to be used only partly to improve personal physical security, the deduction allowed is only a proportion of the included amount (*subsection (4)*). In determining whether or not this section applies, certain matters may be disregarded (*subsection (5)*).
1656. In the case of a service within subsection (1), if the benefit resulting to the employee consists wholly or mainly of an improvement of the employee's physical security, a deduction equal to the included amount is allowed (*subsection (6)*).
1657. *Subsection (7)* provides that the fact that an asset or a service improves the personal physical security of a member of the employee's family or household, as well as that of an employee, does not prevent a deduction being allowed under this section. In subsection (7) the expression "member of the employees' family or household" is not defined in the source legislation; but in this Act this expression is covered by the general definitions in section 721(4) and (5). See *Note 39* in Annex 2.
1658. *Subsection (8)* omits the reference to "living accommodation" in section 52(3)(b) of FA 1989 on the basis that this expression is already encompassed by the word "dwelling".

Chapter 6: Deductions from seafarers' earnings

1659. This Chapter rewrites section 192A of and Schedule 12 to ICTA. These provide a deduction, commonly called the Foreign Earnings Deduction ("FED") for seafarers against earnings for a year in which the seafarer is resident and ordinarily resident in the United Kingdom. This deduction has something of the flavour of an exemption in that the amount deductible is equal to an amount of earnings rather than any costs or expenses incurred.

Section 378: Deduction from seafarers' earnings: eligibility

1660. This section sets out the conditions for eligibility for the deduction. Broadly speaking, seafarers must spend no less than half of a qualifying period of at least 365 days outside the United Kingdom and not more than 183 consecutive days in the United Kingdom during the qualifying period.
1661. It is possible to combine various periods of absence from the United Kingdom to determine whether the test has been satisfied. Paragraph 3 of Schedule 12 to ICTA deals with this by using the terms "qualifying period", "relevant periods", "a single qualifying period", "the last qualifying period" and the "intervening period". These concepts and their various combinations are difficult to follow.
1662. So, in *subsection (2)* the new term "eligible period", which consists of either a period of continuous absence from the United Kingdom or a "combined period" (another new term which is itself defined in *subsection (3)*) has been introduced.

Section 379: Calculating the deduction

1663. This section sets out the amount of the deduction which may be allowed from the earnings attributable to the eligible period. *Subsection (1)* derives from section 192A(1) of ICTA.
1664. *Subsection (2)* derives from the rule in paragraph 3(3) Schedule 12 to ICTA concerning earnings for a period of leave immediately following an eligible period. That rule says

that the emoluments for such a period of leave may be taken as attributable to the qualifying period, but only to the extent that this would not mean having to treat any emoluments for one tax year as belonging to a different tax year. Essentially this rule allows emoluments for a period of leave to be attributed to the qualifying period to the extent that they are emoluments for the tax year during which the qualifying period ends.

1665. *Subsection (3)* makes the deduction subject to the limit contained in the following section.

Section 380: Limit on deduction where UK duties etc. make amount unreasonable

1666. This section derives from paragraph 2 of Schedule 12 to ICTA. It contains anti-avoidance provisions against attempts to manipulate the amount of the earnings to take advantage of the relief.

1667. The rules in paragraph 2(3) of Schedule 12 to ICTA for determining associated employments end with the words “but paragraph (b) above shall not be construed as requiring an individual to be treated in any circumstances as under the control of another person”. These words did not appear to have any policy or practical purpose and have been omitted as unnecessary. The rules are now the same as in section 24 and rather than repeat them here *subsection (4)* contains a cross-reference to that section.

Section 381: Taking account of other deductions

1668. This section contains the rules for calculating the amount of the earnings for the purposes of this Chapter. It derives from paragraph 1A of Schedule 12 to ICTA.
1669. All the other employment income deductions are allowed against the full amount of earnings from the employment for the tax year in question. However, the deduction is only allowed in respect of the earnings from the employment which are attributable to an eligible period.
1670. This means that in some circumstances only a part of a seafarer’s earnings for a year may be eligible for the deduction. If the deduction was computed and allowed by reference to the gross earnings for the eligible period, this would displace any other employment income deductions, with the effect that those other deductions, which were for a full year, would be allowed against the earnings for only part of the year.
1671. To prevent this, this section requires that the amount of the earnings for the eligible period is to be computed by first deducting all of the employment income deductions and any capital allowances from the gross earnings of the employment for the year. The net product of this calculation is then apportioned to find the earnings for both the eligible and non-eligible periods.
1672. Paragraph 1A of Schedule 12 to ICTA lists the deductions which are to be taken into account in determining the earnings for the purposes of the FED. However, this list is not complete. For example, it does not refer to deductions under sections 201AA or 201A of ICTA, or under sections 50 to 52 of FA 1989.
1673. This appears to be unintended. In practice, all the other employment income deductions and capital allowances are taken into account when calculating the earnings eligible for the FED. Accordingly the list has been extended to include all those which may be made under the appropriate employment income provisions. This is a minor change to the law. See *Change 103* in Annex 1.

Section 382: Duties on board ship

1674. This section determines whether duties performed on particular voyages are regarded as having been performed in or outside the United Kingdom. It derives from paragraph 5 of Schedule 12 to ICTA and section 132(4)(b) of ICTA.

1675. This section modifies one of the rules in section 132(4)(b) of ICTA, but only for the specific purpose of identifying the duties and earnings which are eligible for the FED. For all other purposes, the rules in section 40 are unaffected by this section.

Section 383: Place of performance of incidental duties

1676. This section derives from paragraph 6 of Schedule 12 to ICTA and sets out the rules (which apply only to the FED), regarding the performance of duties which are incidental to the main duties of the employment.
1677. Under section 132(2) of ICTA, if the duties of an employment are mainly performed outside the United Kingdom, any duties incidental to those performed in the United Kingdom are treated as being performed outside the United Kingdom. However, this rule does not apply when deciding whether or not a seafarer is absent from the United Kingdom to determine entitlement to the FED. This exception to the section 132(2) rule is in section 132(3) and has been rewritten in *subsection (4)* of this section.

Section 384: Meaning of employment “as a seafarer”

1678. This section defines what this means. It derives from section 192A(2) of ICTA. The exception for earnings from Crown employments derives from section 132(4)(a) of ICTA and ensures that those earnings do not qualify for the FED.

Section 385: Meaning of “ship”

1679. This section derives from section 192A(3) of ICTA. “Ship” takes its everyday meaning, subject to the exception in respect of an “offshore installation” as provided by the Mineral Workings (Offshore Installations) Act 1971. Further guidance on the meaning of those terms is given in the Inland Revenue Schedule E manual at paragraphs SE 33221 to 33222.

Part 6: Employment income: income which is not earnings or share-related

Chapter 1: Payments to non-approved pension schemes

Overview

1680. This Chapter sets out the charge to tax on an employee whose employer makes payments to a non-approved pension scheme. It derives from section 595 of ICTA. It is one of the free-standing Schedule E charges presently covered by paragraph 5 of section 19(1) of ICTA and now brought into charge as “specific employment income”.

Section 386: Charge on payments to non-approved retirement benefits schemes

1681. This section derives from section 595(1) of ICTA and sets out the charge to tax on an employee where the employer makes certain payments to non-approved pension (“retirement benefits”) schemes. *Subsections (1), (2) and (3)* derive from section 595(1) and (1)(a) of ICTA.
1682. *Subsection (4)* reflects the amendment made to section 595 by paragraph 6 of Schedule 6 to FA 2002. This resolved the order of priority between section 595 and section 148 of ICTA.
1683. *Subsection (5)* derives from section 612 of ICTA. The other provisions in Chapter I of Part XIV of ICTA are not exclusively relevant to employment income and will be rewritten at a later stage. This subsection applies the definitions of “employee” and “director” which are in section 612(1).
1684. *Subsection (6)* derives from section 595(5) of ICTA. It may be noted that the reference in that subsection applies to section 595 only. In the new section the reference is applied to the whole Chapter which ensures that relief under section 596(3) of ICTA is available in

cases where the benefits are intended to be provided to persons other than the employee. This is a minor change to the law. See *Change 104* in Annex 1.

1685. *Subsection (7)* acts as a signpost to the reliefs available under section 392 and section 266A of ICTA. The latter is a new provision inserted by paragraph 36 of Schedule 6 to this Act and derives from section 595(1)(b) of ICTA.

Section 387: Meaning of “non-approved retirement benefits scheme”

1686. This section defines such a scheme. It derives from section 596(1) of ICTA.

Section 388: Apportionment of payments in respect of more than one employee

1687. This section derives from section 596(4) of ICTA. It provides that where a single payment is made to a non-approved scheme in respect of more than one employee, that payment is apportioned between the employees. Each is taxed only on an appropriate share of the payment.

1688. *Subsection (2)* introduces a formula for making the apportionment.

Section 389: Exception: employments where earnings charged on remittance

1689. This section derives from section 596(2)(a) of ICTA, which provides an exception from the charge where the employee’s earnings are chargeable under Case III of Schedule E. That charge is now dealt with in sections 22 and 26.

Section 390: Exception: non-domiciled employees with foreign employers

1690. This section derives from section 595(2)(b) of ICTA and provides a further exception from the charge under section 386 of this Act. This is where the earnings are (in the terminology of ICTA) “foreign emoluments” and the payment is to a retirement benefits scheme which corresponds to approved or relevant statutory schemes etc. As the term “foreign emoluments” has been dropped this section instead sets out the relevant circumstances for the exception to apply.

Section 391: Exception: seafarers with overseas earnings

1691. This section legislates the Inland Revenue’s practice of exempting payments from the charge when they are made to seafarers who have no net chargeable earnings from the employment in question for the year as a result of the foreign earnings deduction set out in Chapter 6 of Part 5 of this Act. This is a minor change to the law. See *Change 105* in Annex 1.

Section 392: Relief where no benefits are paid or payable

1692. This section derives from section 596(3) and (4) of ICTA and allows an application for relief where the relevant benefits are not subsequently received from the scheme. Under this section the application is made to and considered by the Inland Revenue rather than the Board. See *Change 158* in Annex 1.

1693. The source legislation provides for an application for relief only from the employee. However, some benefits might not be due until after the employee has died. In practice the Inland Revenue have always accepted applications by the employee’s personal representatives. *Subsection (3)* legislates that practice. It is a minor change to the law. See *Change 104* in Annex 1.

Chapter 2: Benefits from non-approved schemes

Overview

1694. This Chapter applies to benefits provided by non-approved retirement benefits schemes.

Section 393: Application of this Chapter

1695. This section defines the scope of the Chapter. The Chapter applies to any benefit provided by a non-approved retirement benefits scheme other than pensions and annuities within the pension income Part. *Subsection (1)* derives from section 596A(1) of ICTA. *Subsection (2)* derives from section 596A(6) of ICTA.
1696. Section 596A(7) of ICTA has not been rewritten in this Act. See *Note 40* in Annex 2.

Section 394: Charge on benefit to which this Chapter applies

1697. This section establishes the charge and the basis of assessment. It ensures that the charge has priority over all other charges in this Act.
1698. *Subsection (1)* applies if an individual receives the benefit. It derives from section 596A(2) of ICTA. The benefit counts as employment income of the individual for the tax year in which the benefit is received.
1699. *Subsection (2)* applies if a person other than an individual receives the benefit. It derives from section 596A(3) of ICTA. There is a charge under Schedule D Case VI on the scheme administrator for the tax year in which the benefit is received. This charge is not employment income. Therefore it does not need to be excluded from the definition of "PAYE employment income" in section 683.
1700. *Subsection (4)* specifies the rate of tax for the Schedule D Case VI charge. It derives from section 596A(5) of ICTA.
1701. *Subsection (5)* establishes the order of priority. The charge under this Chapter takes priority over all other charges in this Act. In its application to lump sums the section derives from section 596A(8) of ICTA. It also legislates the interpretation that the specific charge in section 596A takes priority over a general charge under Schedule E.

Section 395: Application of sections 396 and 397: general rules

1702. This section applies if the benefit received is a lump sum. It derives from section 596A(8), (9) and (15) of ICTA.
1703. The section has two functions.
1704. First, it introduces sections 396 and 397. Section 396 exempts the charge under section 394 if certain conditions are met. Section 397 modifies the charge under section 394 if certain conditions are met.
1705. Second, it sets out the condition that is common to both sections 396 and 397 and which must be met if either section is to apply.
1706. The common condition is given in *subsection (4)*. It derives from sections 596A(8) and (9) of ICTA. The employer has to have paid a contribution or contributions with a view to providing the benefit and the employee has to have been assessed to tax in respect of that contribution or contributions. The assessment may be under section 595 of ICTA or section 386(1) of this Act depending on when the contribution was made.
1707. *Subsection (5)* puts the onus on the taxpayer to show that the conditions in *subsection (4)* are satisfied. It derives from the assumptions in section 596A(15) of ICTA.

Section 396: Certain lump sums not taxed by virtue of section 394

1708. This section exempts lump sum benefits if:
- all the profits on the scheme investments are brought into charge to tax, and;
 - the lump sum has been provided to one of the persons listed in *subsection (1)(b)*.

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1709. The section derives from sections 596A(8) and (15) of ICTA.
1710. A further requirement for the exemption to apply is that the condition in section 395(4) is met; see section 395(2).
1711. In *subsection (1)(a)* the phrase “brought into charge to tax” means brought into charge to United Kingdom tax.
1712. *Subsection (2)* puts the onus on the taxpayer to show that the income and gains of the scheme are brought into charge to tax. It derives from the assumptions in section 596A(15) of ICTA.

Section 397: Certain lump sums: calculation of amount taxed by virtue of section 394

1713. This section allows a deduction from the amount of the lump sum that is charged to tax if:
- any of the profits on the scheme investments are not brought into charge to tax, and;
 - the condition in section 395(3) is satisfied.
1714. The section derives from sections 591D(6) and 596A(9) to (17) of ICTA. It rewrites section 596A(9) as a free-standing provision. See *Change 106* in Annex 1.
1715. *Subsection (3)* gives the amount of the deduction. It is the total of:
- any contribution the employee has paid, and;
 - any contribution the employer has paid that has been taxed on the employee.
1716. *Subsection (3)* derives from section 596A(10) and is subject to *subsection (4)*. *Subsection (4)* applies the formula in *subsection (6)* if any of the persons listed in *subsection (5)* has the right to receive, or expectation of receiving, a further lump sum or sums. *Subsections (4), (5) and (6)* derive from sections 596A(11) to (13) of ICTA.
1717. *Subsection (7)* prevents double deductions. It derives from section 596A(14) of ICTA.
1718. *Subsection (8)* derives from the assumptions in section 596A(15) of ICTA.
1719. *Subsection (9)* derives from section 591D of ICTA. It prevents a claim that the scheme funds have been brought into charge to tax because they have suffered a charge under section 591C of ICTA (cessation of approval: tax on certain schemes).
1720. *Subsection (10)* gives the meaning of “market value”. It derives from section 596A(17) of ICTA and cross-refers to sections 272 and 273 of TCGA 1992. The reference to section 273 of TCGA 1992 is new. See *Note 41* in Annex 2.

Section 398: Valuation of benefits

1721. This section provides the rules for calculating the value of the benefit.
1722. It derives from section 596A(4) and section 596B of ICTA.
1723. The language in section 596A(4) and section 596B of ICTA is almost identical to that in two other provisions:
- paragraph 12 of Schedule 11 to ICTA, which deals with the valuation of benefits paid on the termination of employment; and
 - paragraph 10(3) of Schedule 12 to FA 2000, which deals with the provision of services through an intermediary.

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1724. Paragraph 12 of Schedule 11 to ICTA has been rewritten as section 415 of this Act. Paragraph 10(3) of Schedule 12 to FA 2000 has been rewritten as section 55 of this Act. The rewrite of the three sections reflects the similarities.
1725. *Subsection (1)* gives the rule if the benefit is paid in cash. It derives from section 596A(4)(a) of ICTA.
1726. *Subsection (2)* gives the rule if the benefit is not paid in cash. It derives from section 596A(4)(b) of ICTA.
1727. *Subsection (5)* provides that references to the employer in the benefits code include the former employer. This subsection is needed because most employees will have retired before the benefit is paid and their employer will be a former employer.
1728. *Subsection (6)* adapts the benefits code if the benefit provided is accommodation costing over £75,000 and the person receiving the benefit makes good an amount that exceeds the rental value. It overrides the rule in section 106(3) that the taxpayer is allowed to deduct only the excess amount of rent paid. The taxpayer is allowed a deduction for the full amount of the excess.
1729. In the source legislation dealing with benefits the rules for calculating the value of living accommodation costing over £75,000 do not apply if the accommodation was first occupied before 31 March 1983. This rule has been rewritten as a saving; see paragraph 21 of Schedule 7 to this Act. The rule does not apply to section 596B of ICTA. So paragraph 21 of Schedule 7 does not apply for the purposes of this Chapter.

Section 399: Employment-related loans: interest treated as paid

1730. This section applies if the benefit provided is a loan at a rate of interest lower than the official rate.
1731. It derives from section 596C of ICTA.
1732. Tax is charged on the cash equivalent of the loan. This is calculated using the official interest rate. But the cash equivalent is not in fact interest. The section treats the taxpayer as having paid interest. The taxpayer can then claim tax relief on the deemed payment if real interest would have qualified for relief. The language in section 596C of ICTA is almost identical to that in paragraph 13 of Schedule 11 to ICTA, which deals with benefits paid on the termination of employment. That provision has been rewritten as section 416 of this Act.
1733. *Subsection (4)* prevents the notional interest being treated as income of the lender or as mortgage interest payable under deduction of tax in the hands of the payer.

Section 400: Interpretation

1734. This section gives the meaning of various terms used in the Chapter.
1735. It derives from definitions in Chapter 1 of Part 14 of ICTA.
1736. *Subsection (1)* includes a clarification of the meaning of “employee” and the definitions of “administrator”, “relevant benefits” and “ex-spouse”.
1737. Section 611AA of ICTA defines “administrator” as follows:
- (1) In this Chapter references to the administrator, in relation to a retirement benefits scheme, are to the person who is, or the persons who are, for the time being the administrator of the scheme by virtue of the following provisions of this section.
 - (2) Subject to subsection (7) below, where—
 - (a) the scheme is a trust scheme, and

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- (b) at any time the trustee, or any of the trustees, is or are resident in the United Kingdom,
the administrator of the scheme at that time shall be the trustee or trustees of the scheme.
- ((3) Subject to subsection (7) below, where—
- (a) the scheme is a non-trust scheme, and
- (b) at any time the scheme sponsor, or any of the scheme sponsors, is or are resident in the United Kingdom,
the administrator of the scheme at that time shall be the scheme sponsor or scheme sponsors.
- ((4) At any time when the trustee of a trust scheme is not resident in the United Kingdom or (if there is more than one trustee) none of the trustees is so resident, the trustee or trustees shall ensure that there is a person, or there are persons—
- (a) resident in the United Kingdom, and
- (b) appointed by the trustee or trustees to be responsible for the discharge of all duties relating to the scheme which are imposed on the administrator under this Chapter.
- ((5) At any time when the scheme sponsor of a non-trust scheme is not resident in the United Kingdom or (if there is more than one scheme sponsor) none of the scheme sponsors is so resident, the scheme sponsor or scheme sponsors shall ensure that there is a person, or there are persons—
- (a) resident in the United Kingdom, and
- (b) appointed by the scheme sponsor or scheme sponsors to be responsible for the discharge of all duties relating to the scheme which are imposed on the administrator under this Chapter.
- ((6) Without prejudice to subsections (4) and (5) above—
- (a) the trustee or trustees of a trust scheme, or
- (b) the scheme sponsor or scheme sponsors of a non-trust scheme,
may at any time appoint a person who is, or persons who are, resident in the United Kingdom to be responsible for the discharge of all duties relating to the scheme which are imposed on the administrator under this Chapter.
- ((7) Where at any time there is or are a person or persons—
- (a) for the time being appointed under subsection (4), (5) or (6) above as regards a scheme, and
- (b) resident in the United Kingdom,
the administrator of the scheme at that time shall be that person or those persons (and no other person).
- ((8) Any appointment under subsection (4), (5) or (6) above—
- (a) must be in writing, and
- (b) if made after the time when the scheme is established, shall constitute an alteration of the scheme for the purposes of section 591B(2).
- ((9) In this section—
- (a) references to a trust scheme are to a retirement benefits scheme established under a trust or trusts;

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- (b) references to the trustee or trustees, in relation to a trust scheme and to a particular time, are to the person who is the trustee, or the persons who are the trustees, of the scheme at that time;
 - (c) references to a non-trust scheme are to a retirement benefits scheme not established under a trust or trusts, and
 - (d) references to the scheme sponsor or scheme sponsors, in relation to a retirement benefits scheme and to a particular time, are references to any person who established the scheme and is in existence at that time or, if more than one, all such persons.
1738. Section 612(1) of ICTA provides that “employee”
- (a) in relation to a company, includes any officer of the company, any director of the company and any other person taking part in the management of the affairs of the company, and
 - (b) in relation to any employer, includes a person who is to be or has been an employee.
1739. The definition of “ex-spouse” derives from section 659D of ICTA as inserted by section 79 and paragraph 17 of Schedule 10 to Finance Act 2000.
1740. Section 612(1) of ICTA defines “relevant benefits” as follows:
- ‘relevant benefits’ means any pension, lump sum, gratuity or other like benefit given or to be given on retirement or on death, or by virtue of a pension sharing order or provision, or in anticipation of retirement, or, in connection with past service, after retirement or death, or to be given on or in anticipation of or in connection with any change in the nature of the service of the employee in question, except that it does not include any benefit which is to be afforded solely by reason of the disablement by accident of a person occurring during his service or of his death by accident so occurring and for no other reason.

Chapter 3: Payments and benefits on termination of employment etc.

Overview

1741. This Chapter contains another of the free-standing Schedule E charges covered by paragraph 5 of section 19(1) of ICTA. It derives from section 148 of, and Schedule 11 to, ICTA. The provisions apply to charge to tax payments made and benefits provided when an employment ends or the terms of it are changed. As such payments and provision of benefits may continue for a period after the event, the charge to tax continues year by year as long as they continue.

Section 401: Application of this Chapter

1742. *Subsection (1)* derives from section 148(1) of, and paragraph 2(1) of Schedule 11 to, ICTA. It sets out the circumstances in which payments and benefits come within the provisions of the Chapter. The reference to “relative” has been expanded to make it clear that only “blood relatives” are included.
1743. “Personal representatives” is a defined term in section 721 of this Act. It is not defined in paragraph 2(1) of Schedule 11 to ICTA. This is a minor change to the law. See *Change 159* in Annex 1.
1744. Section 148(5) of ICTA has not been rewritten in this Chapter. The reason for that is explained in *Note 42* in Annex 2.
1745. *Subsection (2)* is a signpost to the exceptions which may apply.

1746. *Subsection (3)* prevents a double charge to tax in cases where there may be some doubt as to whether a benefit or payment is within this Chapter or is within another charge to tax. It also ensures that anything which is not chargeable by virtue of the provisions in Part 3 of this Act will be within the provisions of this Chapter if there is a cessation of or change in the employment. It derives from part of the end-words of section 148(1) of ICTA.
1747. *Subsection (4)* derives from section 148(6) of, and paragraph 2(2) of Schedule 11 to, ICTA. It provides that payments to people other than the employee may be within the scope of this Chapter. It also provides that throughout the provisions which this Chapter uses to determine what and how much is chargeable, any references to employee and employer include the person whose employment has terminated and his former employer. This means that those provisions do not need to refer to former employees and former employers.

Section 402: Meaning of “benefit”

1748. This section derives from section 148(2), (2A) and (3) of ICTA and includes a minor change to the law. See *Change 107* in Annex 1.
1749. *Subsection (1)* explains which benefits are within the scope of this Chapter. Subsection (1)(a) defines them as any benefits received by the employee or former employee which are received as set out in subsection (1) and which, if received as an employee for performing the duties of the employment, would be taxable earnings from the employment. This will include any benefit which would come within the definition of earnings in section 62 of this Act and any benefit for which an amount is treated as earnings by a provision in the benefits code. Subsection (1)(b) includes those benefits which would be within subsection (1)(a) but to which an “earnings-only exemption” applies.
1750. “Earnings-only exemption” is defined in section 227 of this Act. Part 4 of this Act contains most of those exemptions. Section 227(4) lists exemptions that are contained in Part 7 and apply in respect of general earnings. Some of these may be “earnings-only” exemptions. Section 227(1) and (2) may be used to identify which are “earnings-only” exemptions and which are “employment income” exemptions.
1751. Subsection (1)(b) means that the only benefits that do not come within the scope of this Chapter are those which are subject to an exemption other than an “earnings-only exemption”. These wider exemptions are labelled “employment income exemptions”, defined in section 227, and serve to exempt payments and benefits from any charge under this Chapter, provided any conditions for the exemption to apply are met.
1752. There are some benefits to which an earnings-only exemption applies, but which are not to be chargeable under this Chapter in the case of a termination of the employment. These are listed in *subsection (2)*.
1753. *Subsection (3)* identifies a benefit which is exempt from the scope of this Chapter in the case of a change in the terms or remuneration of the employment. This prevents the exempted removal benefits falling into this Chapter.
1754. Not all the benefits listed in section 148(2A) of ICTA are included in subsections (2) and (3) of this section. That is because there is no need to include those benefits that are now subject to “employment income exemptions” (which operate to exempt them from all charges under the employment income Parts of this Act).

Section 403: Charge on payment or other benefit

1755. This section contains the charge to tax on termination payments and benefits where they exceed the £30,000 threshold.

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1756. *Subsections (1) and (4)* set out the basis of the charge, the threshold and when amounts are to be taken as exceeding it. These provisions derive from section 148(1) and (3) of, and paragraphs 7(2) and 14(1) of Schedule 11 to, ICTA. Amounts brought into charge by virtue of this section come within “specific employment income” in section 7(4) of this Act. Section 6(3) of this Act provides that the rules in Chapters 4 and 5 of Part 2 do not apply to specific employment income. That derives from section 19(1), paragraph 5 of ICTA and the case of *Nichols v Gibson CA 1996 at 68 TC 611*.
1757. *Subsections (2) and (3)* set out the rules for the timing of the charge to tax, and the time when benefits are treated as received. The rules are similar to the receipts basis for earnings. In cases where payments are made over a period of time, or benefits are provided for some time after the employment has terminated, once the £30,000 threshold has been exceeded, there will be continuing liability as long as payments continue to be made or benefits provided. These provisions derive from section 148(3) and (4) of ICTA.
1758. *Subsections (5) and (6)* make clear who is liable for a tax charge arising by virtue of this Chapter, both in the ordinary course of events and if a payment or benefit is received after the death of the employee or former employee. The latter circumstances are covered by subsection (5), which derives from paragraph 14(2) of Schedule 11 to ICTA. “Personal representatives” is defined in section 721 of this Act. See *Change 159* in Annex 1.

Section 404: How the £30,000 threshold applies

1759. This section deals with two aspects of the £30,000 threshold. The first concerns the payments and other benefits that are to be aggregated. The second concerns the way the £30,000 is to be allocated between payments and benefits received at different times. *Subsections (1) to (3)* deal with the first aspect, and derive from section 148(1) and (6) of, and paragraphs 7, 8 and 16 of Schedule 11 to, ICTA. *Subsections (4) and (5)* relate to the second aspect and derive from section 148(1) of, and paragraph 7 of Schedule 11 to, ICTA.
1760. *Subsection (1)(c)* sets out the circumstances in which the payments and benefits from more than one employer are aggregated. Only one sum of £30,000 is available in respect of an employment, different employments with the same employer and employments with employers who are associated.
1761. *Subsection (2)* explains when employers are “associated” for this purpose. *Subsection (3)(a)* treats the successors to the employer or the person looked at to determine control as if they were the original employer or person. Successors are not defined anywhere in the Tax Acts so the normal meaning applies, being someone who takes the place of another person to perform a like role and duties. *Subsection (3)(b)* defines the time at which one has to consider whether employers are associated to be the “termination or change date”.
1762. *Subsections (4) and (5)* explain how the £30,000 threshold is attributed to the payments and benefits in the order in which they are received.

Section 405: Exception for certain payments exempted when received as earnings.

1763. This section provides that certain payments which would otherwise fall within this Chapter are not to be included. It derives from section 148(2A) of ICTA.
1764. *Subsection (1)* sets out the exemption which is to be taken to apply for this Chapter in the case of a termination of employment.
1765. *Subsection (2)* sets out the exemption which is to be taken to apply for this Chapter in the case of a change in the terms or remuneration of the employment.

1766. Not all the payments listed in section 148(2A) of ICTA are included in subsections (1) and (2) of this section. That is because there is no need to include those benefits that are now subject to “employment income” exemptions which operate to exempt them from all charges under the employment income Parts of this Act or those that are excluded by section 402(2) or (3) of this Act.

Section 406: Exception for death or disability payments and benefits

1767. This section provides an exception where the payment or benefit is due to death, injury or disability. It derives from paragraph 3 of Schedule 11 to ICTA.

Section 407: Exception for payments and benefits under tax-exempt pension schemes

1768. This section provides an exception where the payment is made or benefit provided through certain pension schemes and is due to a change in or termination of employment owing to ill health. This exception derives from paragraph 4 of Schedule 11 to ICTA.
1769. The payment or benefit referred to in *subsection (1)(b)* will usually be a commutation payment calculated by reference to past service.

Section 408: Exception for contributions to tax-exempt pension schemes

1770. This section derives from Inland Revenue Statement of Practice 2/1981, which excepts special contributions to approved schemes and payments for the purchase of an annuity under an approved transaction.
1771. *Subsection (1)* sets out the type of contribution which is excepted.
1772. *Subsection (2)* provides signposts to the definitions of terms used.
1773. This is a minor change to the law. See *Change 108* in Annex 1.

Section 409: Exception for payments and benefits in respect of employee liabilities and indemnity insurance

1774. This section covers the treatment of a payment or benefit received by an employee in connection with a liability arising after the employee’s employment has ceased and its interaction with this Chapter. The payments or benefits in *subsection (1)* are not within this Chapter if the conditions in *subsections (3) to (5)* are met. The section derives from section 92(10) of FA 1995.

Section 410: Exception for payments and benefits in respect of employee liabilities and indemnity insurance: individual deceased

1775. This section covers the treatment of a similar payment or benefit to that described in respect of section 409 where the employee has died. It does not matter whether the former employee’s death gave rise to the cessation of the former employment or simply occurred after that cessation. The payment is specifically excluded from any charge to tax on the personal representatives of the deceased former employee arising by virtue of this Chapter. The section derives from section 92(10) of FA 1995.
1776. “Personal representatives” is defined in section 721 of this Act. See *Change 159* in Annex 1.

Section 411: Exception for payments and benefits for forces

1777. This section provides an exception for certain payments and benefits for members of the armed forces. It derives from paragraph 5 of Schedule 11 to ICTA.

Section 412: Exception for payments and benefits provided by foreign governments etc.

1778. This section provides an exception which is limited to those employed by foreign governments and to particular circumstances. It derives from paragraph 6 of Schedule 11 to ICTA.

Section 413: Exception in certain cases of foreign service

1779. This section provides an exception for payments made in certain cases of “foreign service”. The exception depends on the length of the foreign service up to the date of the termination of, or change in, employment, compared with the whole period of service.

1780. As the period involved exceeds 20 years it is necessary to define “foreign service” in a number of different ways because of the changes in the Schedule E charge over that period. This section derives from paragraphs 9 and 10 of Schedule 11 to ICTA.

1781. *Subsection (3)* deals with the period in which this Act will have effect.

1782. *Subsection (4)* deals with the period in which the “foreign earnings deduction” (in sections 192A or 193(1) of ICTA) was applicable.

1783. *Subsection (6)* deals with the period before the foreign earnings deduction became available and before the Cases of Schedule E were introduced. This ensures that all periods of overseas service are included.

Section 414: Reduction in other cases of foreign service

1784. The exception for foreign service in section 413 may not apply because the length of service is insufficient. If so, the amount charged to tax may be reduced under this section, which derives from paragraphs 9 and 11 of Schedule 11 to ICTA. The amount of the reduction depends on the length of foreign service compared with the total length of service.

1785. The reduction is applied to the amount which remains above the £30,000 threshold.

1786. There is, however, a limitation to the reduction. This is intended to ensure that where tax is deducted from a payment – for example a gift aid payment – enough tax remains in charge to satisfy the tax on the payment. *Subsection (4)* has the effect that any personal reliefs and the reduction added together must not bring the income tax payable below an amount equal to the tax on the gift aid payment.

1787. This is a change from the limit in ICTA that would “reduce the amount of income on which the taxable person is chargeable below the amount of income tax which the taxable person is entitled” to charge or deduct. It is a minor change to the law. See *Change 109* in Annex 1.

Section 415: Valuation of benefits

1788. This section sets out how to value the benefits chargeable under this Chapter. It derives from paragraph 12 of Schedule 11 to ICTA. It applies the valuation rules of the benefits code as set out in Chapters 2 to 10 of Part 3 of this Act.

1789. *Subsection (1)* provides the rule for arriving at the amount of cash benefits.

1790. *Subsection (2)* provides the same rule as that in section 64 of this Act (relationship between earnings and benefits code). The amount of any earnings is considered first, and the cash equivalent under the benefits code “tops up” the earnings with the excess. This link to the benefits code is a minor change to the law. See *Change 110* in Annex 1. The benefits are considered on the basis of what would be chargeable if section 15 of this Act applied.

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1791. *Subsections (3) to (7)* of this section modify the valuation provisions used in the benefits code so that they can apply properly to work out the valuation of benefits brought into the charge to tax under this Chapter. These provisions derive from section 596B of ICTA.
1792. *Subsection (4)* allows the valuation of the cash equivalent to be made by reference to the person chargeable or the recipient of the benefit.
1793. *Subsection (5)* disapplies, for valuation purposes, section 401(4) which treats the employee as the recipient in certain circumstances.
1794. *Subsection (7)* applies where the benefit is living accommodation and an amount has been made good. It overrides the limitation in section 106 of this Act which restricts the deduction to the rent paid, and so allows a deduction of the whole of the amount made good for the purposes of this Chapter.
1795. One of the modifications to the benefit of provided living accommodation is that section 146(8) of ICTA does not apply for the purposes of this Chapter. This refers to accommodation first occupied by the employer before 31 March 1983. In view of the length of time since that date, the provision has been removed from section 107 of this Act. The disapplication of it has also been removed from this section. It is in paragraph 21(2) of Schedule 7 to this Act.

Section 416: Notional interest treated as paid if amount charged for beneficial loan

1796. This section is the equivalent of section 184 of this Act (interest treated as paid) in the benefits code and is written in the same terms.
1797. It allows relief in respect of the benefit of a loan which falls within this Chapter, but prevents it from being treated as real interest paid under deduction of tax.

Part 7: Employment income: share-related income and exemptions

Overview

1798. This Part contains the provisions concerning the income tax treatment of share-related remuneration. The chapters in this Part reflect the major divisions in the legislation relating to shares acquired by employees:
- Chapter 1 is introductory;
 - Chapters 2 to 5 deal with topics whose principal purpose is to impose charges to tax by providing that certain share-related benefits count as employment income (see background in paragraphs 1802 to 1812); and
 - Chapters 6 to 9 deal with income tax aspects of the various schemes and plans that confer tax advantages (see background in paragraphs 1813 and 1814). The sections in these Chapters are supplemented in each case by a Schedule (see background in paragraph 1815) containing the administrative provisions for the scheme or plan in question.
- Chapters 6 to 9 deal with income tax aspects of the various schemes and plans that confer tax advantages (see background in paragraphs 1813 and 1814). The sections in these Chapters are supplemented in each case by a Schedule (see background in paragraph 1815) containing the administrative provisions for the scheme or plan in question.
1799. Chapter 10 deals with a different topic: the exemption given to employees in connection with priority share allocations for employees when an offer of shares to the public is made. The material in Chapter 10 derives from section 68 of FA 1988.

1800. This Part also contains a final chapter (Chapter 11) which contains supplementary provisions relating to employee benefit trusts.
1801. This Part does not include any provisions dealing with the tax consequences of an employee acquiring employment related shares at less than market value. This topic is dealt with in section 162 of ICTA, which treats the acquisition of shares at less than market value as a notional loan to the employee, and uses the rules for beneficial loans to give a cash equivalent of the benefit. Section 162 also sets out the tax charge that arises when employment-related shares are disposed of for more than market value, treating the excess over market value as emoluments. Because of the relationship between section 162 and the rules on beneficial loans, those provisions appear, in this Act, as part of the benefits code, in Chapters 8 and 9 of Part 3, following on from the chapter concerning the treatment of employment-related loans. There are cross-references to Chapters 8 and 9 of Part 3 in section 418(1) of this Act.

Background

1802. Companies have often wished to reward employees by allowing them to acquire shares in the company on advantageous terms. As a matter of legal form, the company may achieve this objective in any one of three ways, for the employee may be given:
- shares (if the company issues its own shares direct to the employee);
 - a purely monetary benefit (if the company allows the employee to acquire shares on advantageous terms); or
 - an option (if the company grants the employee an option to buy shares in the company at some future date).
1803. It is well established that if an employee is given shares, or is allowed to acquire shares on advantageous terms, the amount of the advantage is chargeable to income tax as an earning from the employment. The leading case is *Weight (HM Inspector of Taxes) - v - Salmon (1935) 19 TC 174 (HL)*, where the taxpayer took up opportunities given to him to apply for unissued shares in the company at their par value, which was always less than their market value. The House of Lords held that the difference was an emolument of the taxpayer's employment. In the words of the basic charge to income tax under Schedule E, as it stood at that time, the taxpayer, who was a person "having or exercising an office or employment of profit" had received a "profit" from that office.
1804. As a means of avoiding the charge to tax on such arrangements, established by the decision in *Weight - v - Salmon*, share option schemes became increasingly popular. These schemes differed: but, typically, a company granted to employees, for a nominal sum, an option to buy a stated number of shares at a stated price, which was normally their market value at the date of the grant. If the price of the company's shares rose, an employee could exercise the option and acquire shares at less than the market value then current.
1805. The efficacy of share option schemes was tested in the case of *Abbott - v - Philbin (HM Inspector of Taxes) (1960) 39 TC 82 (HL), [1961] AC 352*, where the House of Lords had to consider two assessments to income tax for different years of assessment. The first assessment was for the year in which the taxpayer received the option. The decision regarding that assessment was that the taxpayer did receive an emolument during that year of assessment, but that the taxpayer obtained no benefit from it at that time, because the option was to buy at what was then the market value. The second assessment was for the year in which the taxpayer exercised the option. The House of Lords held, for that later year of assessment, that the advantage that arose was not a perquisite or profit from the office or employment during the year of assessment. Instead it was an advantage which accrued to the taxpayer as the holder of a legal right that he had acquired in an earlier year. (It might well have been possible to say that the taxpayer had made a gain

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from the disposal of an asset - the option - but capital gains tax was only introduced by FA 1965.)

1806. Legislation to counteract the effect of the decision in *Abbott - v - Philbin* was enacted as section 25 of FA 1966, which imposed a charge to income tax when the option was exercised. This legislation was later re-enacted, and eventually became sections 135 to 140 of ICTA 1988. It now constitutes Chapter 5 of this Part of this Act.
1807. As a means of avoiding a charge under section 25 of FA 1966, share incentive schemes became increasingly popular. These schemes differed: but, typically, a company awarded shares subject to restrictions to employees. The restrictions might (for example) have the result that the shares carried no rights to receive dividends or to vote. The shares, consequently, might be expected to have only a low value. At a later date (or dates) the restrictions would be removed. The consequent increase in value, however, was not subject to the share option rules in section 25 of FA 1966: for the employee did not realise a gain by exercising an option to acquire shares. The shares were already owned.
1808. Legislation to counteract share incentive schemes by charging the employee to income tax on the increase in the value of the shares was introduced in FA 1972. That legislation was considerably amended over the years; and successor legislation was introduced by sections 77 to 89 of FA 1988. That legislation is rewritten in Chapter 4 of this Part of this Act.
1809. At a later stage, long-term incentive plans came increasingly to be used. These schemes also differed; but, typically, a company awarded shares to employees, at no cost or at nominal cost, in circumstances where the employee was only able to enjoy the benefit of those shares if performance conditions specified at the time of the award were met. Some time later, after the performance conditions had been met, the employee would become fully entitled to enjoy the benefit of the shares.
1810. It was initially assumed that there was no charge on the initial award of the shares, but that a charge arose when the employee became entitled to enjoy the full benefit of the shares. Prevailing practice reflected this assumption. However, the view was taken later that a charge arose on the initial award of the shares but not at the later time when the employee became fully entitled to enjoy the benefit of the shares.
1811. Legislation was accordingly introduced in section 50 of FA 1998, which provided for sections 140A to 140C to be inserted into ICTA. The new legislation broadly restored the position to the previous practice - this time on a statutory basis. This legislation now constitutes Chapter 2 of this Part of this Act.
1812. Further legislation was introduced in section 51 of FA 1998, which provided for sections 140D to 140F to be inserted into ICTA. This legislation was aimed at counteracting possible tax avoidance where there was a conversion of one class of shares into another. As a result of such a conversion it was possible to devise structures under which employees could be provided with valuable shares as a form of remuneration without the full value of the shares being brought into charge to income tax. This legislation imposed a charge to income tax at the time of conversion. This legislation now constitutes Chapter 3 of this Part of this Act.
1813. But not all of the legislation relating to employees who acquire shares or options in the companies for which they work is of the type so far described. Various Governments have decided that they wish to confer various advantages on a range of schemes and plans. This has meant additional legislation to set out:
- the characteristics to be possessed by the scheme or plan before it may be approved;
 - the tax advantages that an approved scheme or plan possesses;
 - any procedure to be undertaken before the scheme or plan may be approved;

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- any tax charges that will apply if the shares or options are removed from the scheme or plan (or other “inappropriate” actions are undertaken); and
- any supplementary provisions.

1814. There are currently five different schemes or plans in existence:

- Approved profit sharing (“APS”) schemes. The legislation relating to these schemes was originally contained in FA 1978; and that legislation was consolidated in sections 186 and 187 of, and Schedules 9 and 10 to, ICTA. These schemes are being phased out and they are not included in this Act. There is a cross-reference to these schemes in section 418(3).
- Approved save as you earn (“SAYE”) option schemes. The legislation relating to these schemes was originally contained in FA 1980; and that legislation was consolidated in sections 185 and 187 of, and Schedule 9 to, ICTA. The legislation relating to these schemes now constitutes Chapter 7 of this Part and Schedule 3.
- Approved company share option plans (“CSOPs”). The legislation relating to these schemes was originally contained in FA 1984; and that legislation was consolidated in sections 185 and 187 of, and Schedule 9 to, ICTA. These schemes were then much affected by section 114 of FA 1996. The legislation relating to these schemes now constitutes Chapter 8 of this Part and Schedule 4.
- Share incentive plans (“SIPs”). The legislation relating to these schemes is principally contained in Schedule 8 to FA 2000, under the name “Employee share ownership plans”. The legislation relating to these schemes now constitutes Chapter 6 of this Part and Schedule 2.
- Enterprise management incentives (“EMI”). The legislation relating to the options that qualify as EMI is principally contained in Schedule 14 to FA 2000. That legislation now constitutes Chapter 9 of this Part and Schedule 5 to this Act.

Arrangement of material for share schemes

1815. This Act provides for a “code” for each of SIPs, SAYE schemes, CSOPs and EMIs. That “code” includes all the legislation relating to the particular scheme or plan, covering the tax advantages and any consequential tax charges together with all the rules relating to the qualification criteria and administration of the scheme or plan in question. The material in each “code” has been divided into two principal categories. The material dealing with the tax advantages and consequential tax charges has been placed in the main run of sections in this Part of this Act; but the administrative provisions have been placed in the supporting Schedules 2 to 5 to this Act.

1816. This approach is intended to highlight the legislation relating to the actual tax advantages offered, and any consequential tax charges, so that all the information with a direct impact on an employee’s tax liability appears in one place in the body of this Act.

1817. The provisions relating to the qualification criteria for each code are likely to be relevant to different sets of people (e.g. the company setting up the scheme and its advisers). It therefore seems logical to separate these out and to place them in a Schedule separate from the main run of sections concerning the taxation of employment income.

Chapter 1: Introduction

Overview

1818. This short introductory Chapter consists of five sections:

- Section 417 is concerned with the scope of this Part of the Act;

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- Section 418 is concerned with other provisions relating to share related income;
- Section 419 introduces the provisions that impose duties to provide information to the Inland Revenue;
- Section 420 deals with a computational matter of general application;
- Section 421 deals with the application of this Part to office-holders.

Section 417: Scope of Part 7

1819. This section, which is a drafting addition, introduces the provisions of this Part of this Act. Those provisions contain special rules relating to employees or directors who acquire shares in companies, or options relating to such shares, in connection with their office or employment (see *subsection (1)*).
1820. *Subsection (2)* then lists nearly all the chapters in this Part that follow this introductory Chapter. Of these, it may be said that Chapters 2 to 5 are primarily concerned with charges to income tax that may arise in certain circumstances. Chapters 6 to 9 then deal with the plans and schemes under which employees and directors may be offered shares or options on advantageous terms. And, finally, Chapter 10 deals with a particular income tax exemption that arises when employees or directors benefit from a priority allocation of shares.
1821. *Subsection (3)* lists the chapters in this Part that provide for amounts to count as employment income; and *subsection (4)* lists the chapters in this Part that provide for exemptions and reliefs from income tax. *Subsection (5)* records that there is also a supplementary chapter (Chapter 11) which contains provisions about employee benefit trusts.

Section 418: Other provisions about share-related income and exemptions

1822. This section, which is another drafting addition, sets out where other provisions dealing with share related income and exemptions may be found.
1823. *Subsections (1) and (2)* list other provisions of this Act that deal with share-related income and exemptions.
1824. *Subsection (3)* deals with approved profit sharing schemes (“APS schemes”). This subsection explains that, in view of the phasing out of these schemes, the legislation relating to APS schemes has not been rewritten in this Act. That legislation will accordingly continue to apply while APS schemes continue.
1825. *Subsection (4)* preserves the effect of sections 138 to 140 of ICTA where shares or interests in shares were acquired before 26 October 1987.

Section 419: Duties to provide information

1826. This section lists the provisions in this Part that impose duties to provide information to the Inland Revenue.
1827. This section is also a drafting addition, as, once again, it provides signposts to the various sections that are relevant in this context. As these sections are all placed near the end of the chapters in which they appear, they might otherwise be given insufficient attention.

Section 420: Negative amounts treated as nil

1828. The charges to income tax for which this Part of this Act provides constitute “specific employment income” (see sections 6(1) and 7(4) of this Act). Under ICTA this income is charged to income tax under paragraph 5 of section 19(1) of that Act.

1829. In this Part of this Act, where deductions from a chargeable amount are permitted, the relevant provision signals this fact by using a formula.
1830. This section, which is new, gives effect to the general proposition that it is not possible for an allowable loss to arise under paragraph 5 of section 19(1) of ICTA. Deductions might reduce a chargeable amount to nil; but, beyond this point, they could not be used to create a negative amount and (accordingly) an allowable loss. See *Note 43* in Annex 2.

Section 421: Application of Part 7 to office-holders

1831. The general rule is that the provisions of the employment income Parts apply equally to offices, unless the contrary is stated (see section 5(1)). But, with one exception, the legislation rewritten in this Part does not apply to office-holders. This section deals with these propositions for the whole of this Part of this Act.

Chapter 2: Conditional interests in shares

Overview

1832. Where shares are awarded to employees by reason of their employment, their value (less anything paid for them) will generally be taxable as an emolument. If the shares have restrictions attached to them so that they are subject to risk of forfeiture (typically in the event of performance criteria not being met), the Inland Revenue view until 1998 was that there was not an emolument at the time of award and that liability only arose when the risk of forfeiture was lifted. Legal advice in 1998 showed that this view was wrong. Liability arose in the normal way at the time of the award on the value of the shares taking into account the risk of forfeiture. No liability as an emolument arose at the time that the risk was lifted. Nor would the legislation in sections 77 to 88 of FA 1988 generally bite as there was no event giving rise to an immediate increase in value.
1833. The legislation introduced by sections 140A to 140C of ICTA (together with supplementary provisions in sections 140G and 140H) is intended broadly to restore the position as it existed under the earlier practice. It applies to shares acquired on or after 17 March 1998. In essence the normal income tax emoluments charge on award is removed by section 140A unless the shares can still be subject to forfeiture more than five years after acquisition. The same section then imposes a charge (whether or not there is an emoluments charge) when the employee's interest ceases to be "only conditional", a term which is defined by section 140C. A number of situations are specifically excluded from counting as "only conditional" so that in those circumstances the normal rules of a charge on acquisition apply.
1834. Sections 140G and 140H of ICTA contain supplementary provisions some of which apply solely to the provisions concerning conditional shares (sections 140A to 140C of ICTA), some of which apply solely to the provisions concerning convertible shares (sections 140D to 140F of ICTA) which were introduced at the same time and some which apply to both. In this Act the provisions on convertible shares appear in Chapter 3. This does mean that those supplementary provisions which apply to both types of share have been duplicated, but the overall result is intended to be much easier to follow.

Section 422: Application of this Chapter

1835. *Subsection (1)* of this introductory section derives from section 140A of ICTA and gives the two basic conditions for the provisions to apply. First, the shares must be acquired "as a director or employee" and that term is defined in section 423. The second condition is that the employee's interest in the shares is "only conditional" as defined in section 424. The fact that these provisions only apply to shares acquired on or after 17 March 1998 is made clear in Part 7 of Schedule 7 to this Act, to which there is also a signpost in section 418(1).

1836. *Subsection (2)* is new and sets out a number of useful labels which make for less cumbersome drafting. The fact that this Chapter applies to prospective and former directors and employees is made clear by the reference to the extended definition in section 434(1).

Section 423: Interests in shares acquired “as a director or employee”

1837. *Subsection (1)* explains the circumstances in which shares are regarded as being acquired by a person (“E”) “as a director or employee”. They are broadly equivalent to the circumstances in which a normal earnings charge would arise. The provision derives from section 140H(1) of ICTA. *Subsection (1)(c)* no longer says an assignment “to him” because if the assignment was to anyone else the shares would not have been acquired by E.
1838. *Subsection (2)* qualifies subsection (1) and derives from section 140H(2) of ICTA with only minor modifications.
1839. *Subsections (3)* and *(4)* are based on section 140H(4) of ICTA and explain the treatment when one conditional or convertible interest is exchanged for another.
1840. *Subsection (5)* derives from the opening words of section 140H(4) of ICTA.
1841. *Subsection (6)* contains the definition of “convertible shares”.

Section 424: Meaning of interest being “only conditional”

1842. *Subsection (1)*, which derives mainly from section 140C(1) of ICTA, defines when an interest in shares is “only conditional”. While section 140C of ICTA says “for the purposes of sections 140A and 140B”, the definition is applied more widely by section 140H(5) of ICTA. Hence the definition is now applied “for the purposes of this Chapter”.
1843. *Subsection (2)* summarises the exceptions from subsection (1) which prevent the interest being only conditional so that the normal charge as earnings applies on acquisition. The exceptions derive from section 140C (1A), (2), (3), (3A) and (4) of ICTA.
1844. *Subsection (3)* derives from section 140C(5) of ICTA and expands on the circumstances falling within subsection (1)(a). They are not regarded as including cases where the terms on which the employee is entitled to the interest allow the employee to require a person to acquire the interest at undervalue.
1845. *Subsection (4)* relates back to subsection (1)(b) and derives from the closing words of section 140C(1) of ICTA.
1846. *Subsection (5)* is new and reflects the latest legal advice that the term “articles of association” includes foreign equivalents, thus widening the circumstances in which an interest is not “only conditional”. See *Note 44* in Annex 2.
1847. *Subsection (6)* is supplementary to subsections (2)(b) and (c) and derives from parts of section 140C(3) and 140C(3A) of ICTA.
1848. *Subsection (7)* derives from section 140(6) of ICTA.

Section 425: Cases where this Chapter does not apply

1849. The two rules in this section derive from section 140H(3) of ICTA.
1850. The source legislation specifies that these provisions only apply to Case I employments. *Subsection (1)* rewrites this rule by applying the equivalent test that the earnings must be within section 15 or 21.

1851. *Subsection (2)* explains that the test in subsection (1) is to be applied to the final year of employment in cases where the right or opportunity to acquire the shares is conferred or offered after the employment has ceased.

Section 426: No charge in respect of acquisition of employee's interest in certain circumstances

1852. This section concerns the five year rule and derives from section 140A(3) of ICTA. In the typical case the conditions apply for less than five years at which point the employee has an indefeasible interest in the shares. In those circumstances no charge as an emolument arises on acquisition but this does not affect any charges that may arise under section 135 of ICTA (where the shares are acquired by exercising an option) or section 162 of ICTA (where the shares are acquired at undervalue). In this Act those provisions are in section 476 and Chapter 8 of Part 3 respectively.

Section 427: Charge on interest in shares ceasing to be only conditional or on disposal

1853. *Subsections (1) to (3)* derive from section 140A(4) of ICTA which imposes a tax charge when the risk of forfeiture is lifted or on the earlier disposal of the shares.
1854. *Subsection (4)* is new and acts as a signpost to a provision removing the charge for shares awarded under an approved SIP.

Section 428: Amount of charge

1855. This section concerns the calculation of the taxable charge under section 427. It derives from section 140(5), (7), and (9) of ICTA. A formula has been introduced in *subsection (1)* to make the provisions more user-friendly.
1856. The deductible amount provided by section 140A(7)(b) of ICTA is any amount chargeable in respect of the acquisition of the interest. It is not immediately clear what is meant by that phrase and the approach adopted here is to specify what is allowable. The three charges that are relevant are detailed in paragraphs (b), (c) and (d) of *subsection (2)*. See *Note 45* in Annex 2.
1857. *Subsection (3)* provides that charges under sections 449 and 453 are deductible. It derives from section 140A(7)(c) of ICTA. The opportunity has been taken to make it clear that a charge taken under these provisions is not a deductible amount if it is generated by the same event which gives rise to the charge under this Chapter. This is because the FA 1988 provisions, from which sections 449 and 453 derive, are subject to section 140A of ICTA so that the latter takes priority.

Section 429: Amount or value of consideration given for employee's interest

1858. This section derives from section 140B(1) to (6) of ICTA. Section 140B(7) has been taken to a separate section. This section determines, for the purposes of section 428, the amount allowable as the cost of the shares.

Section 430: Amount or value of consideration given for right to acquire shares

1859. This section derives from section 140B(7) of ICTA which is concerned with calculating the allowable cost where an original option has been exchanged for a replacement option. Section 140B(7) simply refers to the workings of section 136 of ICTA which are not easy to follow. This section spells out what the allowable cost is and the wording follows section 485 which derives from section 136. See *Change 125* in Annex 1.

Section 431: Application of this Chapter where employee dies

1860. This section derives from section 140A(8) of ICTA which gives rules which apply when the employee dies holding the conditional shares. There is a deemed disposal immediately before death and a special market value rule applies.

Section 432: Duty to notify provision of conditional interests in shares

1861. This section derives from those parts of section 140G of ICTA concerning information requirements on the initial award of the conditional shares. Section 140G(1)(b)(i) has been omitted as unnecessary because the original award of the shares cannot itself result in any charge under section 140A of ICTA. Accordingly this section simply focuses on the possibility of there being subsequent events that may result in a charge.
1862. The time limits for providing information throughout Chapters 2 to 5 of Part 7 have been standardised at 92 days after the end of the year in which the matter arose or after the event concerned. In the source legislation for this section the time limit was 30 days after the end of the tax year in which the interest is provided. In addition where a time limit runs from the end of the tax year it is now expressed as “before 7th July” to give greater clarity. See *Change 111* in Annex 1.

Section 433: Duty to notify events resulting in charges under section 427

1863. This section derives from those parts of section 140G of ICTA concerning information requirements on the occurrence of any of the three events (death, disposal of shares, lifting of restrictions) which may result in a charge under section 140A of ICTA. The time limit for providing information has been extended from 30 to 92 days after the end of the tax year in which the event occurred and expressed differently. See *Change 111* in Annex 1.

Section 434: Minor definitions

1864. This section brings together the definitions in section 140H of ICTA and elsewhere in the provisions and adds some new labels for terms used in section 422. In the definition of “terms” the word “include” in section 140H(6) of ICTA has been replaced by “means” to make better sense of the additional words “or in any other way”.
1865. The definition of shares (which comes from section 136(5)(d) of ICTA, as applied with modifications by section 140H(8) of ICTA) includes stock “in so far as the context permits”. This rider has been omitted as unnecessary since there does not appear to be anywhere in this Chapter where the context would not so permit.

Chapter 3: Convertible shares

Overview

1866. Sections 140D to 140F of ICTA (together with supplementary provisions in sections 140G and 140H) were introduced by FA 1998 and apply to shares acquired on or after 17 March 1998. The provisions are concerned with countering possible avoidance in the award of convertible shares by reason of employment. Such shares could be issued having a low value but be later converted to shares of a different class with a higher value. The emoluments charge on award of the shares would be measured by reference to the initial low value and without these provisions the uplift in value on conversion would escape taxation.
1867. The legislation imposes a charge to tax on the market value of the shares immediately after conversion as reduced by sums paid on acquisition or conversion and by any amounts already charged to tax in respect of those shares. No charge arises if all the shares of one class are converted to shares of a new single class and immediately

before conversion the company was either controlled by outside shareholders or was employee-controlled.

1868. Sections 140G and 140H of ICTA contain supplementary provisions some of which apply solely to the provisions concerning convertible shares (sections 140D to 140F of ICTA), some of which apply solely to the provisions concerning conditional shares (sections 140A to 140C of ICTA) which were introduced at the same time and some which apply to both. In this Act the provisions on conditional shares appear in Chapter 2. This does mean that those supplementary provisions which apply to both types of share have been duplicated, but the overall result should be much easier to follow.

Section 435: Application of this Chapter

1869. *Subsection (1)* derives from section 140D(1) of ICTA and gives the basic condition that the shares must be acquired “as a director or employee” and that term is defined in section 436. The reference to interests in shares as well as shares themselves throughout the Chapter derives from section 140F(6) of ICTA. The fact that these provisions only apply to shares acquired on or after 17 March 1998 is made clear in Part 7 of Schedule 7, to which there is also a signpost in section 418(1).
1870. *Subsection (2)* is mainly derived from section 140D(2) of ICTA (but also parts of section 140G(6) and section 140H(5) of ICTA) and defines the meaning of “convertible”.
1871. *Subsection (3)* derives from section 140F(2) of ICTA.
1872. *Subsection (4)* is new and sets out a number of useful labels which make for less cumbersome drafting. The fact that this Chapter applies to prospective and former directors and employees is made clear by the reference to the extended definition in section 446(1).

Section 436: Shares acquired “as a director or employee”

1873. This section derives from subsections (1), (2), (4) and (7) of section 140H of ICTA. It expands on what is meant by shares (or an interest in shares) acquired by a person “as a director or employee”.

Section 437: Cases where this Chapter does not apply

1874. This derives from section 140H(3) of ICTA. It limits the application of this Chapter to cases where the earnings from the employment are within section 15 or 21 and reproduces the restriction in the source legislation to Case I employments.

Section 438: Charge on conversion of shares

1875. This is the charging provision for this Chapter. It derives from section 140D(3) and (4) of ICTA and imposes a charge when the shares are converted to shares of a different class.

Section 439: Amount of charge

1876. This section concerns the calculation of the taxable charge under section 438. It derives from section 140D(5) and (6) of ICTA. A formula has been introduced to make the provisions more user-friendly. As with section 428 the approach now adopted is to specify precisely what deductions are allowable in respect of amounts chargeable in respect of the acquisition of the interest. The three charges that are relevant are detailed in paragraphs (c), (d) and (e) of *subsection (2)*. See *Note 45* in Annex 2.
1877. *Subsection (3)* provides that charges under the provisions derived from sections 78 and 79 of FA 1988 are deductible. It derives from section 140D(6)(d) of ICTA. In

contrast to section 428, there is no need to refer to “a different event” here since the conversion itself does not give rise to a charge under the FA 1988 provisions.

1878. *Subsection (5)* gives the meaning of “market value”, the definition of which is not found in ICTA until section 140F(3).
1879. *Subsection (6)* derives from the definition of “taxable conversion” in section 140D(7) of ICTA.
1880. *Subsection (7)* is new. It meets the point that there should be no reason why a charge arising at the end of the seven-year period in section 79 of FA 1988 should not be a deductible amount. This is a minor change to the law. See *Change 112* in Annex 1.

Section 440: Case outside charge under section 438: conversion of entire class

1881. In ICTA the main exemption from the charge on conversion is tucked away in subsections (8) and (9) of section 140D with related definitions in section 140F. The exemption is now in a separate section and the definitions are in *subsections (4) and (5)*.

Section 441: Case outside charge under section 438: acquisition of conditional interest

1882. This section provides that no charge arises under this Chapter if the new shares are within the scope of Chapter 2. This ensures that where a conditional interest in shares is acquired on the conversion of other shares and under section 426 of the Act there is no charge in respect of the acquisition of the interest, there will not be a charge under this Chapter in respect of the conversion of the other shares. The section derives from section 140D(10) of ICTA.

Section 442: Amount or value of consideration given for shares or conversion

1883. This section derives from section 140E(1) to (6) of ICTA. Section 140E(7) has been taken to a separate section. It determines, for the purposes of section 439, the amount allowable as the cost of the shares or the cost of conversion.

Section 443: Amount or value of consideration given for right to acquire shares

1884. This section derives from section 140E(7) of ICTA which is concerned with calculating the allowable cost where an original option has been exchanged for a replacement option. That section simply refers to the workings of section 136 of ICTA which are not easy to follow. In order to assist readers, this section sets out what the allowable cost is and the wording follows section 485 which derives from section 136 of ICTA. See *Change 125* in Annex 1.

Section 444: Conversion in consequence of employee’s death

1885. This section derives from section 140F(1) of ICTA which deems certain conversions within 12 months of death to have occurred immediately before death.

Section 445: Duty to notify conversions of shares

1886. This section derives from those parts of section 140G of ICTA concerning the information requirements when shares are converted and may result in a charge under this Chapter. The time limit for providing information has been extended from 30 to 92 days after the tax year in which the conversion takes place and expressed differently. See *Change 111* in Annex 1.

Section 446: Minor definitions

1887. This section brings together the definitions in section 140H of ICTA and elsewhere in the source legislation and adds some new labels for expressions used in section 435.

In the definition of “terms” the word “include” in section 140H(6) of ICTA has been replaced by “means” to make better sense of the additional words “or in any other way”.

1888. The definition of shares (which comes from section 136(5)(d) of ICTA, as applied with modifications by section 140H(8) of ICTA) includes stock “in so far as the context permits”. This rider has been omitted as unnecessary since there does not appear to be anywhere in this Chapter where the context would not so permit.

Chapter 4 – Post-acquisition benefits from shares

Overview

1889. This Chapter is concerned with the income tax charges which may arise in respect of shares (or an interest in shares) which have been awarded by reason of an individual’s office or employment.
1890. The initial award of the shares may have given rise to a Schedule E charge as an emolument or benefit or taxed as general earnings under this Act. This Chapter is not concerned with that initial charge. Instead it provides for a charge to tax in certain circumstances on the increase in value of those shares and in respect of any special benefits which are received by virtue of ownership of those shares. The increase in value charges do not apply where the shares have been issued under one of the share schemes approved by the Inland Revenue, but the special benefits charge may still apply.
1891. The provisions in this Chapter derive from sections 77 to 88 of FA 1988. They apply to shares acquired on or after 26 October 1987 and replace legislation in sections 138 and 139 of ICTA which had a similar, though rather more wide-ranging, effect. Sections 138 and 139 of ICTA, together with the interpretation provisions in section 140 of ICTA still apply to shares acquired before 26 October 1987 and that legislation remains on the statute book although it has not been rewritten. Paragraphs 55 to 57 in Part 7 of Schedule 7 to this Act contain the appropriate savings and also rewrite the transitional provisions in section 88 of FA 1988 that are still relevant.
1892. Section 84 of FA 1988 is a capital gains tax provision and is duplicated in section 120(1) of TCGA 1992. As it is not intended to include the provision in this Act, the section has not been rewritten. Amendments to section 120 of TCGA 1992 are made by paragraph 210 of Schedule 6 to this Act.
1893. The 1988 anti-avoidance legislation contains three distinct charges in sections 78, 79 and 80 of FA 1988. That ordering of the charges has been followed in this Act with the corresponding charges now in sections 449, 453 and 457. Other than that, however, much of the material has been moved to present it in a logical and more helpful order. One broad intention is that in respect of each charge the legislation sets out in the following order
- The scope of the charge
 - The calculation of the charge
 - The exceptions from the charge

Section 447: Application of this Chapter

1894. This section sets out the scope of the Chapter. *Subsection (1)* derives from the rule at the end of section 77 of FA 1988 that the provisions are concerned with acquisitions of shares in a company by a director or employee of that or any other company. The fact that these provisions only apply to shares issued on or after 26 October 1987 is made clear in Part 7 of Schedule 7 to which there is also a signpost in section 418(1).
1895. *Subsections (2)* and *(3)* are new. They spell out what subsequent references to “the acquisition” and “the shares” are references to. The fact that this Chapter applies to

prospective and former employees is made clear by the reference to the extended definition in section 470. The definition of “the employer company” is designed to avoid some rather tortuous references to it elsewhere in this Chapter.

1896. *Subsection (4)* derives from the rules in section 77(1) and in section 87(4) of FA 1988 which explain that the Chapter is concerned both with shares acquired by the employee directly and with shares first issued to another person and then assigned to the employee.
1897. *Subsection (5)* derives from section 83(1) of FA 1988. That provision ensures that where the shares are issued to a connected person because the opportunity was offered to that person rather than the employee himself, the acquisition is treated as having been made by the employee. The charges in the Chapter generally operate by reference to beneficial interests and it is not expressly provided in section 83(1) of FA 1988 that the deeming provision applies to beneficial ownership although that is the way the subsection has always been interpreted. This section clarifies the general understanding that the opening words “For the purposes of this Chapter” imply that the shares are deemed to have been acquired by the employee as a director or employee. This clarification is explained in detail in *Note 46* in Annex 2.

Section 448: Cases where this Chapter does not apply

1898. *Subsection (1)* derives from section 77(2) of FA 1988. It limits the scope of the Chapter to cases where the earnings from the employment are within section 15 or 21 reproducing the restriction in the source legislation to Case I employments. See *Note 47* in Annex 2.
1899. *Subsection (2)* derives from section 77(3) of FA 1988 and is an exemption for public offers.
1900. *Subsections (3) and (4)* derive from section 77(4) of FA 1988 and extend the public offer exemption to certain other offers which are made to employees separate from a public offer.

Section 449: Charge on occurrence of chargeable event

1901. This is the first of the charging provisions and derives from parts of section 78(1) and (3) of FA 1988. The meaning of chargeable event, the calculation of the charge and the exceptions appear in separate sections. *Subsection (5)* acts as a signpost to the provisions which remove the charge under various approved schemes.

Section 450: Chargeable events

1902. This section defines what is and is not a chargeable event and derives from section 78(2), (5), (6) and (7) of FA 1988. It will be noted that a new label “outside shareholders” is used as shorthand for the persons within section 78(6)(a) of FA 1988 and the term is defined in section 469.
1903. The words in section 78(6)(c) of FA 1988 “which is not a dependent subsidiary” have been omitted in new subsection (4)(c) on the grounds that they are unnecessary. It is already clear from section 78(1)(b) of FA 1988 that no charge arises if the company is a dependent subsidiary.
1904. *Subsection (6)* derives from section 78(7) of FA 1988. The term “are references to such” has been used instead of “include” to make better sense of the additional words “or in any other way”.

Section 451: Amount of charge

1905. This section, which derives from section 78(3) of FA 1988, specifies the amount of the charge under section 449. The FA 1988 subsection is rather complex and so this section separates out the various ideas to make the provision easier to grasp.

Section 452: Cases outside charge under section 449

1906. This section brings together the various exceptions in sections 77 and 78 of FA 1988.
1907. *Subsection (2)* ensures that if a charge is taken under section 427 in respect of an event then no charge is taken under this section. It derives from the opening words of section 77(1) of FA 1988 which give priority to the charge on conditional shares in section 140A of ICTA (rewritten in Chapter 2 of this Part).
1908. *Subsection (3)* derives from section 78(4) of FA 1988 which contains the let-out if the employee has not been a director or employee of the company or an associated company within the seven years ending with the chargeable event. The source legislation uses the term “the person who acquired the shares” rather than the “employee”. However, since shares acquired by connected persons are treated as acquired by the employee, the effect is the same.
1909. *Subsection (4)* derives from section 78(1)(b) of FA 1988. Shares in dependent subsidiaries are excluded from the charge under section 449 because they are instead subject to a charge under section 453. For the sake of clarity this section replaces the word “at” in the phrase “at the time of the chargeable event” with “immediately before”. See *Note 48* in Annex 2.

Section 453: Charge on increase in value of shares of dependent subsidiary

1910. This is the second of the charging provisions and derives from section 79(1) and (4) of FA 1988. Again, matters concerning what is chargeable, the calculation of the amount and the exceptions have been taken to separate sections.
1911. *Subsection (3)* derives from section 79(4) of FA 1988 and specifies the year of charge.
1912. *Subsections (4)* and *(5)* are new. *Subsection (5)* acts as a signpost to the provisions which remove the charge under various approved schemes.

Section 454: Chargeable increases

1913. This section derives from section 79(2) and (3) of FA 1988 and determines the period over which any rise in the value of the shares is measured in order to be an increase subject to charge.

Section 455: Amount of charge

1914. This section brings together all those parts of section 79 of FA 1988 which concern the calculation of the charge and in particular it makes clear what deductions should be made from the rise in value of the shareholding.
1915. *Subsection (1)* introduces a formula and *subsection (2)* specifies the items that are allowable deductions. *Subsection (3)* derives from section 79(6) of FA 1988 and is concerned with certain cases where the employee receives less than market value for the shares. The aim is to ensure that the employee is only charged on the difference between base value and the actual proceeds. That provision produces the right result where the chargeable increase is calculated by reference to the value of the shares at acquisition, but not where it is calculated by reference to the value of the shares at the later time that the company becomes a dependent subsidiary. The section produces the right result in both situations. It is a minor change to the law. See *Change 113* in Annex 1.
1916. *Subsection (4)* derives from the final two lines in section 79(4) of FA 1988.

Section 456: Cases outside charge under section 453

1917. *Subsection (2)* reflects the opening words of section 77(1) of FA 1988 “subject to section 140A of the Taxes Act 1988”. It ensures that if a charge is taken under section 427 (conditional interests in shares) then no charge is taken under section 453.

This is because if a disposal potentially gives rise to a charge under section 453 (which is more general in its application) and under section 427 then the latter charge has priority.

1918. *Subsection (3)* derives from section 79(7) of FA 1988 and provides a let-out if the employee has not been a director or employee of the company or an associated company in the seven years before the time that the company becomes a dependent subsidiary. As with section 452, the phrasing has been changed to produce a true exception and the reference is to “the employee” rather than “the person who acquired the shares”.

Section 457: Charge on other chargeable benefits from shares

1919. This is the third of the charging provisions and derives from section 80 of FA 1988. The term “chargeable benefit” in *subsection (1)* has replaced “special benefit” in order to be consistent with “chargeable event” and “chargeable increase” in the other charging provisions in this Chapter.
1920. An amount in respect of benefits attaching to shares may be charged on the employee, not only when the shares are owned by the employee (section 80(1) of FA 1988), but also when owned by other persons (section 83(1) and (4) of FA 1988). *Subsection (2)* brings together and clarifies how these rules are considered to operate and remedies the deficiencies in the wording of the source legislation. See *Change 114* in Annex 1.

Section 458: Chargeable benefits

1921. This section derives from the rather complex rules in section 80 of FA 1988 giving further conditions as to when a benefit is a chargeable benefit.
1922. *Subsection (2)* introduces the following three subsections. The approach adopted is to define what are chargeable benefits, replacing the approach in FA 1988 of saying that all benefits are chargeable benefits unless paragraphs (a) and (b) of section 80 apply. This makes the rules easier to understand.
1923. *Subsection (3)* derives from section 80(2)(a) of FA 1988.
1924. *Subsection (4)* derives from section 80(1A) of FA 1988.
1925. *Subsection (5)* introduces the conditions in *subsection (6)* which derive from section 80(3) of FA 1988. *Subsection (6)(a)* uses the new term “outside shareholders” which was first introduced in section 450.
1926. *Subsection (7)* contains two definitions which apply solely for the purposes of this section. The definition of “the company” is new and clarifies which company is being referred to in subsections (4) and (6). The other definition derives from section 87(1) of FA 1988.

Section 459: Amount of charge

1927. This section specifies the amount of the chargeable benefit. It derives from section 80(4) of FA 1988 and the definition of “value” in section 87(1) of FA 1988.

Section 460: Cases outside charge under section 457

1928. This section derives from section 80(5) of FA 1988 which contains the let-out where the employee has not been a director or employee of the company or an associated company in the seven years before the benefit is received. There are two points to note. Section 80(5)(a) of FA 1988 refers to the company in subsection (1) when that subsection contains no reference to a company. It clearly means the company whose shares are mentioned in subsection (1). See *Change 115* in Annex 1. Also, in section 80(5) of FA 1988 the test is expressed to apply to the person receiving the benefit. But by virtue of the connected persons rules in section 83(4) of FA 1988 the

test effectively applies to the employee himself. Accordingly, the test is applied directly to the employee in this section.

Section 461: Related acquisitions of additional shares

1929. This section derives from section 82 (1) and (2) of FA 1988 and concerns the treatment of additional shares received by the employee in respect of an original holding which had been acquired by virtue of the employment. The effect is to treat the new shares as within the Chapter and as having been acquired at the same time as the original shares.
1930. An award of additional shares may give rise to a chargeable benefit within section 457. This section makes it clear that the timing rule in section 82(2)(b) of FA 1988 does not affect the date on which the charge under section 457 is taken. See *Change 116* in Annex 1.

Section 462: Company reorganisations etc.

1931. This section derives from section 82(3) of FA 1988 and concerns exchanges of shares under company reorganisations. The main effect is to adopt the capital gains tax rule under which new holdings are treated as acquired as the original shares were.
1932. *Subsections (3) and (4)* derive from section 82(3)(b) and (c) of FA 1988. Subsection (3) (b) reflects what is meant by the rather obscure phrase “as is mentioned in section 128(1) and (2)” in section 82(3)(b).

Section 463: Disposals of shares to connected persons etc. ignored

1933. This section derives from section 83(2) and (3) of FA 1988. It is reasonably plain what section 83(2) of FA 1988 is trying to do, namely to ignore disposals which are not at arm’s length or are to a connected party so that the employee is deemed to retain the beneficial interest. However it is not clear whether the wording of that subsection achieves that result where the shares were originally issued to a connected party and so have already been subject to the deeming provision in section 83(1) of FA 1988. This has been made clear in this section by specifying that the employee retains the interest. It is a minor change to the law. See *Change 114* in Annex 1.

Section 464: Application to interests in shares

1934. This section derives from section 81 of FA 1988 (which applies for the purposes of charges under sections 79 and 80 of FA 1988). It sets out the supplementary rule that where a person’s interest in shares is increased or reduced it is treated as the acquisition or disposal of a separate interest proportionate to the increase or reduction.

Section 465: Duty to notify acquisitions of shares or interests in shares

1935. This section derives from section 85 of FA 1988 which is the information requirements provision.
1936. The section makes explicit what is implicit in section 85 that the time limit runs by reference to the year in which the additional shares are acquired. This is a minor change to the law. See *Change 116* in Annex 1.
1937. *Subsection (3)* provides that the particulars must be given to the Inland Revenue instead of to the inspector. See *Change 158* in Annex 1.
1938. *Subsection (4)* rewrites the 92-day time limit by requiring the information to be provided before 7 July. This is in line with the new practice in Chapters 2 to 5 of this Part.
1939. *Subsection (5)* is new and ensures that notification of an acquisition need be made only once. This is a minor change to the law. See *Change 116* in Annex 1.

Section 466: Duty to notify chargeable events and chargeable benefits

1940. This section also derives from section 85 of FA 1988 and contains the information requirements where certain charges arise.
1941. *Subsection (2)* provides that the particulars must be given to the Inland Revenue instead of to the inspector. See *Change 158* in Annex 1.
1942. The time limit of 60 days has been extended to 92 days. See *Change 111* in Annex 1.

Section 467: Meaning of “dependent subsidiary”

1943. This section derives mainly from section 86 of FA 1988. For ease of use *subsection (1)* is now introductory and the various conditions have been placed into four separate subsections. In *subsection (4)* the directors’ certificate is now to be given to the Inland Revenue rather than the inspector. See *Change 158* in Annex 1.
1944. The definition of “period of account” in *subsection (8)* derives from section 86(3) of FA 1988. That definition was repealed by FA 2002 and a new definition was inserted into section 832(1) of ICTA. In relation to a company the definitions are effectively the same.

Section 468: Meaning of “employee-controlled”

1945. This section derives from section 87(2) of FA 1988. The definitions of “connected persons” and “control” in ICTA are applied by sections 718 and 719 respectively.

Section 469: Shares “held by outside shareholders”

1946. This section explains the new shorthand term which is used in sections 450 and 458. The definition derives from sections 78(6)(a) and 80(3)(a) of FA 1988.

Section 470: Minor definitions

1947. This section picks up the remainder of the definitions in section 87(1) of FA 1988 which are not included elsewhere. The meaning of “interest in shares” has been expanded to make it clear that it excludes a right to acquire shares eg options. See *Change 117* in Annex 1.

Chapter 5: Share options

Overview

1948. This Chapter is concerned with the income tax charges which may arise in respect of a share option granted to any person by reason of an individual’s office or employment.
1949. The case of *Abbott v Philbin* (1960) 39 TC 82 (HL), [1960] 2 All ER 763, established that under general Schedule E rules, the only occasion of charge is on the grant (or assignment) of the option. The source of any gain arising on the later exercise of the option is the option itself, not the employment.
1950. The effect of this decision was largely reversed by legislation introduced in 1966 and now in sections 135 to 140 of ICTA. The underlying purpose of that legislation is to replace the charge on grant with one on exercise. Indeed that was what the original legislation achieved. However in 1972 the charge on grant was reintroduced for longer-term options to prevent liabilities being pushed too far into the future. At the same time the value of the grant was defined and provision made for any tax paid on grant to be deducted from the tax payable on exercise.
1951. The charging provision, section 135 of ICTA, does three main things.

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

- It provides that the gain on exercise (or on assignment, release or otherwise turning to account) is chargeable to tax under Schedule E provided the employee is in an employment within Case I of Schedule E.
 - If any gain on exercise would be chargeable then it removes the charge on grant, except where the option can be exercised more than ten years after grant.
 - It provides rules regarding the computation of charges that arise on grant and on exercise.
1952. The charges on grant and on exercise are removed where the options are issued under one of the schemes approved by the Inland Revenue. The legislation regarding these schemes has been rewritten in Chapters 7, 8 and 9 of this Part. Those provisions do impose charges to tax in certain circumstances.
1953. The rewritten legislation sets out the scope of the Chapter in the opening sections. It then adopts a logical order by first considering the taxation issues that arise in respect of the receipt and then the issues that arise on exercise, assignment or release. The rules in section 187A of ICTA and in section 4 of the Social Security Contributions (Share Options) Act 2001 which give a deduction to the employee when under an agreement or election he meets some or all of the employer's secondary or special national insurance contribution have been incorporated.
1954. Two provisions in the source legislation have not been rewritten.
- Section 136(4) of ICTA excludes from the charge that part of any gain that arises before 3 May 1966. It only applies to options granted before that date. The provision is regarded as spent and it is not being preserved.
 - Section 137 of ICTA allows for payment of tax under section 135 by instalments. It only applies to options granted before 6 April 1984. The provision is regarded as spent and it is not being preserved.

Section 471: Share options to which this Chapter applies

1955. This section sets out which share options come within the scope of the Chapter. It introduces the term "share option" in place of the cumbersome "right to acquire shares". In fact, although the title of section 135 of ICTA includes the words "share options", that term is not used at all in the source legislation.
1956. *Subsection (1)* makes it clear at the outset that the options concerned are those granted by reason of a person's office or employment. It derives from parts of section 135(1) and (6) and section 140(1) of ICTA.
1957. *Subsection (2)* makes it clear that the shares over which the option is granted can be shares in any body corporate. The normal case, of course, will be the grant of options over shares in the employing company, but the legislation can apply even if the body corporate is totally unconnected with the employment.
1958. *Subsection (3)* makes it clear that the option may be granted to someone other than the director or employee. It derives from section 140(1) of ICTA.
1959. *Subsection (4)* sets out two definitions which help to make the legislation easier to read. For example, the term "the employee" is used instead of "the director or employee of the company". Also, the fact that this Chapter applies to prospective and former employees is made clear by the reference to the extended definition in section 487(1).

Section 472: Introduction to taxation of share options

1960. This is a new introductory section. *Subsection (1)* derives from the *Abbott v Philbin* decision. It makes clear that unless a charge is imposed by this Chapter on exercise,

then the only possible charge is when the option is received. If there is a charge on grant or assignment then it arises by virtue of Chapter 1 of Part 3 as earnings or under Chapter 10 of Part 3 as a taxable benefit.

1961. *Subsection (2)* acts as a signpost to the major exemption from the charge in respect of receipt, ie where the options expire within ten years of being obtained.
1962. *Subsections (3) and (4)* draw attention to charges that may arise when the option is exercised, assigned or released and *subsection (5)* to the different rules that apply for options received under an approved scheme or under the EMI code.

Section 473: Share options to which this Chapter does not apply

1963. This section explains which offices and employments come within the scope of these provisions. *Subsection (1)* brings to the fore the idea that the Chapter is only concerned with options granted in respect of an office or employment the earnings from which fall within sections 15 or 21. This is derived from the restriction in section 140(1) of ICTA, that the legislation only applies to Case I offices and employments, although the exact scope of that restriction was not clear. Clarifying the scope of the restriction is a minor change to the law. See *Change 118* in Annex 1.
1964. *Subsection (2)* derives from section 140(1) of ICTA and makes it clear that the legislation applies to options granted after the employment has ceased if the employment is within sections 15 or 21 in the last tax year in which the employment was held. This section makes it clear that a charge can arise where an option is granted to another person after the employment has ceased. See *Note 49* in Annex 2.

Section 474: No charge in respect of receipt of shorter-term option

1965. This section derives from section 135(2) of ICTA which gives an exemption in respect of receipt of options which expire within ten years provided that any gain on exercise of the option would be chargeable. The proviso is not expressly stated in this section. It follows from the fact the reference to “share option” imports the conditions in sections 471 and 473 and therefore limits the scope of the exemption to options within the Chapter and potentially chargeable on exercise.
1966. *Subsection (2)* also highlights the point, referred to rather obliquely by the opening words of section 135(2) of ICTA, that charges can arise on grant under an approved CSOP scheme in certain circumstances. Other than this instance, it follows that a charge in respect of the receipt can only arise where:
- the award is of a longer-term option; or
 - the circumstances are such that a charge could not arise on exercise. Examples of this would be that the employment (considered at the time of grant) is not within sections 15 or 21, or the holder of the option is an office-holder who is not a director or employee.

Section 475: Value of longer-term option for purposes of liability to tax in respect of receipt

1967. This section derives from the rule in section 135(5)(b) of ICTA regarding the valuation of a longer-term option for the purposes of a charge to tax in respect of the receipt of the option. Section 135(5)(b) says that the value of the option is not less than the current market value of the option shares reduced by whatever the employee has to pay for the shares. In practice, a higher value is never used. Accordingly, the “not less than” part of the rule has been left out. This is a minor change to the law. See *Change 119* in Annex 1.
1968. *Subsection (2)* derives from section 135(5)(b) of ICTA and resolves an ambiguity if the option shares carry conversion rights. It is not clear in the source legislation in such a case whether the value of the option shares or the value of the shares obtained on their

conversion should be the basis of the charge. This section resolves the ambiguity by taking the higher value. This is a minor change in the law. See *Change 120* in Annex 1.

1969. The definition of “market value” in *subsection (3)* derives from section 140(3) of ICTA. It is reasonably plain from the wording of section 140(3) that the intention is to have the same rules about market values as apply in TCGA 1992 although only section 272 is mentioned. The new definition refers to Part 8 of TCGA 1992 rather than just section 272 and is now the same as in Schedules 2, 3, 4 and 5 to this Act. This change in approach is explained in more detail in *Note 23* in Annex 2.

Section 476: Charge on exercise, assignment or release of option by employee

1970. In ICTA, the rules that apply in situations where another person (rather than the employee) realises the gain are in the middle of section 135 surrounded by other material dealing with the more common case in which the gain is realised by the employee personally. In this Act the rules have been separated, this section being concerned with gains realised by the employee and section 477 with gains realised by other persons.
1971. *Subsection (2)* provides that an amount is to count as employment income of the employee. It derives from section 135(1) of ICTA. Such an amount is specific employment income (see section 7(4) of this Act) which replaces the free-standing Schedule E charge. It does not depend on the residence status of the employee at the time of exercise. The charge applies whether the option was originally granted to the employee or to another person and then assigned to the employee; see section 471(3) of this Act. The amount that is to count as employment income (the taxable amount) is determined under section 478.
1972. *Subsection (3)* is new and simply specifies the year for which the taxable amount counts as employment income. It is Inland Revenue practice to apply section 135 of ICTA to charge the gain in the year of exercise etc. See *Note 3* in Annex 2.
1973. *Subsection (4)* refers to the exceptions that apply if the options were granted under an approved scheme or under the EMI code.

Section 477: Charge on employee where option exercised, assigned or released by another person

1974. This section derives from section 135(6) and (7) of ICTA which imposes a charge on the employee where the gain is realised by another person. *Subsection (1)* sets out clearly the three circumstances where an amount is to count as employment income of the employee. The amount that is to count as employment income (the taxable amount) is calculated under section 478.
1975. *Subsection (3)* is new and specifies the year for which the taxable amount counts as employment income. See *Note 3* in Annex 2.
1976. *Subsection (4)* is new. It legislates the present practice of not charging the personal representatives or beneficiaries when the option is exercised following the death of the person to whom the option was granted. See *Change 121* in Annex 1.
1977. *Subsection (5)* derives from section 135(7) of ICTA and contains an exemption where the employee was divested of the share option by operation of law. The reference in section 135(7) of ICTA to “on his bankruptcy or otherwise” has been left out as it adds nothing.
1978. *Subsection (6)* provides that where subsection (5) applies, the gain is chargeable under Schedule D, Case VI. The subsection also removes ambiguity by making it clear that any person charged under Case VI is entitled to the reduction derived from the closing words of section 135(6) of ICTA. This is a minor change to the law. See *Change 122* in Annex 1.

Section 478: Amount of charges

1979. This section identifies those deductions which are made from the amount of the gain (calculated under section 479 or 480) in arriving at the taxable amount.
1980. *Subsection (2)(a) and (b)* reflects the amendments made to section 135 of ICTA by paragraph 1 of Schedule 6 to FA 2002. That changed the rule about giving relief where there had been an earlier charge in respect of the receipt of the option. The amount that is charged to tax in respect of the receipt is now deducted in calculating the taxable amount instead of giving relief in terms of tax. In strictness, a deduction is only due where the option is exercised, assigned or released by the employee. However, in practice it is appropriate to give the deduction where the option is exercised by another person, so long as the same amount is not deducted twice. The section makes any amount charged to tax in respect of the receipt of an option a deductible amount in calculating the taxable amount for the purposes of section 477 (charge where option exercised by another person), but *subsection (3)* prevents double deductions. This is a minor change to the law. See *Change 123* in Annex 1.
1981. *Subsection (2)(c)* allows a deduction in calculating the taxable amount for the amount of any allowable national insurance contributions met by the employee. It derives from section 187A(4) of ICTA.

Section 479: Amount of gain realised by exercising option

1982. This section brings together the parts of section 135(3) and (6) of ICTA which provide the rules regarding the computation of the gain on exercise and a further rule in section 185(8) of ICTA. That rule allows a deduction in calculating the amount of the gain for any charge to tax under section 185(6) of ICTA in respect of the grant at a discount of a share option under an approved CSOP scheme. Those parts of section 135(3) of ICTA which relate solely to the gain on an assignment or release appear in a separate section. The method adopted leads to some repetition between this section and section 480, in order to assist the reader.
1983. *Subsection (1)* introduces a formula for calculating the gain.
1984. *Subsection (2)* specifies the items which are deductible costs in calculating the gain.
1985. *Subsection (3)* derives from the closing words of section 135(4) of ICTA and ensures that the amount paid for the option is deducted only once. It should be noted that section 135(9) of ICTA replicates the effect of section 135(4) of ICTA and has not been separately rewritten. This removes unnecessary material.
1986. *Subsection (4)* provides a signpost to the EMI provisions which modify the calculation of the amount of the gain.

Section 480: Amount of gain realised by assigning or releasing option

1987. This section mirrors section 479 and sets out the rules which apply to the computation of the gain when the option is assigned or released. As the EMI provisions do not apply when an option is assigned or released no signpost is required here.

Section 481: Deductible amount in respect of secondary Class 1 contributions met by employee

1988. Section 187A of ICTA, introduced by section 56(1) of FA 2000, provides relief against a gain chargeable under section 135 of ICTA for amounts of employer's Class 1 National Insurance contributions payable in respect of the gain and met by the employee under arrangements set out in social security legislation. The relief has now been written as a deduction in calculating the taxable amount and does not affect the amount of the gain. It is the amount of the gain (rather than the taxable amount) that is relevant for the purposes of section 120(4) of TCGA 1992 and national insurance provisions. It

is therefore not necessary to reproduce the rule in section 187A(5) of ICTA which prevented relief under section 187A from being taken into account for those purposes.

1989. *Subsection (4)* derives from section 4(3) of the Social Security Contributions (Share Options) Act 2001. Its effect is that one cannot get a deduction under both this section and under section 482 (special contributions).

Section 482: Deductible amount in respect of special contribution met by employee

1990. This section derives from section 4 of the Social Security Contributions (Share Options) Act 2001. That Act enabled the employer or employee as appropriate to cap exposure to employer's Class 1 National Insurance contributions by instead paying a special contribution calculated by reference to any increase in value of the shares subject to the option on 7 November 2000. Although any special contributions had to be paid by 11 August 2001 the relief is due when the gain is realised which may not be for several years.

1991. For the same reasons as explained above in the notes on section 481, the provisions of section 187A(5) of ICTA have not been reproduced in this section. It is not necessary to prohibit a deduction made in calculating the taxable amount and not in calculating the amount of the gain.

Section 483: Extended meaning of "assign" and "release"

1992. This section brings together the two rules regarding the extended meaning of "assign" and "release" to include other situations where options are turned to account. It derives from section 135(8) and section 136(5)(a) of ICTA.

Section 484: Amount or value of consideration given for grant of share option

1993. This section contains supplementary rules for determining the amount allowable as a deduction in respect of the cost of the option in calculating the amount of the gain.
1994. *Subsection (2)* derives from the rule at the end of section 135(3) of ICTA regarding the apportionment of a single sum paid for both the share option and something else. The wording in that subsection is a "just" apportionment. This has been amended to "just and reasonable" to align the wording with that used in sections 429 and 442. This is a minor change to the law. See *Change 124* in Annex 1.
1995. *Subsection (3)* derives from section 135(4) and provides that no account is taken of the value of the duties of the employment performed by the employee. As mentioned in the explanatory note to section 479, section 135(9) of ICTA has not been rewritten as it replicates the effect of the rule in the final part of section 135(4), that the cost of the option can only be deducted once. That rule is rewritten in sections 479(3) and 480(3).

Section 485: Application of this Chapter where share option exchanged for another

1996. This section derives from what is probably the most complex part of the source legislation. Section 136(1) to (3) of ICTA are concerned with creating a form of rollover treatment which applies when a right to acquire shares is effectively swapped for another such right. The effect is to ignore the swap for section 135 purposes and apply the Chapter to the replacement option. Any consideration received which is not represented by the new option is taken into account in calculating the gain in the normal way.
1997. The prevention of the early crystallisation of the charge in the case of a straightforward exchange also has an anti-avoidance effect. In the absence of the provision it could be arranged that a valuable option is exchanged for an option with an apparently lower value (thus generating an immediate, but low tax charge), and there would be no charge on exercise because the new option would not have been issued by reason of employment, but to the employee as option-holder.

1998. Section 136(1) of ICTA is not easy to follow partly because it says that the cost of the new option excludes some things, but includes others; and partly because those rules are in the same long sentence detailing other rules not concerned with working out the allowable cost of the new option. These ideas have been separated and in order to make the provision easier to use *subsection (4)* specifies what is in fact the consideration for the grant of the new option. *Subsections (5)* and *(6)* extend the rollover treatment to cases where the swap is achieved indirectly under arrangements described in section 136(2) and (3) of ICTA.
1999. It may be noted that section 136(2)(b) of ICTA refers to tax “chargeable under this section”. This makes no sense because tax is not chargeable under section 136, but under section 135 of ICTA. The problem stems from consolidation. Previously section 136(2) was part of the same section as section 135. When that section (section 186 of ICTA 1970) was split in two on consolidation the relevant amendment to section 136(2) (b) was missed. This error has been corrected in section 485(5)(b). See *Change 125* in Annex 1.

Section 486: Duty to notify matters relating to share options

2000. This section derives from section 136(6) to (8) of ICTA. The time limit of 92 days after the end of the year of assessment has been rewritten as “before 7th July” in line with the new practice in Chapters 2 to 5 of this Part. The particulars are now to be given to the Inland Revenue rather than to the inspector. See *Change 158* in Annex 1.

Section 487: Minor definitions

2001. This section brings together minor definitions from section 136(5) of ICTA and others from section 187A of ICTA in connection with the deductions for National Insurance contributions.
2002. The definition of shares in section 136(5)(d) of ICTA includes stock “in so far as the context permits”. This rider has been omitted as unnecessary since there does not appear to be anywhere in this Chapter where the context would not so permit.

Chapter 6: Approved share incentive plans

Background

2003. This Chapter, together with Schedule 2, derives from the legislation relating to share incentive plans (or “SIPs” for short). SIPs were previously known as employee share ownership plans (or “ESOPs” for short). The SIPs legislation is the result of a policy designed to bring share ownership in a company to the whole of that company's workforce.
2004. Nearly all the SIPs legislation is contained in Schedule 8 to FA 2000 (introduced by section 47 of that Act). Schedule 8 to FA 2000 was amended, to a certain extent, by Schedule 13 to FA 2001 (introduced by section 61 of that Act), and also by section 95 of that Act. Further amendments to Schedule 8 of FA 2000 were made by section 39 of FA 2002 and also by the Employee Share Schemes Act 2002.
2005. The new legislation relating to SIPs, the majority of which is contained in this Chapter and Schedule 2, is called “the SIP code”: a term introduced in section 488.
2006. The core of the SIP code is that a company establishing a share incentive plan must offer either “free shares” or “partnership shares” (or both) to its employees. Two other types of shares - “matching shares” and “dividend shares” - are dealt with in the SIP code; and either or both of these may also be offered to employees - although this is not essential. And if a SIP is to be “approved” for the purposes of the legislation (and thus obtain the tax advantages available to an approved SIP), there are general requirements

to be met, and also further requirements relating to the eligibility of individuals, to the types of shares that may be awarded, and to the trustees.

2007. The SIP code, accordingly, has a number of distinguishable components:
- it specifies requirements that a SIP must meet before it may be “approved” for the purposes of the SIP code;
 - it deals with the procedural aspects relating to the approval of plans and the withdrawal of approval;
 - it specifies the tax advantages that an approved SIP possesses;
 - it specifies the tax charges that may arise in certain circumstances (for example, when shares cease to be subject to the plan); and
 - it deals with supplementary matters (including interpretation).
2008. Of the components listed in the last paragraph, this Chapter deals with the tax advantages that an approved SIP possesses, and with the tax charges that may arise.
2009. *Schedule 2* deals with the other components listed in that paragraph. After the introduction (in Part 1), that Schedule deals with the requirements that a SIP must meet before it may be “approved” for the purposes of the SIP code (in Parts 2 to 9); with the approval of plans and the withdrawal of approval (in Part 10); and with supplementary matters (in Part 11).
2010. *Schedule 8* to FA 2000 also contained other provisions relating to corporation tax, capital gains tax and stamp duty. These other provisions are dealt with in *Schedule 6* to this Act (consequential amendments). *Schedule 7* to this Act includes provisions designed to avoid any transitional problems arising from the replacement of *Schedule 8* by the provisions contained in this Act.

Overview

2011. In this Chapter, after an introductory section (section 488), the first major topic dealt with is the tax advantages that an approved SIP possesses (in sections 489 to 499). The second major topic dealt with is the tax charges that may arise (in sections 500 to 508). The provisions relating to each major topic have been arranged to deal with the award of shares, then with the holding of shares, and then, finally, with shares ceasing to be subject to the plan. This Chapter concludes with provisions dealing with the making of PAYE deductions in connection with the tax charges that may arise (in sections 509 to 514), and with a section referring to the other provisions in the Tax Acts that deal with SIPs (in section 515).

Section 488: Approved share incentive plans (SIPs)

2012. This section is introductory. It indicates the main components of the SIP code, and defines some terms of general application.
2013. *Subsection (1)* is new, and indicates the main topics dealt with in the SIP code. *Subsection (2)*, which is also new, then indicates which of those topics are dealt with in *Schedule 2*.
2014. *Subsection (3)* contains the definition of “the SIP code”. This definition is also new.
2015. *Subsection (4)* defines terms used generally in the SIP code. Of these terms:
- the definition of an “approved” plan may be deduced from the definition of “approved employee share ownership plan” in paragraph 129(1) of *Schedule 8* to FA 2000; but, in this Act, the definition is now followed by a new provision, stating that the word “approval” has a corresponding meaning;

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- the definition of a “PAYE deduction” generalises the partial definitions in paragraphs 95(10) and 96(5) of Schedule 8 to FA 2000; and
 - the definition of a “share incentive plan” derives from the definition of an “employee share ownership plan” in paragraph 1(1) of Schedule 8 to FA 2000.
2016. *Subsection (5)* draws attention to the fact that there is an index relating to the SIP code at the end of Schedule 2. Expressions contained in that index have the meanings that are indicated there.

The tax advantages

2017. Sections 489 to 499 relate to the first major topic dealt with in this Chapter: the tax advantages possessed by an approved SIP.

Section 489: Operation of tax advantages in connection with approved SIP

2018. This section is introductory, being concerned with the general scope of the tax advantages applying to an approved SIP. Those advantages do not apply to an individual who is not chargeable to tax under Part 2 in respect of the eligible employment (as defined) (see *subsection (2)*).
2019. This section is the first of two that derive from paragraph 77 of Schedule 8 to FA 2000 (the other being section 500).
2020. *Subsections (2)* and *(3)* are derived from paragraph 77(2) of Schedule 8 to FA 2000. The material in that sub-paragraph has been divided to make it easier to understand; and the definition of “the eligible employment” is new.

Section 490: No charge on award or acquisition of shares: general

2021. This section is the first of four that deal with the tax advantages connected with the award of shares. It contains the basic proposition that the employee is not liable to income tax on the value of the beneficial interest in the plan shares that passes to the employee at the time those shares are acquired.
2022. This section derives from paragraph 78(1) of Schedule 8 to FA 2000, a sub-paragraph that has now been divided into two subsections.

Section 491: No charge on award of shares as taxable benefit

2023. This section is the second of four that deal with the tax advantages connected with the award of shares. It provides that an employee is not liable to income tax under Chapter 8 of Part 3. That Chapter forms part of the benefits code, and provides for income tax liabilities to arise on acquisitions of shares.
2024. This section derives from paragraph 78(2) of Schedule 8 to FA 2000. That sub-paragraph contains a second sentence stating that any charge to tax under section 162(6) of ICTA remained unaffected. As the provision is expressed in this section in a form that does not impinge in any way on the provisions rewriting section 162(6) of ICTA (in Chapter 9 of Part 3), this second sentence has been omitted on the basis that it is unnecessary.

Section 492: No charge on partnership share money deducted from salary

2025. This section is the third of four that deal with the tax advantages connected with the award of shares. It provides that an employee is not liable to income tax under Part 2 where partnership share money is deducted from the employee’s salary under a partnership share agreement. The expressions “partnership share agreement” and “partnership share money” are defined in Schedule 2 (in paragraphs 44 and 45

respectively); and these expressions may also be found in the index of defined expressions in paragraph 100 at the end of that Schedule.

2026. This section derives from paragraph 83 of Schedule 8 to FA 2000.

Section 493: No charge on acquisition of dividend shares

2027. This section is the last of four that deal with the tax advantages connected with the award of shares. It provides that a scheme participant is not liable to income tax on the amount applied by the trustees in acquiring dividend shares on the participant's behalf.

2028. This section derives from paragraph 89 of Schedule 8 to FA 2000. *Subsection (1)* reorganises the material in paragraph 89(1); in *subsection (2)* the word "amount" replaces the words "amounts of dividends"; and *subsections (3) to (5)* vary the order of material drawn from paragraph 89(3) and (4) of Schedule 8 to FA 2000.

Section 494: No charge on removal of restrictions applying to shares

2029. This section is the first of three that deal with the tax advantages connected with the holding of shares. *Subsections (1) and (2)* apply where a participant's plan shares are subject to provision for forfeiture, and that provision is varied or removed. In these circumstances a participant is not liable to income tax by virtue of sections 427 or 449. Those sections may be found, respectively, in Chapters 2 and 4 of this Part. *Subsection (3)* provides that a participant is not liable to income tax by virtue of section 449 when the holding period comes to an end. The expressions "provision for forfeiture" and "holding period" are defined in Schedule 2, in paragraphs 99(1) and 36 respectively.

2030. This section derives from paragraph 80(1) and (2) of Schedule 8 to FA 2000. There is a new subsection (1), setting out the circumstances in which subsection (2) applies.

Section 495: No charge on increase in value of shares of dependent subsidiary

2031. This section is the second of three that deal with tax advantages connected with the holding of shares. It provides that a participant is not liable to income tax by virtue of section 453 (charge on increase in value of shares of dependent subsidiary) in respect of any of the participant's shares that are subject to the plan when the chargeable increase is determined for the purposes of that section.

2032. This section derives from paragraph 80(3) of Schedule 8 to FA 2000. In order to make that provision easier to understand, the rewritten legislation now consists of two subsections.

2033. *Subsection (1)* makes a minor change to the law. If plan shares are sold while they are still in the plan it is not the practice of the Inland Revenue to attempt to charge income tax under the dependent subsidiary charge in section 79 of FA 1988. However, there is a problem with the wording in paragraph 80 in that if the "appropriate time" for the purposes of that section is the time of sale it is debatable whether at that point the shares are still subject to the plan. In order to make it clear that no charge to income tax arises under section 453 in such circumstances, the words "or immediately before" have been added before the words "the appropriate time" at the end of this subsection. See *Change 126* in Annex 1.

Section 496: No charge on cash dividend retained for reinvestment

2034. This section is the last of three that deal with the tax advantages connected with the holding of shares. It provides that a participant is not liable to income tax in respect of the amount of a cash dividend that is not reinvested but is carried forward and held by the trust with a view to reinvestment at a later date. It derives from paragraph 91 of Schedule 8 to FA 2000.

Section 497: Limitations on charges on shares ceasing to be subject to plan

2035. This section is the first of two that deal with the tax advantages connected with shares ceasing to be subject to approved SIPs. It provides that liability to income tax only arises in specified limited circumstances when shares cease to be subject to the plan.
2036. This section brings together three general propositions contained in paragraphs 81(7), 86(6) and 93(6) of Schedule 8 to FA 2000 respectively. The opportunity has been taken to bring these three sub-paragraphs into better alignment. All three subsections now refer to “income tax” (as opposed to “tax”); and in *subsection (2)* the reference to “the employee” has been omitted. Paragraph 77(1) of Schedule 8 to FA 2000 may be relied on for the change to the use of the term “income tax”.

Section 498: No charge on shares ceasing to be subject to plan in certain circumstances

2037. This section is the second of two that deal with the tax advantages connected with shares ceasing to be subject to approved SIPs. It provides that a participant is not liable to income tax on shares ceasing to be subject to the plan if the shares so cease because the participant ceases to be in relevant employment in the circumstances specified in subsection (2). The meaning of a participant ceasing to be in relevant employment is explained in paragraph 95 of Schedule 2 to this Act.
2038. This section derives from sub-paragraphs (1) and (2) of paragraph 87 of Schedule 8 to FA 2000. *Subsection (2)(d)* reorganises the material to be found in paragraph 87(3) (d) of Schedule 8.
2039. That paragraph concludes by providing two definitions. The first definition (that of “redundancy”) has now been placed in paragraph 99(1) of Schedule 2 to this Act; and the second (which appears in the rewritten legislation as a definition of “the specified retirement age”) has now been placed in paragraph 98 of Schedule 2.
2040. The material set out in *subsection (2)* of this section is also set out in full in paragraph 32(2) of Schedule 2. This duplication should assist the reader.

Section 499: No charge in respect of incidental expenditure

2041. This section is concerned with incidental expenditure incurred in operating the plan; and provides that an employee is not liable to income tax in respect of such expenditure of the trustees, the company that established the SIP or the employee’s employer.
2042. The section derives from paragraph 78(3) of Schedule 8 to FA 2000, which was added by paragraph 4 of Schedule 13 to FA 2001.
2043. This section makes a minor change to the law in that it is now provided that there is also no liability to income tax for incidental expenditure incurred by the company which established the plan. See *Change 127* in Annex 1.

The charges to tax

2044. Sections 500 to 508 relate to the second major topic dealt with in this Chapter: the consequential tax charges that may arise in certain circumstances.

Section 500: Operation of tax charges in connection with approved SIP

2045. As in the case of section 489, this section is introductory, being concerned with the general scope of the tax charges applying to an approved SIP. Those charges do not apply to an individual who is not chargeable to tax under Part 2 in respect of the eligible employment (as defined) (see *subsection (2)*).
2046. This section is the second of two that derive from paragraph 77 of Schedule 8 to FA 2000 (the other being section 489).

2047. As in the case of section 489, *subsections (2) and (3)* are derived from paragraph 77(2) of Schedule 8 to FA 2000. Once again the material in that sub-paragraph has been divided to make it easier to understand; and the definition of “the eligible employment” is new.

Section 501: Charge on capital receipts in respect of plan shares

2048. This section is the first of three that impose tax charges connected with the holding of shares. It imposes a charge to income tax if a capital receipt is received by a participant in respect of plan shares which have been held for less than five years (three years in the case of dividend shares). The meaning of the term “capital receipt” is dealt with in the following section.
2049. This section is the first of two that derive from paragraph 79 of Schedule 8 to FA 2000. This section derives from sub-paragraphs (1) and (5) of that paragraph, and deals with the matters directly relevant to the charge. *Subsections (1) to (5)* of this section are all derived from paragraph 79(1) of Schedule 8 to FA 2000, which has been divided to make it easier to understand; and *subsection (6)* simplifies the wording of paragraph 79(5) of Schedule 8 to FA 2000.

Section 502: Meaning of “capital receipt” in section 501

2050. This section follows on from section 501, and deals with the definition of the term “capital receipt”. The term is given a very wide definition.
2051. This section is the second of two that derive from paragraph 79 of Schedule 8 to FA 2000. This section derives from the definitional provisions in sub-paragraphs (2) to (4) of that paragraph.
2052. In order to emphasise the provision that will apply most often in practice, *subsection (2)* begins with the words “The general rule”.
2053. In *subsection (5)* the words “pursuant to a direction” have been changed to “as a result of a direction”.

Section 503: Charge on partnership share money paid over to employee

2054. This section is the second of three that impose tax charges connected with the holding of shares. The section imposes a charge to income tax if an amount is paid over to an individual under any of the provisions in Schedule 2 that are listed in this section.
2055. This section derives from paragraph 84 of Schedule 8 to FA 2000.

Section 504: Charge on cancellation payments in respect of partnership share agreement

2056. This section is the last of three that impose tax charges connected with the holding of shares. The section imposes a charge to income tax if an individual receives any money in respect of the cancellation of a partnership share agreement.
2057. This section derives from paragraph 85 of Schedule 8 to FA 2000; but the wording of this section differs very substantially from the wording of that paragraph.
2058. As in the case of other sections in this Chapter, the year that is “the relevant tax year” is specified. The point at which the tax charge arises is not specified in Schedule 8 to FA 2000; but the point has been dealt with explicitly in *subsection (3)*. See *Note 3(B)* in Annex 2.

Section 505: Charge on free or matching shares ceasing to be subject to plan

2059. This section is the first of three that impose tax charges connected with shares ceasing to be subject to SIPs. This section is the main charging provision for free and matching shares; and it provides for the charge to vary with the length of the period for which

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the shares have been held. If the shares have been held for more than five years, there is no income tax liability under this section.

2060. This section derives from sub-paragraphs (1) to (6) of paragraph 81 of Schedule 8 to FA 2000.
2061. *Subsection (1)* introduces two new terms, “the award date” and “the exit date”. These two terms are then deployed in *subsections (2) to (5)*. *Subsection (5)*, by providing that the “relevant tax year” is the tax year in which the exit date falls, has the effect that any charge to tax will arise in that year. See *Note 3(B)* in Annex 2.
2062. *Subsection (6)* combines material at present contained in sub-paragraphs (5) and (6) of paragraph 81.

Section 506: Charge on partnership shares ceasing to be subject to plan

2063. This section is the second of three that impose tax charges connected with shares ceasing to be subject to SIPs. This section is the main charging provision for partnership shares; and, as in the case of section 505, it provides for the charge to vary with the length of the period for which the shares have been held. If the shares have been held for more than five years, then once again there is no income tax liability under this section.
2064. This section derives from sub-paragraphs (1) to (5) of paragraph 86 of Schedule 8 to FA 2000.
2065. *Subsection (1)* introduces a new term, “the exit date”. This term is then deployed in *subsections (2) to (5)*.
2066. As in the case of other sections in this Chapter, the year that is “the relevant tax year” is specified. The point at which the tax charge arises is not specified in Schedule 8 to FA 2000; but as there can be little doubt about the answer, the point has been dealt with explicitly in *subsection (5)*. See *Note 3(B)* in Annex 2.

Section 507: Charge on disposal of beneficial interest during holding period

2067. This section is the last of three that impose tax charges connected with shares ceasing to be subject to SIPs. It applies if a participant disposes of the beneficial interest in free or matching shares during the holding period in breach of the obligations imposed by paragraph 36(1)(b) of Schedule 2 to this Act.
2068. This section derives from paragraph 82(1) of Schedule 8 to FA 2000. (Paragraph 82(2) of Schedule 8 to FA 2000 was repealed by paragraph 5 of Schedule 13 to FA 2001.) *Subsection (1)(a)* contains additional wording to emphasise that this section applies if free or matching shares cease to be subject to the plan during the holding period applying to those shares.
2069. As in the case of other sections in this Chapter, the year that is “the relevant tax year” is specified. As in the case of those other sections, the point at which the tax charge arises is not specified in Schedule 8 to FA 2000; the point is dealt with explicitly in *subsection (3)*. See *Note 3(B)* in Annex 2.

Section 508: Identification of shares ceasing to be subject to plan

2070. This section contains provisions for identifying shares that cease to be subject to SIPs.
2071. This section derives from paragraph 122(6) of Schedule 8 to FA 2000, which is one of the supplementary provisions in Part 13 of that Schedule. It is more convenient to deal with this topic here, alongside the provisions dealing with the tax charges connected with shares ceasing to be subject to SIPs.
2072. Paragraph 122(6) of Schedule 8 is drafted in terms of shares being “awarded” to a participant; but, while it is appropriate to speak of an award of free shares, partnership

shares or matching shares, it is not clear that such terminology is appropriate for dividend shares. It is, however, the intention that all shares in the trust for a particular employee should be pooled, and that shares should come out of the trust on a first in first out basis. *Subsection (2)* has been added to this section to deal with this point. See *Change 128* in Annex 1.

PAYE implications

2073. Sections 500 to 508 deal with the various charges to income tax as employment income that may arise under the SIP code. Sections 509 to 514, which derive from paragraphs 94 to 96 of Schedule 8 to FA 2000 (as amended), deal with the circumstances in which PAYE may be applied to those payments.

Section 509: Modification of section 696 where charge on shares ceasing to be subject to plan

2074. This section, with its reference to section 696, has the effect of providing that where there is an amount that counts as employment income as the result of shares ceasing to be subject to an approved SIP, and where the shares in question are readily convertible assets, PAYE is to be applied on the amount likely to count as employment income under the SIP code.

2075. This section derives from paragraphs 94 and 128 of Schedule 8 to FA 2000, two paragraphs since amended by section 39(2) and (6) of FA 2002.

2076. This section has the consequence that the employer has to use his best estimate of the amount that will be chargeable: there is no requirement that PAYE has to be operated on the precise amount that will eventually count as employment income.

Section 510: Payments by trustees to employer company on shares ceasing to be subject to plan

2077. This section applies where any plan shares cease to be subject to the plan; where there is an amount that counts as employment income of the participant; and where there is an obligation to deduct PAYE in respect of that amount. In these circumstances the principal obligation to account for any PAYE due is that of the employer company (an expression defined in *subsection (7)*). The plan may require the participant to pay sufficient money to the employer company in order to meet the PAYE liability; but, to the extent that it does not do so, this section provides for the trustees to pay sums to the employer company.

2078. This section is the first of three that derive from paragraph 95 of Schedule 8 to FA 2000. That paragraph is long; and it has been thought advantageous to divide it. This section derives from sub-paragraphs (1) to (6) of paragraph 95.

2079. *Subsection (7)* takes account of the amendment made to paragraph 95(6) of Schedule 8 to FA 2000 by section 39(3) of FA 2002.

Section 511: PAYE deductions to be made by trustees on shares ceasing to be subject to plan

2080. This section is relevant where any plan shares cease to be subject to the plan and as a result there is an amount that counts as employment income of the participant. In such a case if either there is no employer company or the Inland Revenue are of the opinion that a PAYE deduction is impracticable, and direct that this section is to apply, the trustees have to account for the PAYE as if the participant were a former employee of the trustees. The practical effect of this is that the trustees have to deduct income tax at the basic rate.

2081. This section is the second of three that derive from paragraph 95 of Schedule 8 to FA 2000. This section derives from sub-paragraphs (7) and (8) of paragraph 95.

Section 512: Disposal of beneficial interest by participant

2082. This section provides for sections 510 and 511 to apply in a modified form where a participant disposes of his beneficial interest in any of his plan shares.
2083. This section is the last of three that derive from paragraph 95 of Schedule 8 to FA 2000. This section derives from sub-paragraph (9) of paragraph 95.

Section 513: Capital receipts: payments by trustees to employer company

2084. This section and section 514 apply where the trustees receive money which gives rise to a capital receipt that counts as employment income in the hands of the participant (see section 501). This section then applies to deal with the “basic” case that arises in these circumstances. The trustees are to pay over an amount equal to the amount of employment income to the employer company (an expression defined in *subsection (5)*), and the employer company is then to account for the PAYE and to pay the balance to the employee.
2085. This section is the first of two that rewrite paragraph 96 of Schedule 8 to FA 2000. This section derives from sub-paragraphs (1) and (2) of paragraph 96. *Subsection (5)* takes account of the amendment made to paragraph 96(2) of Schedule 8 to FA 2000 by section 39(4) of FA 2002.

Section 514: Capital receipts: PAYE deductions to be made by trustees

2086. Section 513 and this section apply where the trustees receive money which gives rise to a capital receipt that counts as employment income in the hands of the participant (see section 501). This section applies in circumstances where either there is no employer company or the Inland Revenue are of the opinion that a PAYE deduction is impracticable, and direct that this section is to apply. In these circumstances, and when making the capital payment to the participant, the trustees are to make a PAYE deduction as if the participant were a former employee of the trustees. The practical effect of this is that the trustees have to deduct income tax at the basic rate.
2087. This section is the second of two that rewrite paragraph 96 of Schedule 8 to FA 2000. This section derives from sub-paragraphs (3) and (4) of paragraph 96.

Section 515: Tax advantages and charges under other Acts

2088. This is a new section, explaining where the remaining provisions in the SIPs code are to be found. The majority are to be found in ICTA (*subsection (1)*); but others are to be found in TCGA 1992 (*subsection (2)(a)*), or in FA 2001 (*subsection (2)(b)*).

Chapter 7: Approved SAYE option schemes

Overview

2089. This Chapter tells an employee receiving or exercising a share option whether or not the option is within the Save-as-You-Earn (“SAYE”) rules and what the tax consequences are. A SAYE option scheme is defined in section 516. This label has not been used in the statute up to now. The name in the source legislation is “savings-related share option scheme” and these schemes are commonly referred to as SAYE share option schemes or simply SAYE schemes in practice.
2090. The label SAYE denotes a SAYE option scheme in these notes.
2091. Unlike in sections 185 and 187 of and Schedule 9 to ICTA, in this Act SAYE has been separated from the CSOP schemes in an attempt to make these rules easier to read and understand.

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2092. The rules for APS schemes (profit sharing schemes approved under Schedule 9 to ICTA) are not rewritten in this Act. These rules will therefore still be found in sections 186 and 187 of and Schedules 9 and 10 to ICTA. There is reference to this in section 418(2) and in Part 8 of Schedule 7 to this Act.
2093. The redrafting of the SAYE and CSOP schemes has been influenced by the way the newer schemes, Enterprise Management Incentives (“EMI”) and Share Incentive Plans (“SIP”), were drafted in FA 2000. This is a matter of style and also part of an attempt to achieve consistency across the share schemes where possible. Codes have been introduced for each scheme or plan as explained in the notes on the introduction to this Part.
2094. Each section of this Chapter and each paragraph of Schedule 3 has a heading to help explain its contents and there are several examples of both sections and paragraphs containing introductory material.
2095. The requirements for the initial and continuing approval of the scheme are now contained in paragraphs 40 to 44 of Schedule 3. There are transitional provisions in Schedule 7 to ensure that a scheme approved under Schedule 9 to ICTA is treated as a SAYE option scheme approved under this Act.

Section 516: Approved SAYE option schemes

2096. This section sets out what is contained in this Chapter and in Schedule 3. It sets the scene: SAYE is a scheme which requires prior approval by the Inland Revenue and which enables the option-holder to benefit from income tax relief.
2097. There are references in the SAYE code in several places to the Inland Revenue, where in ICTA these refer to the Board. This reflects practice and is in line with the approach in FA 2000 to the EMI and SIP codes. The Inland Revenue is defined in section 720 as “any officer of the Board of Inland Revenue”. See *Change 158* in Annex 1.
2098. In *subsection (3)(c)* there is a cross-reference to Part 2 of Schedule 7D to TCGA 1992 which covers the capital gains tax angle (see Schedule 6 to this Act).
2099. Share options are described as being granted rather than obtained in most contexts and especially where the timing of the grant is significant. This ties in with the terminology in EMI and perhaps gives a clearer indication of the exact date of the occasion.
2100. The definitions derive from section 187 of ICTA. There are minor definitions and a new index of defined expressions, at the end of Schedule 3 to this Act. This is based on the approach in the tax-relieved share schemes, introduced by FA 2000. The definition of “share option” matches the one used for EMI in FA 2000 (and in the EMI code). In section 516 there is also a fuller definition of the SAYE option scheme itself than in ICTA.

Section 517: Share options to which this Chapter applies

2101. This is an introductory section, which derives from section 185(1) of ICTA. This Chapter applies to an individual who obtains an option in accordance with the provisions of an approved scheme by reason of his or her employment. This phrase in section 185(1) matches the expression in the benefits code. The rules in paragraph 10 of Schedule 3 to this Act govern the particular employment.
2102. The reference to a commencement date in section 185(1) of ICTA is spent and is not rewritten.

Section 518: No charge in respect of receipt of option

2103. This derives from section 185(2) of ICTA. Here, as elsewhere, the phrase “no liability to income tax arises” expresses this type of exemption.

Section 519: No charge in respect of exercise of option

2104. This and the following section derive from section 185(3) and (4) of ICTA and explain the conditions for relief from income tax on the exercise of an option and on post-acquisition benefits.
2105. The relief and the exceptions are set out in a more straightforward way and in a positive framework. No liability to income tax arises in the circumstances set out in this section (subject to the two conditions in *subsections (2) and (3)*) on the exercise of an option in accordance with the approved provisions of the scheme. Under condition A, the option is exercised after three years from the date on which it is granted. This period between grant and exercise is the norm for a SAYE scheme.
2106. There are a number of circumstances however for an early (pre-three year) exercise which are catered for in SAYE schemes. Rules about these appear in Schedule 3 to this Act. Following on from section 185(4) of ICTA, this section identifies those circumstances for which tax relief is provided. But under condition B the position is expressed positively, although the formulation makes reference to the circumstances where tax relief is not available on the early exercise of an option.
2107. There is a clarification of the time limit in section 185(4) of ICTA, which refers to the exercise of an option within three years of its being obtained in subsections (2) and (3)(a). This section confirms that the period is inclusive of the date of the grant. So, if granted an option on 1 January 2002, an employee can be confident that it can be exercised on the same date three years later and the exercise will qualify for income tax relief. See *Change 129* in Annex 1.
2108. There are similar clarifications in the CSOP code and there are references to time limits elsewhere in the notes on the approved schemes. These are instances where, to a greater or lesser extent, doubt may exist as to whether or not the “trigger date”, from which a period is measured, is to be included in the period. As the law ignores fractions of a day when computing periods of this nature, the start date for the various periods has been identified.
2109. The Inland Revenue practice under which the charge on the exercise, assignment and release of unapproved share options is lifted after the death of an option holder has now been given statutory effect in section 477(4). There is a cross-reference to this section in *subsection (4)*. Also, to make it clear that the operation of section 477 acts in conjunction with the approved share scheme rules, which concern the time when a share option lapses after death, there is also a signpost to paragraph 32 of Schedule 3 to this Act in *subsection (5)(a)*.
2110. In *subsection (5)(b)* there is a direct signpost to paragraph 42(3) of Schedule 3 to this Act, under which, for SAYE, the option holder is protected against the possibility of approval being withdrawn from an approved scheme.

Section 520: No charge in respect of post-acquisition benefits

2111. This section mirrors the previous section and gives relief in the same circumstances from income tax on specified charges on an increase in the value of shares acquired by way of a tax-relieved exercise.
2112. There is a signpost in *subsection (3)* to paragraph 42(3) of Schedule 3 to this Act under which, for SAYE, the option holder is protected against the possibility of approval being withdrawn from an approved scheme.

Chapter 8: Approved CSOP schemes

Overview

2113. This Chapter tells an employee receiving or exercising a share option whether or not the option is within a CSOP scheme and what the tax consequences are. A CSOP scheme is defined in section 521. The acronym CSOP stands for a company share option plan. This label has not been used in the statute up to now but it is commonly used in practice.
2114. The label CSOP denotes a CSOP scheme in these notes.
2115. Unlike in sections 185 and 187 of and Schedule 9 to ICTA, in this Act CSOP has been separated from the SAYE schemes in an attempt to make these rules easier to read and understand.
2116. The rules for APS scheme (profit sharing schemes approved under Schedule 9 to ICTA) are not being rewritten in this Act. These rules will therefore still be found in sections 186 and 187 of and Schedules 9 and 10 to ICTA. There is reference to this in section 418(2) and in Part 8 of Schedule 7 to this Act.
2117. The redrafting of the CSOP and SAYE schemes has been influenced by the way the newer schemes, Enterprise Management Incentives (“EMI”) and Share Incentive Plans (“SIP”), were written in FA 2000. This is a matter of style and also part of an attempt to achieve consistency across the share schemes where possible. Codes have been introduced for each scheme or plan as explained in the notes to the introduction to this Part.
2118. Each section of this Chapter and each paragraph of Schedule 4 has a heading to help explain its contents and there are several examples of both sections and paragraphs containing introductory material.
2119. The requirements for the initial and continuing approval of the scheme are now contained in paragraphs 28 to 32 of Schedule 4. There are transitional provisions in Schedule 7 to ensure that a scheme approved under Schedule 9 to ICTA is treated as a CSOP scheme approved under this Act.

Section 521: Approved CSOP Schemes

2120. This section sets out what is contained in this Chapter and in Schedule 4 to this Act. It sets the scene: CSOP is a scheme which requires prior approval by the Inland Revenue and which enables the option-holder to benefit from income tax relief. There is also provision here for amounts to count as employment income in certain circumstances.
2121. There are references in the CSOP code in several places to the Inland Revenue, where the relevant provisions in ICTA referred to the Board. This reflects practice and is in line with the approach in FA 2000 to EMI and SIP codes. The Inland Revenue is defined in section 720 as “any officer of the Board of Inland Revenue”. See *Change 158* in Annex 1.
2122. In *subsection (3)(c)* there is a cross-reference to Part 3 of Schedule 7D to TCGA 1992 which covers the capital gains tax angle (see Schedule 6 to this Act).
2123. Share options are described as being granted rather than obtained in most contexts and especially where the timing of the grant is significant. This ties in with the terminology in EMI and perhaps gives a clearer indication of the exact date of the occasion.
2124. The definitions derive from section 187 of ICTA. There are minor definitions and a new index of defined expressions, at the end of Schedule 4 to this Act. This is based on the approach in the tax-relieved share schemes, introduced by FA 2000. The definition of “share option” matches the one used for EMI in FA 2000 (and in the EMI code). There is for the first time a definition of the CSOP scheme in section 521.

Section 522: Share options to which this Chapter applies

2125. This is an introductory section, which derives from section 185(1) of ICTA. This Chapter applies to an individual who obtains an option in accordance with the provisions of an approved scheme by reason of his or her employment. This phrase in section 185(1) matches the expression in the benefits code. The rules in paragraph 8 of Schedule 4 to this Act govern the particular employment.
2126. The reference to a commencement date in section 185(1) of ICTA is spent and is not being rewritten. This is also the case with section 185(9) of ICTA, which is specific to CSOP.

Section 523: No charge in respect of receipt of option

2127. *Subsection (1)* derives from section 185(2) of ICTA. Here as elsewhere the phrase “no liability to income tax arises” expresses this type of exemption.
2128. *Subsection (2)* also derives from section 185(2) of ICTA.

Section 524: No charge in respect of exercise of option

2129. This and the following section bring together section 185(3) and (5) of ICTA and incorporate paragraph 27(3) of Schedule 9 to ICTA, which was formerly referred to in section 185(3).
2130. These two sections explain the conditions for relief from income tax on the exercise of an option and on post-acquisition benefits. As with the SAYE provisions, this section makes the circumstances of relief and the exceptions more straightforward, expressing them in a positive form.
2131. No liability to income tax arises in the circumstances set out in the condition in *subsection (2)*. The option has to be exercised between three years and ten years after receipt and three years after a previous exempt exercise, as defined in *subsection (3)*.
2132. There are therefore three dates crucial to this relief. The three year period in *subsection (2)(a)(i)* begins with the day on which the option is granted. There is a minor change in relation to the exercise on the tenth anniversary of the grant in *subsection (2)(a)(ii)*. See *Change 129* in Annex 1.
2133. In *subsection (2)(b)* the rule makes it clear that the period is inclusive of the exercise of the current option. (In section 185(5)(b) of ICTA the period looks back to the date of an earlier exercise.) The effect is that if there is an exempt exercise of an option on 1 January 2002, an employee can be confident that a further exercise on the same date three years later will qualify for income tax relief.
2134. There are similar clarifications in the SAYE code and there are references to time limits elsewhere in the explanatory notes on the approved schemes. These are instances where it might be open to doubt whether or not the trigger date, from which a period is measured, is to be included in the period. As the law ignores fractions of a day when computing periods of this nature, this section identifies the start date for the various periods.
2135. The Inland Revenue practice under which the charge on the exercise, assignment and release of unapproved share options after the death of an option holder is lifted has now been given statutory effect in section 477(4). There is a new cross-reference to this section in *subsection (4)*. Also, to make it clear that the operation of section 477 acts in conjunction with the approved share scheme rules, which concern the time when a share option lapses after death, there is a signpost to paragraph 25 of Schedule 4 in *subsection (5)*.

Section 525: No charge in respect of post-acquisition benefits

2136. This section mirrors the previous section and also derives from section 185(3) and (5) of ICTA. It gives relief in the same circumstances from income tax on specified charges (post-acquisition charges under section 449 and section 453) on an increase in the value of shares acquired by way of a tax-relieved exercise. The exercise has to meet the condition set out in section 524. See *Note 50* in Annex 2.

Section 526: Charge where option granted at a discount

2137. This section derives from section 185(6) and (8) of ICTA. Section 185(7) of ICTA which covers the capital gains tax consequences (relief against a double charge) is now in Part 3 of Schedule 7D to TCGA 1992 (see Schedule 7 to this Act).

2138. The section imposes a charge in the rare case that the total of any consideration given for the grant of the option and the amount payable on exercising the option is less than the market value of the shares at the time the option is granted. The option has to be granted at a price which is not manifestly less than the market value at that date (which is the rule in paragraph 22 of Schedule 4, formerly paragraph 29 of Schedule 9 to ICTA). Therefore this charge can only occur where there has been an agreement to fix the value earlier than the date of the grant or a mistake is made on the valuation.

2139. The language of *subsections (2) and (4)* reflects the new approach to expressing “charge”.

2140. In response to a suggestion made in the consultation process leading up to this Act, “the price” in *subsection (1)(b)* has been changed to “the amount payable” since price implies an amount payable per share. A further clarification has also been introduced. This is the reference to “the maximum number of shares” that can be acquired under the option, which specifies the number of shares in the frame in order to make the comparison required.

2141. The reference to the discount being earned income has been dropped, as this has no continuing effect.

2142. Under *subsection (4)*, “knock-on” relief is given against further income tax charges on the same shares. This is a signpost only now; the way the relief is given is included in sections 194, 479 and 480.

Chapter 9: Enterprise management incentives

Overview

2143. This Chapter contains the information that an employee needs in order to be able to establish the tax consequences of receiving or exercising a share option that is within the enterprise management incentives (“EMI”) rules.

2144. A code has been introduced for EMI options as for SAYE, CSOP and SIPs as explained in the notes on the introduction to this Part.

2145. Those parts of the EMI code that determine which options are within the scope of the scheme are separated out and appear in Schedule 5. Schedule 5 refers to “share options”, where appropriate, so as to align this phraseology with SAYE and CSOP. There is a definition of “share option” in section 527.

2146. The requirements for a qualifying option, deriving from Schedule 14 to FA 2000, are now contained in Schedule 5 to this Act. There are transitional provisions in Schedule 7 to ensure that where a share option was a qualifying option under Schedule 14 to FA 2000, it is treated as a qualifying option for the purposes of the EMI code.

Section 527: Enterprise management incentives: qualifying options

2147. This section sets out what is contained in this Chapter and in Schedule 5. As well as being a new scene-setting section, it includes material drawn from paragraph 1(1) of Schedule 14 to FA 2000 about what is a qualifying option.
2148. In *subsection (3)(c)* there is a cross-reference to Part 4 of Schedule 7D to TCGA 1992 which covers the capital gains tax angle, (see Schedule 7 to this Act).

Section 528: No charge on receipt of qualifying option

2149. This section prevents tax being chargeable on receipt of a qualifying option. It derives from paragraphs 42(1) and 43 of Schedule 14 to FA 2000.

Section 529: Scope of tax advantages: option must be exercised within 10 years

2150. This section explains that the tax advantages described in the following sections only apply if the option is exercised within ten years of it being granted. If the option being exercised is a replacement for a previous option, it must be exercised within ten years from when the original option was granted in order to qualify for the tax advantages. This derives from paragraph 42 of Schedule 14 to FA 2000.
2151. The words “the date of the” have been added before “grant” in subsection (2)(b) to clarify the effect of the rule in paragraph 42 which provides for a ten year period exclusive of the date of the grant.

Section 530: No charge on exercise of option to acquire shares at market value

2152. This section, which derives from paragraph 44 of Schedule 14 to FA 2000, deals with the situation where an employee is granted an option with an exercise price not less than the market value of the shares at the time the original option is granted. In this situation, there is no charge on the exercise of the option (or a replacement option) under section 476. This provision is subject to section 532 which outlines what happens if a disqualifying event takes place.

Section 531: Limitation of charge on exercise of option to acquire shares below market value

2153. This section sets out how to calculate the amount chargeable under section 476 when a qualifying option (or replacement option) is exercised to acquire shares for less than their market value when the option was originally granted. It derives from paragraph 45 of Schedule 14 to FA 2000.
2154. This provision is subject to section 532 which outlines what happens if a disqualifying event takes place.
2155. There are formulae to aid understanding of the text in this and in the succeeding section, which provide the basis for the calculation of the charges.
2156. There is no successor to paragraph 46 of Schedule 14 to FA 2000 (exercise of option to acquire shares at nil cost). This is redundant in that it is a variation of the situation in this section. Small changes have been made to sections 531 and 532 to ensure that the whole picture is preserved. In subsection (1) of section 531 there is a new “(or at nil cost)” and in both subsection (2) of this section and subsection (4) of section 532, a reference to “if any” in the definition of “ACS”.
2157. There is a further point affecting both this and the next section. The source legislation includes a provision that stating that if the section 476 gain was nil there is no liability to income tax. Sections 531 and 532 now use a formulaic approach and a more general solution has been found to deal with negative results. Section 420 provides for the

position where a formula in Part 7 would produce a negative result. The result is to be taken to be nil.

Section 532: Modified tax consequences following disqualifying events

2158. This section sets out what happens where there has been a disqualifying event and the option had not been exercised within 40 days of that event. The 40-day period of grace is in recognition of the fact that the option-holder may have no control over a disqualifying event.
2159. This provision derives from paragraph 53 of Schedule 14 to FA 2000. The section now has a more comprehensive heading and is in a more prominent position before the sections describing the various types of disqualifying event. This draws out the impact of such an event on income tax relief.
2160. The broad effect of an amendment in paragraph 11 of Schedule 14 to FA 2001 was that this set of rules wholly replaces those included in paragraphs 44 and 45 of Schedule 14 to FA 2000 (rewritten in sections 530 and 531), if a disqualifying event occurs. There is a slight change in the wording to reflect this, referring to the option being “within”, for example, section 530, rather than section 530 applying.
2161. The effect of the provision is to separate out and relieve the gain in the value of the share option accruing over the period up to the disqualifying event, leaving any gain accruing between the disqualifying event and the date of exercise fully chargeable. There is of course the usual deduction for anything paid for the grant of the option.
2162. As noted in relation to the preceding section there is no successor to paragraph 46 of Schedule 14 to FA 2000. Another small change has been made to this section to ensure that the whole picture is preserved. In *subsection (4)* there is an added reference to “if any” in the definition of “ACS”.
2163. The provision in sub-paragraph (2D) of paragraph 53 of Schedule 14 to FA 2000, has not been reproduced. This was a provision that stated that if the section 476 gain was nil there is no liability to income tax. This and the preceding section now use a formulaic approach and a more general solution has been found to deal with negative results. Section 420 provides for the position where a formula in Part 7 would produce a negative result. The result is to be taken to be nil.
2164. *Subsection (6)* contains a clearer exposition of the rule in paragraph 53(3) of Schedule 14 to FA 2000 from which it derives. This ensures that the operation of this section does not result in a higher taxable amount than would be charged under section 476, if the EMI provisions did not apply. In this situation no part of either this section or of sections 530 and 531 apply (and so the amount is counted as income under section 476).

Section 533: Disqualifying events

2165. This is a new provision, which provides the reader with a list of the possible disqualifying events and notes where they are described in full.

Section 534: Disqualifying events relating to relevant company

2166. This section sets out those events that can happen to the company whose shares are the subject of a qualifying option that would lead to that share option ceasing to qualify under EMI. These are “disqualifying events”. It derives from paragraph 47(1) and (2) and paragraph 48 of Schedule 14 to FA 2000.
2167. The word “being” has been changed to “becoming” in *subsection (1)(b)* to better match the wording and meaning of *subsection (1)(a)*.
2168. The definition of “control” is covered by section 840 of ICTA, see *Note 51* in Annex 2.

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

2169. In *subsection (4)*, which derives from paragraph 47(2) of Schedule 14 to FA 2000, the reference to the “original” option has been dropped from the phrase “when the option was granted”. There is no scope in paragraph 47(2)(b)(ii) of Schedule 14 to FA 2000 to refer to any option other than the qualifying option, mentioned in paragraph 47(2) (a) (in subsections (3) and (4)(a) of this section). This could be either an original or a replacement option. Also the words “of a group” no longer follow “parent company” in subsection (4)(b).
2170. To clarify the position if there has been a replacement option, there is a cross-reference to paragraph 41(5) (b) of Schedule 5.
2171. The words “from the grant” in the source legislation have been changed to “the period of two years after the date” of the grant in *subsection (5)* to clarify the rule. This new wording provides for a period exclusive of the date of the grant.

Section 535: Disqualifying events relating to employee

2172. This section sets out the disqualifying events that can occur in relation to an employee. These result in the share option held by that employee ceasing to qualify under EMI. It derives from paragraphs 47(1) (part), (3), and 52(1), (2) and (6) of Schedule 14 to FA 2000 and relates to provisions in Schedule 5 to this Act. It picks up on some new expressions introduced in paragraph 26 of that Schedule to set out more clearly the requirement on working time.
2173. First there is the employment requirement in *subsection (1)(a)*. Next, under *subsection (1)(b)*, there is a disqualifying event if, on the facts of the arrangement between employer and employee (usually the contract), the employee ceases to meet the requirement as to commitment of working time, contained in paragraph 26 of Schedule 5 to this Act.
2174. Finally, and the different nature of this test is emphasised by the words “in addition” in *subsections (2) to (5)*, there is what is known as the “working time rule”. This takes into account the time actually spent by the employee on work in the relevant employment.
2175. The provisions in paragraphs 47 and 52 of Schedule 14 to FA 2000 are cumbersome to operate, do not work satisfactorily in all circumstances and could impact harshly on employees working flexi-time. Under *subsections (2) to (5)* there is a much simpler “working time rule”. See *Change 130(A)* in Annex 1.
2176. There is another minor change to the law in *subsection (3)*. This corrects an omission in the source legislation, by providing a cross-reference to paragraph 26(3) of Schedule 5 to this Act. See *Change 130(B)* in Annex 1.

Section 536: Other disqualifying events

2177. This section lists the other events that can result in a share option ceasing to qualify under EMI. It derives from paragraphs 47(1) and 51 of Schedule 14 to FA 2000.

Section 537: Alterations of share capital for purposes of section 536

2178. Among the disqualifying events in section 536 are certain kinds of alteration of the company’s share capital. Section 537 sets out what kind of alteration comes into play for the purposes of section 536(1)(b) and (c). It derives from paragraphs 47(1) and 49 of Schedule 14 to FA 2000.
2179. There is a change in the wording in *subsection (4)* compared to the final paragraph of paragraph 49(1). “References to restrictions ... or to rights ... *include*”, followed by an interpretation, is replaced by “any reference to a restriction ... or a right ... *is a reference to such a restriction ... or right*”, followed by the same interpretation. This rephrasing makes better sense of the final words in the sentence, “or in any other way”.

Section 538: Share conversions excluded for purposes of section 536

2180. Among the disqualifying events in section 536 is a conversion of the shares, to which the option relates, into a different class. Section 538 prevents a share conversion being a disqualifying event if it meets certain conditions as set out in subsections (2) and (3). This section derives from paragraph 50 of Schedule 14 to FA 2000.

Section 539: CSOP and other options relevant for purposes of section 536

2181. Among the disqualifying events in section 536 is the grant of a CSOP option if, after this grant, the total value of the shares for which the employee holds unexercised employee options under EMI or CSOP exceeds £100,000. This section explains the meaning of CSOP options and employee options for those purposes. It derives from paragraph 51(1) to (4) of Schedule 14 to FA 2000.

2182. There is a new definition of a group of companies, in contexts where there is no reference to the parent company, in paragraph 58 of Schedule 5 to this Act.

Section 540: No charge on acquisition of shares as taxable benefit

2183. This section prevents there being a charge to tax under Chapter 8 of Part 3 in respect of shares acquired by the exercise of a qualifying option, if the employee is resident and ordinarily resident in the United Kingdom. This derives from paragraph 54 (1) of Schedule 14 to FA 2000.

2184. The wording of the source legislation suggests that the residence tests apply at the time the option is exercised. In practice the Inland Revenue applies the test at the time of the grant of the option. In this section it has been made clear that the tests can be applied at the time of the grant or at the time of the exercise of a qualifying option. See *Change 131* in Annex 1.

2185. The content of paragraph 54(2) of Schedule 14 to FA 2000 is in section 541, rather than in this section, since it relates to a charge under Chapter 9 of Part 3 which is not affected by the EMI provisions.

Section 541: Effects on other income tax charges

2186. The fact that a share option may be a qualifying share option under EMI does not prevent the ordinary operation of certain other income tax provisions. This section sets out what those provisions are. This includes a reference to the possibility of a charge under section 453 in *subsection (1)(c)*. This last subsection derives from section 79 of FA 1988 and, though not immediately relevant since an EMI option cannot be granted over shares in a subsidiary, can apply to shares acquired on exercise of the option if there is a subsequent take-over.

2187. The section also describes what relief may be available as a deductible amount from a charge to tax under sections 427 or 438 in respect of shares acquired under the option.

2188. This section derives from paragraphs 54 (2) and 55 of Schedule 14 to FA 2000.

Chapter 10: Priority share allocations

Overview

2189. This Chapter derives from section 68 of FA 1988 which applies to offers made on or after 23 September 1987. That section exempts the benefit derived by directors and employees from a priority allocation of shares.

2190. Section 68 of FA 1988 starts by granting a complete exemption from the charge as emoluments in respect of any benefit derived from an entitlement to a priority allocation of shares. Then, in some circumstances, the legislation brings back into charge any

discount enjoyed by employees. It does so by excluding the relevant amount from the initial exemption. The rules for calculating this amount are different from the normal rules for calculating emoluments.

2191. When section 68 of FA 1988 was enacted, it only dealt with relatively straightforward offers where there was a single public offer under which both members of the public and directors and other employees applied for shares including any priority shares.
2192. Successive amendments catered for more complex share offers. These included offers where, because of legal and other technical issues, the priority shares for directors and employees were subject to a separate employee offer. Each new tranche of legislation was “bolted on” to what had gone before. This was done by imposing the fiction that the separate public and employee offers were in fact a single offer – “the offer”.
2193. This led to some rather dense and convoluted legislation – particularly in the rules for the limits on the number of priority shares and the “similar terms” condition. In order to try to make the provisions easier to understand, that fiction has been abandoned and the Act instead uses the following structure: sections 542 and 543 deal with single share offers; sections 544 and 545 deal with share offers with separate public and employee offers; and sections 546 to 548 deal with supplementary material that is common to both.
2194. It should be noted that section 68(4) of FA 1988 (dealing with the capital gains aspects) does not appear in this Chapter. Instead, paragraph 212 of Schedule 6 to this Act inserts a new section 149C in TCGA 1992. In addition, section 68(6) of FA 1988, the original commencement provision, is omitted on the grounds that it is spent.

Section 542: Exemption: offer made to public and employees

2195. This section is concerned with offers which are open to both the public and employees. *Subsection (1)* derives from section 68(1) of FA 1988 and introduces the basic conditions for the exemption. The exemption itself is found in *subsection (2)* and is from liability to income tax as earnings. It follows that the exemption does not apply to a benefit received in connection with a change or termination within Chapter 3 of Part 6 of this Act which derives from section 148 of ICTA.
2196. *Subsections (3) to (6)* derive from sections 68(2), (2A) and (2B) of FA 1988 and give the detailed conditions which must be satisfied in order for the exemption to apply. In contrast to the source legislation, dealing with the conditions one by one should be clearer.
2197. *Subsection (7)* introduces section 543 which excludes certain discounts from the exemption in this section.

Section 543: Discount not covered by exemption in section 542

2198. This section derives from section 68(1A) of FA 1988 and excludes from the exemption in section 542 the benefit of certain discounts enjoyed by a director or employee in acquiring the priority shares. The discount therefore remains taxable as earnings. In calculating the taxable discount the amount of any registrant discount (see section 547) is disregarded.

Section 544: Exemption: different offers made to public and employees

2199. This section is concerned with cases where there are separate offers to the public and employees. *Subsection (1)* derives mainly from section 68(1ZA) of FA 1988 and introduces the basic conditions for the exemption. The exemption itself is found in *subsection (2)* and is from liability to income tax as earnings. It follows that the exemption does not apply to a benefit received in connection with a change or termination within Chapter 3 of Part 6 of this Act which derives from section 148 of ICTA.

2200. *Subsections (3) to (6)* derive from sections 68(1ZB), (2), (2A), (2B) and (2C) of FA 1988 and give the detailed conditions which must be satisfied for the exemption to apply. Subsection (3) requires the case of each company whose shares are subject to the employee offer to be considered. In the FA 1988 provisions, the fiction that the public offer and the employee offer are a single offer means that, reading subsections 68(2)(a) and 68(2C) together, a company whose shares are *only* subject to the public offer also has to be considered. In such a case, the limit on the number of shares allocated to employees, imposed by section 68(2)(a), will never be exceeded. These companies are not therefore mentioned. See *Note 52* in Annex 2.
2201. *Subsection (7)* introduces section 545 which excludes certain discounts from the exemption in this section.

Section 545: Discount not covered by exemption in section 544

2202. This section derives from section 68(1) of FA 1988 and excludes from the exemption in section 544 the benefit of any discount (disregarding the registrant discount) enjoyed by a director or employee in acquiring the priority shares. The discount therefore remains taxable as earnings.
2203. *Subsections (3) to (6)* derive from the rather complex provisions in section 68(5B) and (5C) of FA 1988 which determine the “appropriate notional price” of the shares in the offer. Generally this is the notional price, but in some circumstances it is a proportion of the notional price. A formula has been introduced to make the basis of the calculation clearer.

Section 546: Meaning of being entitled “on similar terms”

2204. This section derives from sections 68(3) and (3A) of FA 1988 and explains the condition that entitlement to a priority allocation of shares must be on “similar terms”.
2205. *Subsections (3) to (6)* only apply where the allocation of shares in a company for directors and employees of the company is different from the allocations for directors and employees of other companies.

Section 547: Meaning and amount or value of “registrant discount”

2206. This section derives from section 68(5A) of FA 1988 which defines “registrant discount”. Section 68(5A)(b) requires at least 40% of shares which are allocated to members of the public *other than employees and directors* to be allocated to individuals entitled to the discount. It is not made explicit what this phrase means. *Subsection (4)* has been drafted to make clear that the intention is to exclude employees and directors who are entitled to a priority allocation. This change in approach is explained in detail in *Note 53* in Annex 2.
2207. In this section the label “subscribing employee” has been used to describe those directors and employees who subscribe for shares under the offers and who comply with the same registration requirements as members of the public.

Section 548: Minor definitions

2208. This section contains the definitions used in this Chapter and mainly derives from section 68(5) of FA 1988. That legislation does not define “director” (except to include prospective and former directors) or “shares”. The definitions introduced here are discussed in *Change 132* in Annex 1.

Chapter 11: Supplementary Provisions about employee benefit trusts

Background

2209. Chapters 6, 7, 8 and 9 of this Part set out the provisions for the four types of share scheme: share incentive plans (“SIPs”), Save As You Earn option schemes (“SAYE”), company share ownership plans (“CSOPs”) and enterprise management incentives (“EMIs”).
2210. Each of those schemes includes a number of requirements that the employee must meet. One of the conditions common to each of the schemes is that the employee must not have a “material interest” in the company whose shares are subject to the scheme. A “material interest” means entitlement to more than a certain percentage of the relevant company’s share capital.
2211. In determining whether or not the “material interest” test is satisfied, the entitlement of the individual to any of the company’s shares includes any such entitlement held by any “associates” of the individual.
2212. One kind of associate could be a trustee of a settlement of which the individual is a beneficiary. And one kind of trust that may well exist in the context of a company that is running share incentive schemes is an employee benefit trust. An employee wishing to participate in the share scheme may therefore need to know whether or not to count the trustees of the employee benefit trust as “associates” for the purposes of the “material interest” test.
2213. Each of the four types of share scheme mentioned in paragraph 2209 includes provisions directed to the issue whether the trustees of an employee benefit trust should be counted as associates. The provisions are to the same effect, and state, in each case, that the general rule is that the trustees are not counted as associates if neither the individual in question (with or without associates) nor any associate of the individual (with or without associates) controls more than a stated percentage of the ordinary share capital of the company.

Overview

2214. This Chapter contains provisions relating to employee benefit trusts. It deals with two issues.
2215. The first issue dealt with is the obvious question “What is an employee benefit trust?”. In the source legislation an employee benefit trust is stated, in the case of each of the four schemes, to have the same meaning as in paragraph 7 of Schedule 8 to ICTA. That Schedule is not being re-enacted, as it relates to profit-related pay schemes which will be effectively spent by the time that this Act takes effect. It will therefore no longer be possible to refer to the meaning of “employee benefit trust” as used in the legislation relating to profit related pay schemes. That definition, instead, is set out in this Chapter. The definition, in sections 550 and 551, derives from paragraph 7 of Schedule 8 to ICTA.
2216. The second issue dealt with relates to the general rule mentioned in paragraph 2213: for there are cases where the general rule is supplemented by further rules. In these cases, which depend upon the employee or an associate receiving a payment from the employee benefit trust, the employee (or the associate) is treated as owning the “appropriate percentage” of the ordinary share capital of the company, in addition to any percentage of that share capital actually owned. These provisions, in sections 552 to 554, derive from paragraph 7(9) to (12) of Schedule 8 to ICTA.

Section 549: Application of this Chapter

2217. This section sets out the ambit of this Chapter. *Subsections (1) to (3)* are drafting additions, while *subsection (4)* derives from material in paragraph 7(3) and (12) of Schedule 8 to ICTA.
2218. In *subsection (4)(b)*, the words “the company which are subject to” have been added near the end of this provision. Although these words do not form part of paragraph 7(12), it is thought that they should have been included, and that the legislation is easier to understand if they are included. See *Note 54* in Annex 2.
2219. *Subsection (5)* provides that, in this Chapter, the term “employee” includes the holder of an office. This general proposition holds good for the employment income Parts (see section 5), but was disappplied for the purposes of Part 7 in section 421. However, the provisions of this Chapter are governed by the definition of the term “employment” in section 169(1) of ICTA, which includes an office, so the general proposition that an “employee” includes an office-holder has been reinstated.

Section 550: Meaning of “employee benefit trust”

2220. This section sets out the basic ingredients of an employee benefit trust, as follows:
- all or most of the employees of the company must be eligible to benefit; and
 - apart from certain exceptions, there have been no disposals of property subject to the trust since 13 March 1989.
2221. This section derives from paragraph 7(5) of Schedule 8 to ICTA.
2222. *Subsection (4)* provides more information about the exceptions to the “no disposals since 13 March 1989” rule. Disposals that do not prevent the trust from being an employee benefit trust are either those made in the ordinary course of the management of the trust or “qualifying disposals”, as defined in section 551.

Section 551: “Qualifying disposals” for purposes of section 550

2223. This section sets out that a “qualifying disposal” can be of any of the ordinary share capital of the company, or money paid outright, provided one of three conditions is met. This section derives from paragraph 7(6) and (7) of Schedule 8 to ICTA.
2224. The conditions mentioned are set out in *subsections (2), (4) and (5)*.
2225. *Subsection (3)* is new. Although *subsection (2)* refers to “employees of the company”, it is Inland Revenue practice to extend the benefit of this provision to employees of a subsidiary company (a subsidiary company being taken to mean a company under another company’s control, with the word “control” taking the meaning in section 840 of ICTA). *Subsection (3)* reflects that Inland Revenue practice. See *Change 133* in Annex 1.

Section 552: Attribution of interest in company to beneficiary or associate

2226. This section sets out that in certain circumstances the individual (or an associate of the individual) is treated as owning the “appropriate percentage” of the company’s ordinary share capital. It derives from paragraph 7(9) of Schedule 8 to ICTA.
2227. The relevant circumstances are that the individual in question (or an associate) has received a payment from the employee benefit trust since 13 March 1989 and the property subject to the trust included any ordinary share capital of the company at any time during the three years preceding that payment.

2228. The “appropriate percentage” of the company’s ordinary share capital that the individual (or associate) is treated as owning in those circumstances is specified in section 553.

Section 553: Meaning of “appropriate percentage” for purposes of section 552

2229. This section sets out how the “appropriate percentage” is to be calculated. It derives from paragraph 7(10) of Schedule 8 to ICTA.
2230. There are a number of factors to be taken into account in working out the “appropriate percentage” of the company’s ordinary share capital for the purposes of section 552. The main calculation consists of a straightforward fraction using “P” and “D” to signify the numbers to be fed into that fraction. The expressions “P” and “D”, however, take rather more explaining.
2231. “P” is either the total of any payments received by the individual or associates from the trust during the 12 months up to and including the day the relevant payment is made (*subsection (2)*) or, if smaller, the distributions made by the company to the trustees of the employee benefit trust during the period of three years up to and including the day the relevant payment is made (*subsection (3)*).
2232. “D” is the aggregate distributions made during the three years preceding the relevant payment, divided by the number of years in which such distributions were actually made (*subsection (4)*).
2233. It is difficult to express the ideas in this calculation in simpler terms than those used in paragraph 7(10) of Schedule 8 to ICTA; but the section includes a mini method statement for the calculation of “D”.

Section 554: Attribution of further interest in company

2234. This section sets out in that in certain circumstances the individual (or an associate of the individual) is treated as owning, not only the “appropriate percentage” of the company’s ordinary share capital determined under section 552 but an additional percentage as well. It derives from paragraph 7(11) of Schedule 8 to ICTA.
2235. The “appropriate percentage” may be increased if the individual (or associate) receives payments from other trusts that own shares in the company. This section sets out in what circumstances the appropriate percentage may be so increased, and how to work out the total percentage of the company’s share capital that the individual (or associate) is treated as owning.
2236. *Subsection (3)* sets out material that has no precise counterpart in ICTA; but its inclusion in this Act should make the legislation clearer.

Part 8: Former employees: deductions for liabilities

Overview

2237. This Part contains provisions that give relief for payments made against liabilities arising from a former office or employment. To qualify for relief those payments must be made in the run-off period defined in the provisions. This Part derives from the provisions in section 92 of FA 1995 but subsections (6) to (8) are dealt as consequential amendments in paragraphs 217 and 219(2) of Schedule 6 to this Act. Subsection (10) is dealt with in sections 409 and 410 of this Act.
2238. In most instances there will not be any income from the relevant employment against which to set the payment incurred because that employment must have ceased. Relief for the payment is therefore given against total income. That contrasts with the corresponding provisions for similar payments incurred in an ongoing office or employment, found in sections 346 to 350 in Chapter 2 of Part 5 of this Act, which

derive from section 201AA of ICTA. Under those provisions the payment can only be set against earnings from the employment that gives rise to the liabilities that led to the payment being incurred.

2239. Section 92 of FA 1995 operated by importing concepts from section 201AA of ICTA. This Part does not follow that approach and instead is as self-contained as possible.

Section 555: Former employee entitled to deduction from total income

2240. This section sets out the circumstances under which entitlement to a deduction arises. It derives from parts of section 92(1) and (5) of FA 1995.

Section 556: Deductible payments made outside the time limits allowed

2241. This section gives the start and finish dates of the run-off period referred to in the overview above. It derives from section 92(2)(a) of FA 1995.
2242. *Subsection (1)* is more precise than the source legislation about when the payment must be made. See *Change 134* in Annex 1.

Section 557: Deductible payments wholly or partly borne by the former employer etc.

2243. This section gives a method for determining the amount of any deduction due to a former employee in one of two circumstances where that employee has not paid or borne the whole of the cost of the payment personally. It derives from parts of section 92(4) and (5) of FA 1995.
2244. The first circumstance is that the former employer (as defined in section 563) of this Act has borne some or all of the cost involved. The second circumstance is that the cost has been met from the proceeds of a contract of insurance against the risk(s) that gave rise to the need to make the payment. A deduction for the payment involved is available only to the extent that the former employee has been treated as having received a relevant retirement benefit or post-employment earnings.

Section 558: Meaning of “deductible payment”

2245. This section derives from section 201AA(1), (7), (8) and (9) of ICTA and from section 92(2)(b) of FA 1995. It describes the different sorts of payments that can qualify as a deduction under this Part.

Section 559: Liabilities related to the former employment

2246. This section describes the types of liability that can give rise to payments that are eligible for relief. It derives from section 201AA(2) of ICTA and from section 92(2)(b) of FA 1995.

Section 560: Meaning of “qualifying insurance contract”

2247. This section describes the conditions that have to be met if an insurance contract is to fall within the scope of this Part. It derives from section 201AA(3)(a) to (d) and (4) of ICTA and from section 92(2)(b) of FA 1995.
2248. *Subsections (2) to (5)* state the conditions that have to be met for an insurance contract to come within section 558(1).

Section 561: Connected contracts

2249. This section describes what determines whether insurance contracts are connected with one another. It derives from section 201AA (5) and (6) of ICTA and from section 92(2)(b) of FA 1995.

2250. *Subsections (1) to (3)* define when insurance contracts are connected.
2251. *Subsections (4) to (7)* provide for that connection to be ignored in certain specified circumstances.

Section 562: Meaning of “former employee” and “employment”

2252. This section defines what is meant by a “former employee”, giving some non-exhaustive examples of the sort of posts covered. It is based on and developed from the definition of “employment” in section 4 of this Act. It is sufficiently wide in scope to include what are commonly described as “shadow directors”, as defined in the full out words of section 67(1) of this Act. See *Note 1* in Annex 2.

Section 563: Other interpretation

2253. This section contains definitions of some terms used throughout this Part. It derives from section 92(4) (part) and (9) of FA 1995.
2254. In particular this section has an extended definition of “former employer”. See *Note 1* in Annex 2.

Section 564: Application of this Part to office-holders

2255. The provisions in this Part are written in terms of the “former employee”. This section extends the provisions so that they apply equally to former office-holders. It echoes the provisions in section 5 of this Act. The section derives from part of section 92(4) and (9) of FA 1995. See *Note 1* in Annex 2.

Part 9: Pension Income

Overview

2256. This Part identifies the income that is taxed as pension income.
2257. The Part charges income described as a pension in the source legislation. It also charges other income that is in the nature of pension income but is not described as a pension in the source legislation.
2258. Different Chapters in the Part identify the various forms that pension income can take and set out the rules governing each form. For each category of income the Chapters specify the person liable to tax and the basis of the charge.
2259. There is no statutory definition of “pension” for tax purposes, although voluntary pensions are specifically included. So “pension” has its ordinary meaning. That is a very wide meaning. The definition of “pension” fills almost three columns of the Oxford English Dictionary.
2260. The Part sets out the exemptions that apply to income that would otherwise be chargeable. It also sets out the deductions that are allowed in calculating taxable pension income; payroll giving donations and the 10% deduction for certain overseas government pensions. The 10% deduction for foreign pensions is dealt with by cross-reference to section 65(2) of ICTA.

Chapter 1: Introduction

Overview

2261. This Chapter sets out the structure of the pension income Part.

Section 565: Structure of Part 9

2262. This is the only section in the Chapter. It is new.

2263. Chapter 2 imposes the charge and explains how exemptions and deductions are dealt with.
2264. Chapters 3 to 15 identify:
- what is chargeable - “pension income”;
 - how to calculate the amount chargeable - “taxable pension income”; and
 - who is chargeable - the person liable for the tax.
2265. Chapters 16 to 18 identify a number of exemptions. All the exemptions apply for all income tax purposes and not just for the purposes of this Part.

Chapter 2: Tax on pension income

Overview

2266. This Chapter imposes the charge on “net taxable pension income” and explains how to calculate “net taxable pension income”. There are four steps in the process:
- **Step one** - identify the income as pension income;
 - **Step two** - exclude any exempt income;
 - **Step three** - calculate the amount of “taxable pension income”; and
 - **Step four** - calculate “net taxable pension income” by allowing certain deductions from “taxable pension income”.
2267. These steps are carried out for each source of pension income separately; see paragraph 2275.
2268. The Chapter also includes a signpost to the various provisions that identify the person liable for any tax charged.

Section 566: Nature of charge to tax on pension income and relevant definitions

2269. This section identifies the different forms of pension income that are chargeable. It is new.
2270. “Pension income” is identified in *subsection (2)*. Pension income includes not only pensions and annuities but other types of income that are in the nature of a pension. The types of pension income are listed in *subsection (4)*. The length of the list reflects the variety of forms that pension income takes and the different ways in which those forms are treated for tax purposes.
2271. *Subsection (1)* provides that the charge on “pension income” does not apply to any exempt income. “Exempt income” is defined in *subsection (3)* to mean any income that is exempted from income tax by one of the sections in Chapters 16 to 18 of the pension income Part. This means that “exempt income” is included in the definition of “pension income” but is not taxed as pension income. This point is reinforced in section 567(4). See paragraph 2277.
2272. For example, section 641 (wounds and disability pensions) gives an exemption to various types of war pension. Those pensions fall within the ordinary meaning of United Kingdom pension in section 569 so they are included in “pension income” but because of the exemption they are not charged to tax.

Section 567: Amount charged to tax

2273. This section imposes the charge to tax and explains how the charge is calculated. It is new.

2274. *Subsection (1)* imposes the charge.
2275. *Subsection (2)* provides that the charge is imposed on “net taxable pension income”. Each pension, annuity or other item of pension income is treated separately in the calculation of net taxable pension income. So, if a taxpayer receives two occupational pensions, net taxable pension income is calculated for the income from each pension.
2276. *Subsection (4)(a)* explains that the amount of “taxable pension income” is given in the relevant section in Chapters 3 to 15. Each of those Chapters has a section entitled “taxable pension income”. Those sections give the rules for calculating the amount of the “taxable pension income” for the income dealt with in the Chapter.
2277. *Subsection (4)(b)* makes it clear that “taxable pension income” does not include any exempt income. The definition of “exempt income” is in section 566(3).

Section 568: Person liable for tax

2278. This section is a signpost to the sections in Chapters 3 to 15 that identify the person liable to pay the tax charged. It is new.

Chapter 3: United Kingdom pensions: general rules

Overview

2279. This Chapter applies to United Kingdom pensions.

Section 569: United Kingdom pensions

2280. This section identifies pensions paid by or on behalf of a person who is in the United Kingdom as pension income. It derives from paragraph 3 of Schedule E (section 19(1) of ICTA) but it also covers payments taxed by paragraph 2 of Schedule E and section 133 of ICTA.
2281. *Subsection (1)* applies to any pension paid by or on behalf of a person who is in the United Kingdom. It derives from paragraph 3 of Schedule E (section 19(1) of ICTA). The territorial scope in this section is mirrored by section 573 (in Chapter 4), which taxes foreign pensions. That section applies to a pension paid by or on behalf of a person who is outside the United Kingdom. Together these two provisions ensure that all pensions paid by or to persons in the United Kingdom will be taxed.
2282. *Subsection (2)* limits the scope of the section. It applies only to pensions not identified by one of the specific provisions of the pension income Part. This gives the section the character of a sweep-up provision. Normally a sweep-up provision would come after the specific provisions. But that would not be the right approach here.
2283. One of the objectives of the pension income Part is to remove the overlap that exists in ICTA. Paragraph 3 of Schedule E (section 19(1) of ICTA) imposes a general charge on United Kingdom pensions. But there are also two provisions that impose a specific and overlapping charge on a United Kingdom pension. Section 597 of ICTA imposes a specific charge on pensions paid by approved retirement benefits schemes and paragraph 2 of Schedule E (section 19(1) of ICTA) imposes a specific charge on pensions paid by the Crown.
2284. To remove any overlap the pension income Part needs to identify discrete forms of pension income. The general provision in section 569 is subject to the sections that identify specific forms of pension income. This results in the sweep-up nature of section 569. But despite its sweep-up nature section 569 will apply to many taxpayers. For example, nearly all public sector pensions will be within this section. If the position of the section in the Part is to reflect its importance it needs to come before the sections that apply to specific types of pension income. Also, making the section the first of the

provisions that identify pension income gives a natural opening to the pension income Part. It is immediately obvious that all United Kingdom pensions are to be taxed.

2285. *Subsection (3)* is a signpost to Chapter 4, which gives the general rules for foreign pensions. It is not possible for a pension to be a United Kingdom pension as defined in section 569(1) and a foreign pension as defined in section 573. This is because the qualifying conditions are mutually exclusive.
2286. The pension income Part does not rewrite paragraph 2 of Schedule E (section 19(1) of ICTA). That provision applies to annuities, pensions and stipends payable by the Crown or out of the public revenue. All these forms of income will be taxed in the general charge on United Kingdom pensions in section 569.
2287. “Annuity” in paragraph 2 of Schedule E (section 19(1) of ICTA) is used in the sense of a regular income payment rather than a purchased annuity. Given the wide meaning of “pension” an annuity payable by the Crown is a pension. So it is not necessary for this Act to rewrite a specific charge on annuities payable by the Crown.
2288. The charge on annuities in paragraph 2 of Schedule E (section 19(1) of ICTA) does not apply to any annuity taxed by paragraph (c) of Schedule D Case III (section 18(3) of ICTA). As the pension income Part has not rewritten the charge on annuities in paragraph 2 of Schedule E the reference to paragraph (c) of Case III is redundant. So it is not necessary for this Act to rewrite the reference to paragraph (c) of Schedule D Case III (section 18(3) of ICTA).
2289. Paragraph 2 of Schedule E (section 19(1) of ICTA) imposes a specific charge on a pension payable by the Crown or out of the public revenue. The pension income Part does not retain this specific charge. Either the payment is a pension or it is not. The fact that the payment is made by the Crown cannot make it a pension. A pension paid by or on behalf of a person in the United Kingdom will be taxed by section 569. It is not necessary for this Act to rewrite the specific charge on a pension payable by the Crown or out of the public revenue.
2290. Paragraph 2 of Schedule E (section 19(1) of ICTA) imposes a specific charge on a stipend payable by the Crown or out of the public revenue. A stipend paid by the Crown does not need particular identification. If a payment described as a stipend represents earnings as defined in section 62 it will be taxed as employment income. If the payment described as a stipend is not earnings it will fall within the ordinary meaning of “pension”. So it is not necessary for this Act to rewrite the specific charge on a stipend payable by the Crown or out of the public revenue.

Section 570: “Pension”: interpretation

2291. This section ensures the charge applies to voluntary pensions. It derives from section 133(2) of ICTA.
2292. The scope of section 133(2) of ICTA has been considered in two tax cases. In *Johnson v Holleran* [1988] 61 TC 433 and *Johnson v Farquhar* [1991] 64 TC 395 it was held that section 133(2) of ICTA applies for all the purposes of Schedule E and not merely for the purposes of section 133(1).
2293. The effect of the section is that any pension paid by or on behalf of a person in the United Kingdom will be taxed even if there is no contractual right to receive the pension.

Section 571: Taxable pension income

2294. This section sets out the basis of assessment. It identifies the amount of taxable pension income, which feeds into the computation of net taxable pension income in section 567.
2295. The section derives from section 41 of FA 1989. That section provides that income taxed by paragraphs 2 and 3 of Schedule E (section 19(1) of ICTA) and section 133 of

ICTA is charged on the amount accruing in the tax year. This means that the charge is calculated on the amount accruing from day to day without regard to when the income is actually paid.

Section 572: Person liable for tax

2296. This section identifies the person chargeable. It is new.
2297. The pension income Part includes income that ICTA taxes under Schedule E and income that ICTA taxes under Schedule D. For income taxed under Schedule D section 59(1) of ICTA identifies the person chargeable as the person “receiving or entitled” to the income.
2298. There is no equivalent of section 59(1) of ICTA for pensions that ICTA taxes under Schedule E. It would be inconsistent to identify a person chargeable for some but not all pension income. The pension income Part avoids this inconsistency. It makes the person liable for tax on pension income the person receiving or entitled to the income in all cases where ICTA did not specify the person chargeable. See *Change 135* in Annex 1.

Chapter 4: Foreign Pensions: general rules

Overview

2299. This Chapter applies to pensions paid by or on behalf of a person who is outside the United Kingdom.

Section 573: Foreign pensions

2300. This section identifies pensions paid by or on behalf of a person who is outside the United Kingdom as pension income. Taken together with section 569 this section ensures that all pensions paid by or to persons in the United Kingdom are taxed. It derives from sections 18(3) and 58(1) of ICTA, both of which create a charge under Schedule D Case V.
2301. *Subsection (1)* identifies the income that is within the section. It includes the restriction that the section applies only if the pension is paid to a person resident in the United Kingdom. As is the case for United Kingdom pensions there is no definition of “pension”. The word has its ordinary meaning.
2302. *Subsection (2)* limits the scope of the section. The section applies only to pensions not identified in one of the specific provisions of the pension income Part. This is a similar structure to section 569 which covers pensions paid by or on behalf of a person who is in the United Kingdom. There are two reasons why the general charge on foreign pensions is subordinate to the specific charging provisions of the pension income Part.
2303. First, as for United Kingdom pensions, each section should identify a discrete source of pension income. To achieve this it is necessary to remove the overlap of the charging provisions in ICTA.
2304. Second, there are two sorts of pension paid by or on behalf of a person who is outside the United Kingdom that ICTA taxes under Schedule E rather than Schedule D Case V. The pension income Part has to deal specifically with those pensions in order to maintain the effect of ICTA. The two sorts affected are those taxed by section 580 (approved retirement benefits schemes) and section 615 (certain overseas government pensions).
2305. It is possible for an approved retirement benefits scheme to be operated by or on behalf of a person outside the United Kingdom. A pension or annuity paid by such a scheme is taxed by section 580. The payer is obliged to operate PAYE. The 10% deduction in section 65(2) of ICTA is not available for these pensions.

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

2306. Section 615 applies to a pension paid in the United Kingdom by or on behalf of certain overseas governments for service to those governments. In practice these pensions are paid by the Crown Agents. The Crown Agents operate PAYE when paying the pensions.
2307. *Subsection (3)* is a signpost to Chapter 3, which gives the general rules for United Kingdom pensions. It is not possible for a pension to be a foreign pension as defined in section 573(1) and a United Kingdom pension as defined in section 569(1). This is because the qualifying conditions are mutually exclusive.

Section 574: “Pension”: interpretation

2308. This section ensures the charge applies to voluntary pensions. It derives from section 58(2) of ICTA.
2309. *Subsection (1)* identifies voluntary pensions using the same language that section 570 uses to identify United Kingdom voluntary pensions. But the rules for foreign voluntary pensions are slightly different from the rules for United Kingdom voluntary pensions. For a foreign voluntary pension there is no equivalent of section 133(2) of ICTA (see paragraph 2291). A foreign pension paid on a voluntary basis will be taxable only if it meets the conditions in section 58(2) of ICTA.
2310. *Subsections (2) and (3)* set out the conditions in section 58(2) of ICTA. The effect of the Interpretation Act 1978 is that the reference to “widow” in section 58(2)(b) of ICTA includes “widower”. Subsection (2)(b) makes this effect explicit.
2311. *Subsection (4)* gives the meaning of “office”. It applies section 5 in Part 2 (Employment Income: charge to tax).

Section 575: Taxable pension income

2312. This section deals with the basis of assessment. It identifies the amount of taxable pension income, which feeds into the computation of net taxable pension income in section 567. The section invokes sections 65, 68, 584 and 585 of ICTA. It is new.
2313. In ICTA the basis of assessment for a foreign pension is given by the rules of Schedule D Case V. The pension income Part does not repeat those rules but cross-refers the reader to them. The rules are in section 65 of ICTA and include the remittance basis. Section 65 is modified by the rules for Irish income in section 68 of ICTA. Sections 584 and 585 of ICTA are also relevant. Section 584 gives relief for income taxed on an arising basis if that income cannot be remitted to the United Kingdom. Section 585 gives relief for income taxed on a remittance basis if the remittances are delayed. There is a specific reference to retrospective payments of pension income in section 585(2) of ICTA.

Section 576: Person liable for tax

2314. This section identifies the person chargeable. It derives from section 59(1) of ICTA.

Chapter 5: United Kingdom social security pensions

Overview

2315. This Chapter identifies certain social security benefits as pension income. These are pensions that are paid in the form of social security benefits.

Section 577: United Kingdom social security pensions

2316. This section identifies the six United Kingdom social security benefits taxed as pension income.

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

2317. ICTA does not impose a specific charge on these social security benefits. They are taxed either by section 617 of ICTA as social security benefits or by paragraph 2 of Schedule E (section 19(1) of ICTA) as a pension.
2318. The charge on industrial death benefit and graduated retirement benefit derives from paragraph 2 of Schedule E (section 19(1) of ICTA). The charge on the other benefits derives from section 617(1) of ICTA.
2319. *Subsection (2)* describes each of the benefits by reference to the relevant provisions of the National Insurance Act 1965, the Social Security Contributions and Benefits Act 1992 and their Northern Ireland equivalents.
2320. The subsection includes all three categories of state retirement pension. Category A pensions are paid in respect of a person's own contributions. Category B pensions are paid in respect the person's spouse's contributions. Category D pensions are payable to persons over 80 years of age who do not qualify for a Category A or B pension.

Section 578: Taxable pension income

2321. This section sets out the basis of assessment. It identifies the amount of taxable pension income, which feeds into the computation of net taxable pension income in section 567.
2322. The section derives from section 41 of FA 1989. That section provides that income taxed by paragraph 3 of Schedule E (section 19(1) of ICTA) and section 617(1) of ICTA is charged on the amount accruing in the tax year. This means that the charge is calculated on the amount accruing from day to day without regard to when the income is actually paid.

Section 579: Person liable for tax

2323. This section identifies the person chargeable. It is new.
2324. In ICTA this income is taxed under Schedule E. It does not identify the person chargeable. This section identifies the person liable for tax on the benefits within Chapter 5 as the person receiving or entitled to the income. See *Change 135* in Annex 1.

Chapter 6: Approved retirement benefits schemes

Overview

2325. This Chapter identifies the payments made by approved retirement benefits schemes that are charged to tax as pension income.

Section 580: Pensions and annuities

2326. This section applies to pensions and annuities paid by an approved retirement benefits scheme.
2327. It derives from section 597 of ICTA.
2328. *Paragraph (a)* applies to pensions and annuities paid on retirement. It derives from section 597(1) of ICTA. The word "pension" in section 597(1) is subject to the interpretation rule in section 612(1) of ICTA that pension includes annuity. It also covers income drawdowns.
2329. *Paragraph (b)* derives from section 597(3) of ICTA, which deals with bought-out annuities. This paragraph applies to a number of annuities that are purchased through the operation of an approved retirement benefits scheme. For example, deferred annuities that satisfy the approval requirements in section 591(2)(g) of ICTA or annuities written on the winding-up of a scheme or to discharge a pension sharing order.

2330. It does not cover the case where a member of the scheme transfers the value of the benefits to an approved personal pension scheme and takes an annuity or income withdrawals from that scheme. Such an annuity or income withdrawal would be taxed by Chapter 8 of the pension income Part (Approved personal pension schemes).
2331. This section does not rewrite section 597(2) of ICTA. That provision is a transitional measure introduced when the basis of assessment switched from Schedule D Case III to Schedule E. It allows the Board to authorise the pension payer to continue to treat the annuity as if it were taxed under Schedule D Case III. This is to give the payer time to set up a PAYE scheme. This power is no longer needed.
2332. The section applies to all approved schemes as defined in section 586 including United Kingdom approved schemes operated by or on behalf of a foreign employer. There is no territorial restriction in section 597 of ICTA. So there is no territorial restriction on the operation of the section.

Section 581: Taxable pension income

2333. This section deals with the basis of assessment. It identifies the amount of taxable pension income, which feeds into the computation of net taxable pension income in section 567.
2334. The section derives from section 41 of FA 1989. That section provides that income taxed by section 597 of ICTA is charged on the amount accruing in the tax year. This means that the charge is calculated on the amount accruing from day to day without regard to when the income is actually paid.

Section 582: Person liable for tax

2335. This section identifies the person chargeable. It is new.
2336. In ICTA this income is taxed under Schedule E. It does not identify the person chargeable. The section identifies the person liable for tax on pensions and annuities within section 580 as the person receiving or entitled to the income. See *Change 135* in Annex 1.

Section 583: Unauthorised payments

2337. This section applies to unauthorised payments made by approved retirement benefits schemes. It derives from sections 599A(9) and 600 of ICTA.
2338. *Subsection (2)* prevents the section applying if the payment has been taxed by section 623 as a return of surplus funds from an additional voluntary contributions scheme. It derives from section 599A(9) of ICTA.
2339. *Subsection (3)(a)* identifies the type of scheme to which the section applies. It derives from section 600(1) of ICTA. The scheme must be approved when the unauthorised payment is made. The section applies to schemes approved under Chapter 1 of Part 14 of ICTA or its predecessor Chapter 2 of Part 2 of FA 1970.
2340. The pension income Part does not repeat the reference to schemes approved under Chapter 2 of Part 9 of ICTA 1970. These are former approved superannuation schemes that lost their approval in 1980. It is not necessary for this Act to rewrite the reference to these schemes.
2341. Paragraph (c) of section 600(1) of ICTA refers to schemes approved under section 208 of ICTA 1970. These are also former approved superannuation schemes that lost their approval in 1980. But they may still enjoy the advantages that come from approval if they satisfy the conditions in section 608 of ICTA. Section 608 has been rewritten in Chapter 7 of this Part (Former approved superannuation schemes). The charge on

unauthorised payments made by those schemes is dealt with in that Chapter rather than here.

2342. *Subsection (3)(b)* gives the condition that the payment is not authorised by the scheme rules or made as a consequence of paragraph 33 of Schedule 6 to FA 1989. Paragraph 33 of Schedule 6 to FA 1989 applies to the return of employee additional voluntary contributions. It deems the rules of an additional voluntary contributions scheme to include a requirement to repay surplus funds whether or not such a payment is authorised by the scheme rules. The charge on the return of these funds is dealt with in Chapter 13 of this Part (Return of surplus additional voluntary contributions).
2343. *Subsection (4)* prevents the section applying to a pension or annuity. This avoids any overlaps with section 580.
2344. *Subsection (6)* prevents a double charge if the unauthorised payment is either a repayment of the employee's contributions or a commutation of the pension. If these payments exceed the benefits authorised by the scheme rules this Chapter will tax them as unauthorised payments. Subsection (6) is needed to prevent the payments being taxed again by sections 598 or 599 of ICTA. Those provisions impose specific charges on the repayment of the employee's contributions or the commutation of the pension. The regulations referred to in subsection (6) apply to superannuation funds approved before 6 April 1980. These regulations are not yet obsolete.
2345. *Subsection (7)* clarifies the meaning of "payment". It derives from section 600(4) of ICTA.

Section 584: Taxable pension income

2346. This section sets out the basis of assessment for unauthorised payments. It identifies the amount of taxable pension income, which feeds into the computation of net taxable pension income in section 567.
2347. The section derives from sections 600(2) and (4) of ICTA.

Section 585: Person liable for tax

2348. This section identifies the person chargeable. It derives from section 600(2) of ICTA.
2349. The person liable for tax is the employee or the ex-spouse, no matter who received the payment.

Section 586: Meaning of "retirement benefits scheme" etc.

2350. This section invokes various definitions in ICTA.
2351. It derives from the interpretations in Chapter 1 of Part 14 of ICTA.
2352. *Subsection (1)* defines "retirement benefits scheme" and "approved".
2353. "Retirement benefits scheme" is defined in section 611 of ICTA as follows:

In this Chapter "**retirement benefits scheme**" means, subject to the provisions of this section, a scheme for the provision of benefits consisting of or including relevant benefits, but does not include -

- (a) any national scheme providing such benefits; or
 - (b) any scheme providing such benefits which is an approved personal pension scheme under Chapter IV of this Part.
2354. The definition of "approved" includes a reference to Chapter 2 of Part 2 of FA 1970. This is the legislation that introduced the new code for approved retirement benefits schemes. That code is now in Chapter 1 of Part 14 of ICTA.

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

2355. *Subsection (2)* deals with third party arrangements. It derives from section 612(2) of ICTA. It makes it clear that a pension or annuity paid through a third party is covered by section 580.
2356. *Subsection (3)* clarifies the meaning of “employer”. It derives from section 612(2A) of ICTA.

Section 587: Application to marine pilots’ benefit fund

2357. This section ensures that the provisions of Chapter 6 apply to a marine pilots’ benefit fund. It derives from section 607 of ICTA.
2358. The purpose of the legislation is to allow self-employed marine pilots to belong to an occupational pension scheme. Such membership would normally be available only to employees.
2359. One effect of the applying the provisions of Chapter 6 to a marine pilots’ benefit fund is that the Schedule D Case VI charge on unauthorised payments has been rewritten as a pension income charge. See *Change 136* in Annex 1.

Section 588: Meaning of “employee” and “ex-spouse”

2360. This section clarifies the meaning of “employee” and defines the meaning of “ex-spouse”.
2361. *Subsection (1)* derives from the definition of “employee” in section 612(1) of ICTA and the definition of “ex-spouse” in section 659D of ICTA.
2362. *Subsection (2)* derives from the definition of “director” in section 612(1) of ICTA.

Section 589: Regulations

2363. This section allows the Board of Inland Revenue to make regulations for the administration of the charges identified in this Chapter. It derives from section 612(3) of ICTA.

Chapter 7: Former approved superannuation funds

Overview

2364. This Chapter identifies the payments made by former approved superannuation funds that are charged to tax as pension income.

Section 590: Annuities

2365. This section applies to annuities paid by former approved superannuation funds. It derives from section 608(4) of ICTA.
2366. “Former approved superannuation fund” means an occupational pension scheme that was approved under section 208 of ICTA 1970. These schemes lost their approval in 1980 when the code for retirement benefit schemes in Chapter 1 of Part 14 of ICTA took full effect. But section 608 of ICTA allows a scheme approved under section 208 of ICTA 1970 to remain exempt from income tax on its fund income provided two conditions are met. First, no further contributions are made into the scheme. Second, no changes are made to the scheme rules.
2367. The section uses the same language as section 580 to identify the arrangements under which the annuities are paid.

Section 591: Taxable pension income

2368. This section deals with the basis of assessment. It identifies the amount of taxable pension income, which feeds into the computation of net taxable pension income in section 567.
2369. The section derives from section 608(4) of ICTA.
2370. ICTA charges section 608(4) annuities under Schedule E. But they are not included in the list, in section 41 of FA 1989, of income that is taxed on the amount accruing in the tax year. The basis of assessment indicated in section 608(4) of ICTA is the annuity paid in the tax year. This section makes that basis of charge clear.

Section 592: Person liable for tax

2371. This section identifies the person chargeable. It is new.
2372. ICTA taxes this income under Schedule E. It does not identify the person chargeable. This section identifies the person liable for tax on annuities within section 590 as the person receiving or entitled to the income. See *Change 135* in Annex 1.

Section 593: Unauthorised payments: application of section 583

2373. This section applies to unauthorised payments from former approved superannuation funds. It derives from sections 599A(9) and 600 of ICTA.
2374. Section 600(1) of ICTA imposes a charge on:
a payment made out of funds which are held for the purposes of a scheme which is approved for the purposes of -
this Chapter; ... or
(c) section 208 ... of the 1970 Act.
2375. Schemes can no longer be approved under section 208 of ICTA 1970. The present tense, “is approved”, was introduced into the opening paragraph of section 600 of ICTA by Schedule 6 of FA 1989. It is used because subsection (1)(a) of section 600 applies to retirement benefits schemes approved under Chapter 1 of Part 14 of ICTA (dealt with by section 583 in Chapter 6 of this Part). But the charge on unauthorised payments still applies to schemes approved under section 208 ICTA 1970. That charge is rewritten in this section so that this Chapter deals with all the charges on former approved superannuation funds.
2376. The rules in section 600 of ICTA that apply to former approved superannuation funds are the same as those that apply to approved retirement benefits schemes. Rather than repeating those rules this section applies sections 583, 584, 585 and 588.
2377. *Subsection (1)* identifies the payments to which section 593 is applied. The payment must not be authorised by the rules of the fund or be made as a consequence of paragraph 33 of Schedule 6 to FA 1989. The effect of paragraph 33 of Schedule 6 to FA 1989 is discussed in paragraph 2342.
2378. *Subsection (2)* prevents section 593 applying if the payment has been taxed by section 623 as a return of surplus funds from an additional voluntary contributions scheme. It derives from section 599A(9) of ICTA.
2379. *Subsection (3)* clarifies the meaning of payment. It derives from section 600(4) of ICTA.

Section 594: Meaning of “former approved superannuation fund”

2380. This section identifies the superannuation funds that are covered by this Chapter. It derives from section 608(1) of ICTA.

Chapter 8: Approved personal pension schemes

Overview

2381. This Chapter identifies the payments made by approved personal pension schemes or arrangements that are taxed as pension income.

Section 595: Annuities

2382. This section identifies annuities from approved personal pension schemes as pension income. It derives from section 648A of ICTA.

2383. The effect of section 648A(1)(b) of ICTA is preserved by a consequential amendment to section 18(1)(b) of ICTA. This amendment ensures that an annuity taxed in the pension income Part is not also taxed under Schedule D.

2384. Section 648A(2) of ICTA has not been rewritten as it is no longer needed. That provision is a transitional measure introduced when the basis of assessment switched from Schedule D Case III to Schedule E. It allows the Board to authorise the pension payer to continue to treat the annuity as if it were taxed Schedule D Case III. This is to give the payer time to set up a PAYE scheme. This power is no longer needed.

Section 596: Taxable pension income

2385. This section deals with the basis of assessment. It identifies the amount of taxable pension income, which feeds into the computation of net taxable pension income in section 567.

2386. The section is new. Tax is charged on the amount of the annuity received in the tax year. See *Change 137* in Annex 1.

Section 597: Person liable for tax

2387. This section identifies the person chargeable. It is new.

2388. ICTA taxes this income under Schedule E. It does not identify the person chargeable. This section identifies the person liable for tax on annuities within section 595 as the person receiving or entitled to the income. See *Change 135* in Annex 1.

Section 598: Income withdrawals

2389. This section identifies income withdrawals from approved personal pension arrangements as pension income. It derives from section 643(5) of ICTA.

Section 599: Taxable pension income

2390. This section deals with the basis of assessment. It identifies the amount of taxable pension income, which feeds into the computation of net taxable pension income in section 567.

2391. The section derives from section 643(5) of ICTA. It makes it clear that tax is charged on the total of the income withdrawals made in the tax year.

Section 600: Person liable for tax

2392. This section identifies the person chargeable. It is new.

2393. ICTA taxes this income under Schedule E. It does not identify the person chargeable. This section identifies the person liable for tax on income withdrawals within section 598 as the person receiving or entitled to the income. See *Change 135* in Annex 1.

Section 601: Unauthorised personal pension payments

2394. This section identifies unauthorised payments from personal pension schemes or arrangements as pension income. It derives from section 647 of ICTA.
2395. *Subsection (2)* defines “personal pension payment”. It derives from section 647(1) of ICTA.
2396. *Subsection (4)* deals with the case in which the payment is made at a time when the scheme and the individual’s arrangements are approved. It derives from section 647(2)(a) of ICTA. A payment that is not authorised by the scheme rules is taxable.
2397. *Subsection (5)* deals with the case in which the payment is made at a time when the scheme is not approved. It derives from section 647(2)(b) of ICTA. A payment is taxable if it would not have been authorised by the rules of the scheme when the scheme was last approved.
2398. *Subsection (6)* deals with the case in which the payment is made at a time when the arrangements are not approved. It derives from section 647(2)(b) of ICTA. A payment is taxable if it would not have been authorised by the arrangements when the arrangements were last approved.
2399. *Subsection (7)* provides that “payment” includes non-cash payment. It derives from section 647(4) of ICTA.

Section 602: Taxable pension income

2400. This section deals with the basis of assessment. It identifies the amount of taxable pension income, which feeds into the computation of net taxable pension income in section 567.
2401. The section derives from section 647(3) of ICTA.

Section 603: Person liable for tax

2402. This section identifies the person chargeable. It derives from section 647(3) of ICTA.

Section 604: Meaning of “personal pension scheme” and related expressions

2403. This section cross-refers to various definitions and interpretations.
2404. It derives from section 630(1) of ICTA.
2405. The definition of “approved” in section 630(1) of ICTA is:
- (a) in relation to a scheme (other than an approved retirement benefits scheme), means approved by the Board under this Chapter; and
 - (b) in relation to arrangements, means -
 - (i) made in accordance with a scheme which is for the time being, and was when the arrangements were made, an approved scheme; or
 - (ii) made in accordance with a scheme which is for the time being an approved converted scheme but which was, when the arrangements were made, an approved retirement benefits schemebut does not refer to cases in which approval has been withdrawn.
2406. The definition of “income withdrawal” in section 630(1) of ICTA is:
- a payment of income, under arrangements made in accordance with a personal pension scheme, otherwise than by way of an annuity.
2407. The definition of “personal pension arrangements” in section 630(1) of ICTA is:

arrangements made by an individual in accordance with a personal pension scheme.

2408. The definition of “personal pension scheme” in section 630(1) of ICTA is:

a scheme whose sole purpose is the provision of annuities, income withdrawals or lump sums under arrangements made by individuals in accordance with the scheme.

Chapter 9: Retirement annuity contracts

Overview

2409. This Chapter identifies annuities paid under a retirement annuity contract as pension income.

Section 605: Annuities

2410. This section applies to annuities paid under a retirement annuity contract. It derives in part from section 18(1)(a)(i) of ICTA and in part is new.

2411. “Retirement annuity contract” is a widely understood term although it is not defined in ICTA. It means a contract that satisfies the conditions for relief set out in Chapter 3 of Part 14 of ICTA. It has not been possible to enter into such a new contract since 1988. But premiums and annuities will be paid under existing contracts for many years to come.

2412. In ICTA there is no specific charge on annuities paid under retirement annuity contracts. The annuities are taxed by the ordinary rules of Schedule D Case III. The pension income Part creates a specific charge on annuities paid under retirement annuity contracts in the pension income Part for two reasons.

2413. First, retirement annuity contracts remain an important source of retirement income for the self-employed.

2414. Second, the specific charge will help to establish a clear boundary between those annuities that qualify for the relief given by section 656 of ICTA and those that do not. This point is particularly relevant for the purchased life annuities dealt with in Chapter 10. It is discussed in paragraphs 2425 and 2426 of the explanatory notes on that Chapter.

Section 606: Meaning of “retirement annuity contract”

2415. This section defines “retirement annuity contract”. It derives from sections 620, 621 and 622(3) of ICTA.

2416. The term “retirement annuity contract” is not defined in ICTA or the Finance Acts. This section introduces a definition based on the conditions under which the premiums qualify for tax relief.

2417. *Paragraph (a)* applies to annuity contracts and trust schemes. It derives from sections 620 and 621 of ICTA. Section 620 applies to annuity contracts that have as their main object the payment of a retirement annuity to an individual. It also applies to trust schemes established to pay retirement annuities to an individual in an occupational group. Section 621 covers contracts to pay annuities to the spouse or dependant of the individual.

2418. *Paragraph (b)* applies to substituted contracts. It derives from section 622(3) of ICTA. Section 622 is concerned with the option to apply the accrued benefits arising from a maturing contract in taking out another contract. It is no longer possible to exercise this option to create a new retirement annuity contract. But annuities are still paid under substituted contracts. So a reference to substituted contracts is needed in the definition of “retirement annuity contract”.

Section 607: Taxable pension income

2419. This section deals with the basis of assessment. It identifies the amount of taxable pension income, which feeds into the computation of net taxable pension income in section 567.
2420. It derives from section 64 of ICTA.

Section 608: Person liable for tax

2421. This section identifies the person chargeable. It derives from section 59(1) of ICTA.

Chapter 10: Other employment-related annuities

Overview

2422. This Chapter identifies various purchased life annuities as pension income. It applies to purchased life annuities in the nature of pension income that are not identified in other Chapters of the pension income Part.
2423. In ICTA there is no specific charge on the annuities included in this Chapter. They are taxed as annual payments under the ordinary rules of Schedule D Case III. There are two reasons for creating a specific charge on these annuities in the pension income Part.
2424. First, the pension income Part should include all the income in the nature of pension income.
2425. Second, it is the clearest way of dealing with sections 656 and 657 of ICTA.
2426. A purchased annuity includes a payment of income and an element that in economic terms is the return of capital. Section 656 of ICTA exempts the capital element of an annuity payment from income tax. But this relief is not given to the annuities listed in section 657(2) of ICTA. Those annuities are:
- annuities paid by the tax-advantaged schemes including those paid to give effect to pension sharing orders. The tax-advantaged schemes are approved retirement benefits schemes, approved personal pension schemes and retirement annuity contracts;
 - annuities in the nature of pension income other than those paid by the tax-advantaged schemes; and
 - annuities purchased in accordance with a direction in a will, or to provide for an annuity payable by virtue of a will or settlement out of income of property disposed of by the will or settlement.
2427. This Chapter taxes the annuities described in the second bullet in paragraph 2426. Other Chapters of the pension income Part tax the annuities described in the first bullet. This will allow section 657 of ICTA to be rewritten so it applies only to the annuities in the third bullet.

Section 609: Annuities for the benefit of dependants

2428. This section applies to annuities if their purchase qualified for relief under section 273 of ICTA. It derives in part from section 18(1)(a)(i) of ICTA and in part is new.
2429. *Subsection (1)* is new. It identifies the annuities as pension income.
2430. *Subsection (2)* derives from section 18(1)(a)(i) of ICTA. It limits the scope of the section if the annuity is a foreign annuity. Foreign annuities are taxable only if paid to persons resident in the United Kingdom.

Section 610: Annuities under sponsored superannuation schemes

2431. This section applies to an annuity purchased under a sponsored superannuation scheme. It derives in part from section 18(1)(a)(i) of ICTA and in part is new.
2432. *Subsection (1)* is new. It identifies the annuities to be taxed as pension income. To do this the section has to describe the process under which the annuities are paid. It does this using the same language that section 580 uses to identify annuities paid by approved retirement benefits schemes.
2433. *Subsection (2)* derives from section 18(1)(a)(i) of ICTA. It limits the scope of the section if the annuity is a foreign annuity. Foreign annuities are taxable only if they are paid to persons resident in the United Kingdom.
2434. *Subsection (3)* ensures there is no overlap with other sections in the pension income Part. The definition of “sponsored superannuation scheme” in section 624(1) of ICTA predates the introduction of approved retirement benefits schemes in Chapter 1 of Part 14 of ICTA. An approved retirement benefits scheme is likely to be within the definition of “sponsored superannuation scheme”. In ICTA an annuity paid by an approved retirement benefits scheme is taxed under Schedule E. The annuities identified in this section are taxed under Schedule D. A Schedule E charge takes priority over a Schedule D charge. This subsection preserves that order of priority.
2435. *Subsection (4)* defines “sponsored superannuation scheme”. It cross-refers to section 624(1) of ICTA. The definition of “sponsored superannuation scheme” in section 624(1) of ICTA is as follows:

‘a sponsored superannuation scheme’ means a scheme or arrangement -

- (a) relating to service in particular offices or employments, and
- (b) having for its object or one of its objects to make provision in respect of persons serving in those offices or employments against future retirement or partial retirement, against future termination of service through death or disability, or against similar matters,

being a scheme or arrangement under which any part of the cost of the provision so made is or has been borne otherwise than by those persons by reason of their service (whether it is the cost or part of the cost of the benefits provided, or of paying premiums or other sums in order to provide those benefits, or of administering or instituting the scheme or arrangement).

Section 611: Annuities in recognition of another’s services

2436. This section applies to an annuity purchased by any person in recognition of another’s services. It derives in part from section 18(1)(a)(i) of ICTA and in part is new.
2437. *Subsection (1)* is new. It identifies the annuities to be taxed as pension income.
2438. *Subsection (2)* derives from section 18(1)(a)(i) of ICTA. It limits the scope of the section if the annuity is a foreign annuity. Foreign annuities are taxable only if they are paid to persons resident in the United Kingdom.
2439. *Subsection (3)* ensures there is no overlap with other sections in the pension income Part. An annuity paid by an approved retirement benefits scheme may be purchased in recognition of another’s services. In ICTA an annuity paid by an approved retirement benefits scheme is taxed under Schedule E. The annuities identified in this section are taxed under Schedule D. A Schedule E charge takes priority over a Schedule D charge. This subsection preserves that order of priority.
2440. *Subsection (4)* gives the meaning of “office”. It applies section 5 in Part 2 (Employment Income: charge to tax).

Section 612: Taxable pension income: UK annuities

2441. This section deals with the basis of assessment if the annuity arises from a source in the United Kingdom. It identifies the amount of taxable pension income, which feeds into the computation of net taxable pension income in section 567.
2442. The section derives from section 64 of ICTA.

Section 613: Taxable pension income: foreign annuities

2443. This section deals with the basis of assessment if the annuity arises from a source outside the United Kingdom. It identifies the amount of taxable pension income, which feeds into the computation of net taxable pension income in section 567.
2444. The section invokes sections 65, 68, 584 and 585 of ICTA. It is new.
2445. In ICTA the basis of assessment for a foreign pension is given by the rules of Schedule D Case V. The pension income Part does not repeat those rules but cross-refers the reader to them.
2446. *Subsection (4)* makes it clear that the 10% deduction in section 65(2) of ICTA and the relief in section 585(2) of ICTA apply to these annuities. See *Change 138* in Annex 1.

Section 614: Person liable for tax

2447. This section identifies the person chargeable for all the annuities in this Chapter. It derives from section 59(1) of ICTA.

Chapter 11: Certain overseas government pensions paid in the UK

Overview

2448. This Chapter identifies certain pensions paid in respect of government service overseas as pension income.

Section 615: Certain overseas government pensions paid in the United Kingdom

2449. This section derives from paragraph 4 of Schedule E (section 19(1) and section 133(2) of ICTA).
2450. Paragraph 4 of Schedule E imposes a charge on certain pensions paid by or on behalf of overseas governments to United Kingdom residents. It refers to a “pension or annuity”. As in paragraph 2 of Schedule E “annuity” is used here in the sense of a regular income payment rather than a purchased annuity. The word “pension” has a wide meaning. An annuity taxed by paragraph 4 of Schedule E is within that meaning. It is not necessary for this Act to rewrite the reference to annuities.
2451. *Subsection (2)* identifies the categories of person to whom the pension must be paid. The effect of the Interpretation Act 1978 is that “widow” includes “widower”. The subsection incorporates this effect. The pension must be payable in respect of overseas government service.
2452. *Subsection (4)* identifies the countries covered by the section. It does this by reference to other legislation. In December 2002 the countries covered were:
- (a) A country which forms part of Her Majesty’s dominions. These are:
- Anguilla, Bermuda, British Antarctic Territory, British Indian Ocean Territory, British Virgin Islands, Cayman Islands, Falkland Islands, Gibraltar, Montserrat, Pitcairn, Henderson, Ducie and Oeno Islands, St Helena, St Helena Dependencies (Ascension Island, Tristan da Cunha), South Georgia and South Sandwich Islands, Turks and Caicos Islands.

(b) Any other country mentioned in Schedule 3 of British Nationality Act 1981. These are:

Antigua and Barbuda, Australia, The Bahamas, Bangladesh, Barbados, Belize, Botswana, Brunei, Canada, Republic of Cyprus, Dominica, Fiji, The Gambia, Ghana, Grenada, Guyana, India, Jamaica, Kenya, Kiribati, Lesotho, Malawi, Malaysia, Maldives, Malta, Mauritius, Namibia, Nauru, New Zealand, Nigeria, Pakistan, Papua New Guinea, Saint Christopher and Nevis, Saint Lucia, Saint Vincent and the Grenadines, Seychelles, Sierra Leone, Singapore, Solomon Islands, South Africa, Sri Lanka, Swaziland, Tanzania, Tonga, Trinidad and Tobago, Tuvalu, Uganda, Vanuatu, Western Samoa, Zambia, Zimbabwe.

((c) Any territory under Her Majesty's protection. There are no such countries at present.

2453. The section does not identify the individual countries. This is because it would then be necessary to amend primary tax legislation to take account of any changes. A recent example is Hong Kong's change of status. The section follows the pragmatic approach of ICTA.
2454. *Subsection (5)* prevents the section applying to payments made by the United Kingdom government. The phrase "public revenue of the United Kingdom" is retained because it has a settled technical meaning. It means a payment out of the United Kingdom Consolidated Fund. The reference to Northern Ireland is needed because there is also a Northern Ireland Consolidated Fund.
2455. *Subsection (6)* defines "overseas government service". It derives from the definition of "relevant service" in paragraph 4 of Schedule E (section 19(1) of ICTA).
2456. *Subsection (7)* derives from section 133(2) of ICTA. That section extends the charge on pensions taxed under Schedule E to voluntary pensions. Section 133(2) applies to these overseas government pensions if any are paid on a voluntary basis.

Section 616: Taxable pension income

2457. This section deals with the basis of assessment. It identifies the amount of taxable pension income, which feeds into the computation of net taxable pension income in section 567.
2458. It derives from section 41 of FA 1989. Section 41 charges pensions on the amount accruing in the tax year. This means that the charge is calculated on the amount accruing from day to day without regard to when the income is actually paid.

Section 617 Deduction allowed from taxable pension income

2459. This section allows a deduction of 10% from the amount chargeable. It derives from section 196 of ICTA. The deduction feeds into the calculation of net taxable pension income in section 567(3).

Section 618: Person liable for tax

2460. This section identifies the person chargeable. It is new.
2461. In ICTA this income is taxed under Schedule E. ICTA does not identify the person chargeable. This section identifies the person liable for tax on pensions within section 615 as the person receiving or entitled to the income. See *Change 135* in Annex 1.

Chapter 12: House of Commons Members' Fund

Overview

2462. This Chapter identifies periodical payments granted out of the House of Commons Members' Fund as pension income.

Section 619: The House of Commons Members' Fund

2463. This section derives from section 613(3) of ICTA.

2464. The section will apply to a very small number of taxpayers, possibly no more than 100. The House of Commons Members' Fund was established in 1939. It was superseded by the Parliamentary Contributory Pension Fund in 1964. The 1939 fund continues to make grants to former Members and their dependants. These grants are described as "periodical payments".

2465. *Paragraph (a)* applies to grants made to former Members and their dependants who qualify for grants under the House of Commons Members' Fund Act 1939.

2466. *Paragraphs (b) and (c)* apply to grants made to former Members and their dependants who receive grants under section 4 of the House of Commons Members Fund Act 1948 because they do not qualify under the 1939 Act. These payments are made from sums appropriated from the fund and the income earned on those appropriated amounts.

2467. Section 613(1) and (2) of ICTA deal with Members' contributions to the fund. Because Members no longer pay these contributions it is not necessary for this Act to rewrite section 613(1) and (2).

Section 621: Taxable pension income

2468. This section deals with the basis of assessment. It identifies the amount of taxable pension income, which feeds into the computation of net taxable pension income in section 567.

2469. The section derives from section 613(3) of ICTA and makes it clear that tax is charged on the full amount paid in the tax year.

Section 622: Person liable for tax

2470. This section identifies the person chargeable. It is new.

2471. In ICTA this income is taxed under Schedule E. ICTA does not identify the person chargeable. This section identifies the person liable for tax on payments within section 619 as the person receiving or entitled to the income. See *Change 135* in Annex 1.

Chapter 13: Return of surplus employee additional voluntary contributions

Overview

2472. Members of retirement benefits schemes can boost the pensions they will receive by making additional voluntary contributions (AVCs). They may make AVCs to their employer's scheme or to a separate "free-standing" AVCs scheme. If these schemes are "approved" by the Inland Revenue the member is entitled to tax relief on the payments and the investment income of the scheme is exempt. If a scheme does particularly well it is possible for the total benefits available to a member to exceed the maximum benefits permitted under the approval rules. The scheme administrator then has to return surplus AVCs to the member. In paying back the surplus the administrator has to deduct a special tax charge (see section 599A(2) of ICTA) designed to recover the tax relief in respect of both the AVCs and the investment income.

2473. This Chapter is concerned with the treatment of the scheme member. If the scheme administrator has to return surplus AVCs the member is treated by section 595A(5) as having received the payment net of basic rate tax. This Chapter rewrites this charge as pension income. See *Change 139* in Annex 1.

Section 623: Return of surplus employee additional voluntary contributions

2474. This section identifies a return of surplus funds to a member of an exempt approved retirement benefits scheme or a relevant statutory scheme as pension income. It derives from sections 599A(1), (5), (9) and (10) of ICTA.
2475. *Subsection (4)* requires the payment to be to or for the benefit of an employee. The meaning of “employee” is extended by section 612(1) of ICTA to include future and former employees. This is made clear in section 628(1).
2476. Section 599A(1) of ICTA applies to payments made to or for the benefit of employees or their personal representatives. But section 599A(5) of ICTA applies only to payments made to or for the benefit of employees. For this reason the section makes no mention of personal representatives.
2477. *Subsection (5)* prevents the payments also being taxed as a repayment of the employee’s contributions or as a commutation of the pension. It derives from section 599A(9) of ICTA. The section uses the same language as section 583(6). The regulations referred to in subsection (3)(b) apply to superannuation funds approved before 6 April 1980. These regulations are not yet obsolete.
2478. Section 599A(9) of ICTA gives this section priority over any charge under section 600 of ICTA. That rule has been included in the rewrite of section 600 as section 583(2).

Section 624: Taxable pension income

2479. This section sets out the basis of assessment. It identifies the amount of taxable pension income, which feeds into the computation of net taxable pension income in section 567.
2480. It derives from section 599A(5). Tax is charged on the grossed up amount of the payments made in the tax year.

Section 625: Person liable for tax

2481. This section identifies the person chargeable. It derives from section 599A(5) and (8) of ICTA.

Section 627: Meaning of “grossing up”

2482. This section explains what is meant by “grossing up”. It is new. Although the concept of grossing up is familiar it is not explained in ICTA.

Section 628: Interpretation

2483. This section cross-refers to various definitions in ICTA. It derives from the interpretations given in Chapter 1 of Part 14 of ICTA.
2484. Subsection (1) clarifies the meaning of “employee”. It gives the meaning of “exempt approved scheme” and “relevant statutory scheme” by cross-reference.
2485. “Exempt approved scheme” is defined in section 592(1) of ICTA as follows:

This section has effect as respects -

- (a) any approved scheme which is shown to the satisfaction of the Board to be established under irrevocable trusts; or

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(b) any other approved scheme as respects which the Board, having regard to any special circumstances, direct that this section shall apply;
and any scheme which is for the time being within paragraph (a) or (b) above is in this Chapter referred to as an ‘exempt approved scheme’.

2486. “Relevant statutory scheme” is defined in section 611A(1) of ICTA as follows:

In this Chapter any reference to a relevant statutory scheme is to -

- (a) a statutory scheme established before 14th March 1989, or
- (b) a statutory scheme established on or after that date and entered in the register maintained by the Board for the purposes of this section, or
- (c) a parliamentary pension scheme.

2487. *Subsection (2)* derives from the definition of “director” in section 612(1) of ICTA.

2488. *Subsection (3)* derives from section 599A(10) of ICTA and the definition of employee in section 612(1) of ICTA.

2489. *Subsection (4)* applies the definition of “office” in section 5(3) in Part 2 (Employment Income: charge to tax).

Chapter 14: Pre-1973 pensions paid under the Overseas Pensions Act 1973

Overview

2490. This Chapter identifies certain pensions paid since 6 April 1973 under the Overseas Pensions Act 1973 as pension income.

Section 629: Pre-1973 pensions paid under the Overseas Pensions Act 1973

2491. This section derives from section 616(3) of ICTA.

2492. Section 616(3) of ICTA was introduced to deal with a consequence of the Overseas Pensions Act 1973. Under the Overseas Pensions Act 1973 the United Kingdom government took responsibility for paying certain pensions previously paid by Commonwealth governments. This converted the pensions from foreign pensions taxed under Schedule D Case V to United Kingdom pensions taxed under Schedule E. This might have been to the taxpayer’s disadvantage because the income could no longer be taxed on the remittance basis.

2493. The effect of section 616(3) of ICTA is to treat the pensions as if they are still paid by the overseas government. To qualify the pension must have been paid since 6 April 1973 to the original pensioner, or to the original pensioner’s widow or widower.

2494. *Subsection (1)(b)* introduces the term “pre-1973 pension”. That term is defined in section 630.

2495. *Subsection (2)* prevents the section applying to any part of the pension that is paid under the Pensions (Increase) Act 1971. These increases to the pension have always been paid by the United Kingdom government and have always been taxed as United Kingdom pensions.

Section 630: Interpretation

2496. This section defines various terms used in the Chapter. It derives from section 616(3) and (4) of ICTA.

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2497. *Subsection (1)* defines “original pensioner”. It derives from section 616(4) of ICTA. The pensioner must be the person whose service earned the pension and he or she must have retired before 6 April 1973.
2498. *Subsection (2)* defines “pre-1973 pension”. The pension must have been paid since 6 April 1973 to the original pensioner or to the pensioner’s widow or widower. The recipient must be resident in the United Kingdom.

Section 631: Taxable pension income

2499. This section deals with the basis of assessment. It identifies the amount of taxable pension income, which feeds into the computation of net taxable pension income in section 567.
2500. It derives from section 616(3) of ICTA and invokes sections 65 and 68 of ICTA.
2501. Section 616(3) of ICTA treats the pension as if the original overseas government or body paid it. This section adopts a different approach. The practical effect of section 616(3) is to tax the pension as a foreign pension. The section legislates the practical effect.
2502. In ICTA the basis of assessment for a foreign pension is given by the rules of Schedule D Case V. The pension income Part does not repeat those rules but cross-refers the reader to them. There is no cross-reference to sections 584 and 585 of ICTA. These sections will not apply if the United Kingdom government pays the pensions.

Section 632: Person liable for tax

2503. This section identifies the person chargeable. It derives from section 59(1) of ICTA.

Chapter 15: Voluntary annual payments

Overview

2504. This Chapter identifies voluntary annual payments as pension income.

Section 633: Voluntary annual payments

2505. This section derives from sections 58(2) and 133(1) of ICTA.
2506. Section 58 of ICTA imposes a charge on voluntary pensions and voluntary annual payments paid by or on behalf of a person outside the United Kingdom. Section 133 of ICTA imposes a charge on voluntary pensions and voluntary annual payments paid by or on behalf of a person in the United Kingdom. The charges on voluntary pensions have been rewritten in Chapters 3 and 4. These are the Chapters that deal with United Kingdom and foreign pensions generally. As voluntary annual payments are not pensions it is not appropriate to include them in Chapters that deal with pensions. So the charges on voluntary annual payments have been rewritten in a separate Chapter.
2507. The conditions for the section to apply are very similar to those that apply to foreign voluntary pensions. Those conditions have been rewritten in section 574 and are repeated in this section. The only difference is in subsection (4), which deals specifically with foreign voluntary annual payments. Subsection (4) restricts the charge to payments made to persons resident in the United Kingdom. This restriction is not needed in section 574 because the same effect is achieved by section 573.

Section 634: Taxable pension income: UK voluntary annual payments

2508. This section is concerned with the basis of assessment if the annual payment is paid by or on behalf of a person who is in the United Kingdom. It identifies the amount

of taxable pension income, which feeds into the computation of net taxable pension income in section 567.

2509. The section derives from section 41 of FA 1989. That section provides that income taxed by section 133 of ICTA is charged on the amount accruing in the tax year. This means that the charge is calculated on the amount accruing from day to day without regard to when the income is actually paid.

Section 635: Taxable pension income: foreign voluntary annual payments

2510. This section deals with the basis of assessment if the annual payment is paid by or on behalf of a person who is outside the United Kingdom. It identifies the amount of taxable pension income, which feeds into the computation of net taxable pension income in section 567.
2511. It invokes sections 65, 68, 584 and 585 of ICTA. It is new.
2512. In ICTA the basis of assessment for a foreign pension is given by the rules of Schedule D Case V. The pension income Part does not repeat those rules but cross-refers the reader to them.

Section 636: Person liable for tax

2513. This section identifies the person chargeable for both United Kingdom and foreign source payments.
2514. For a payment made by or on behalf of a person who is in the United Kingdom the section is new. ICTA taxes this income under Schedule E. It does not identify the person chargeable. The section identifies the person liable for tax on annual payments within section 633 as the person receiving or entitled to the income. See *Change 135* in Annex 1.
2515. For a payment made by or on behalf of a person who is outside the United Kingdom the section is derived from section 59(1) of ICTA.

Chapter 16: Exemption for certain lump sums

Overview

2516. This Chapter is concerned with lump sums paid under tax-advantaged pension schemes.

Section 637: Exemption for lump sums provided under certain pension schemes etc.

2517. This section exempts lump sums paid under tax-advantaged pension schemes from income tax. It derives from section 189 of ICTA.
2518. A lump sum is not a pension. The exemption is included in the pension income Part because the payment of lump sums is a feature of many pension schemes.
2519. *Subsection (1)* provides the exemption. Section 620(3) of ICTA allows the Board of Inland Revenue to approve a retirement annuity contract that pays a lump sum in specified circumstances. These lump sums have always been considered to be tax-free. The section makes this clear by including these payments in the exemption. See *Change 140* in Annex 1.
2520. *Subsection (2)* limits the scope of the exemption. The exemption applies only if:
- the payment has been earned; or
 - the taxpayer has lost his or her job or has suffered a loss of earnings and either event is due to ill health.

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2521. This limitation is intended to prevent “golden handshakes” being paid as exempt lump sums.
2522. *Subsection (4)* limits the exemption given to lump sum payments made under retirement annuity contracts to payments that satisfy the conditions for approval in section 620(3) of ICTA.
2523. *Subsection (5)* defines and clarifies various terms used in the section. In part it is new and in part it derives from Part XIV of ICTA.
2524. “Approved personal pension arrangements” derives from section 630(1) of ICTA.
2525. “Personal pension arrangements” is defined in section 630(1) of ICTA as follows:
arrangements made by an individual in accordance with a personal pension scheme.
2526. “Approved” in relation to personal pension arrangements is defined in section 630(1) of ICTA as follows:
(i) [arrangements] made in accordance with a scheme which is for the time being, and was when the arrangements were made, an approved scheme; or
(ii) made in accordance with a scheme which is for the time being an approved converted scheme but which was, when the arrangements were made, an approved retirement benefits scheme;
but does not refer to cases in which approval has been withdrawn.
2527. The definition of “office” applies section 5 in Part 2 (Employment income: charge to tax).
2528. *Subsection (6)* defines “tax-exempt pension scheme”. A scheme described in section 221(1) and (2) of ICTA 1970 is a former approved superannuation scheme. These schemes lost their approval in April 1980. But it is still possible for such a scheme to pay a lump sum and so the reference to these schemes is not obsolete.
2529. *Subsection (7)* defines “relevant statutory scheme”, “retirement benefits scheme” and, in relation to retirement benefits schemes, “approved”.
2530. Section 611A(1) of ICTA gives the meaning of “relevant statutory scheme” as follows:
(a) a statutory scheme established before 14th March 1989, or
(b) a statutory scheme established on or after that date and entered in the register maintained by the Board for the purposes of this section, or
(c) a parliamentary pension scheme.
2531. Section 611(1) of ICTA gives the meaning of “retirement benefits scheme” as follows:
‘retirement benefits scheme’ means, subject to the provisions of this section, a scheme for the provision of benefits consisting of or including relevant benefits, but does not include -
(a) any national scheme providing such benefits; or
(b) any scheme providing such benefits which is an approved personal pension scheme under Chapter IV of this Part.

Chapter 17: Exemptions: any taxpayer

Overview

2532. This Chapter exempts various pensions from any charge to income tax. The exemption applies whether or not the taxpayer is resident in the United Kingdom.

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2533. Four of the provisions rewritten in this Chapter, sections 315, 318, 330 and 617 of ICTA, provide that the “income shall not be treated as income for any income tax purpose”. Either they use that phrase or a very similar form of words. Section 317 of ICTA, rewritten as section 638, provides that the income “shall be disregarded for all the purposes of the Income Tax Acts”.
2534. In order to make the exemptions simple and consistent the phrase “no liability to income tax arises” is used throughout this Act to express exemption from tax. See *Note 28* in Annex 2.

Section 638: Awards for bravery

2535. This section exempts pensions and annuities paid to holders of various awards for bravery. It derives from section 317 of ICTA.

Section 639: Pensions in respect of death due to military or war service

2536. This section exempts pensions and allowances paid on death due to service in the armed forces, wartime service in the merchant navy or war injuries. It derives from section 318 of ICTA.
2537. *Paragraph (a)* applies to pensions and allowances paid in respect of both civilians and members of the armed forces. It derives from section 318(2)(a) of ICTA. Section 318(2) identifies the exempted pensions in general terms. This avoids the need to identify the specific schemes under which the pensions are paid. The section follows the pragmatic approach of section 318(2). This is because the pensions are paid under a range of schemes. It avoids the need to amend primary tax legislation every time a new scheme is introduced.
2538. *Paragraph (b)* applies to pensions and allowances paid in respect of members of the armed forces who died in peacetime service before the 1939–1945 war. It derives from section 318(2)(b) of ICTA.
2539. *Paragraph (c)* applies to pensions and allowances paid by countries outside the United Kingdom. It derives from section 318(2)(c) of ICTA.

Section 640: Exemption under section 639 where income withheld

2540. This section extends the exemption identified in section 639 if the pension or allowance is reduced because another pension or allowance is also payable. It derives from section 318(3) of ICTA.

Section 641: Wounds and disability pensions

2541. This section applies to wounds and disability pensions paid to members of the armed forces and civilians. It exempts the pensions from any charge to income tax. It derives from section 315 of ICTA.
2542. *Paragraphs (a) to (d) of subsection (1)* identify pensions paid to members of the armed forces. They are derived from section 315(2)(a) to (d) of ICTA. Section 315(2)(a) to (d) identifies the pensions in general terms. This avoids the need to identify each of the various schemes under which the pensions are paid. The section follows the pragmatic approach of section 315(2).
2543. The section uses the term “the armed forces of the Crown” rather than “the naval, military or air forces of the Crown”. The two terms have the same meaning. They cover all United Kingdom service personnel, including members of the regular forces, the reserve forces and the women’s services. The term has also been used in the rewrite of sections 197 and 316 of ICTA (sections 296 and 297).

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2544. Paragraphs (e) and (f) of subsection (1) apply to pensions paid to civilians and members of the merchant navy who have been disabled as a result of war service. They are derived from section 315(2)(e) of ICTA. This Act does not rewrite the reference to the Injuries in War (Compensation) Act 1915 as there are no surviving beneficiaries of these schemes.
2545. Paragraph (g) of subsection (1) also applies to pensions paid to civilians and members of the merchant navy. This is new. It gives statutory effect to the practice of extending the exemption to pensions granted by schemes established under sections 3 to 5 of the Pensions (Navy, Army, Air Force and Mercantile Marine) Act 1939. See *Change 141* in Annex 1.
2546. Subsection (2) prevents the exemption applying to any amount not attributable to disablement or disability. It derives from section 315(3) of ICTA.

Section 642: Compensation for National-Socialist persecution

2547. This section exempts annuities and pensions paid by the German and Austrian Governments to victims of National-Socialist persecution. It derives from section 330 of ICTA.
2548. Paragraph 46 of Schedule 6 to this Act repeals the reference to section 330 of ICTA in section 65(2) of ICTA. The exemption means the reference is unnecessary.

Section 643: Malawi, Trinidad and Tobago and Zambia government pensions

2549. This section exempts certain pensions paid since 6 April 1973 in respect of government service in Malawi, Trinidad and Tobago and Zambia. It derives from sections 616(1) and (2) of ICTA.
2550. Sections 616(1) and (2) of ICTA were introduced in 1973 to deal with a consequence of the Overseas Pensions Act 1973. Under the Overseas Pensions Act 1973 the United Kingdom government took over responsibility for paying certain pensions previously paid by Commonwealth governments. In 1973 the United Kingdom had double taxation agreements in force with three countries under which government service pensions paid by those countries were exempt from United Kingdom tax.
2551. The effect of the Overseas Pensions Act 1973 was to make these pensions United Kingdom pensions. The benefit of the exemptions given by the double taxation agreements would have been lost if they had not been preserved in some way. Section 616(1) and (2) of ICTA preserved the exemptions by treating the pensions as if they were still paid by the original government. The practical effect is that the pensions are exempt as long as the relevant provisions of the double taxation agreement are unchanged. The section legislates the practical effect.
2552. Subsection (5) prevents the exemption applying to any part of the pension that is paid under the Pension (Increase) Act 1971. These increases have always been paid by the United Kingdom government and have always been taxed under Schedule E as United Kingdom pensions.

Section 644: Pensions payable where employment ceased due to disablement

2553. This section exempts disablement pensions paid solely as a consequence of work-related illness or accident or war injuries. It gives statutory effect to ESC A62. See *Change 142* in Annex 1.
2554. Subsection (1) applies the section to qualifying disablement pensions.
2555. Subsection (2) defines “disablement pension”. It is a pension paid to a person who has left an employment because of disablement. The section does not apply to pensions paid by tax-approved pension schemes. These are approved retirement benefits schemes and former approved superannuation funds.

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2556. *Subsection (4)* gives the meaning of “office”. It applies section 5 in Part 2 (Employment income: charge to tax).

Section 645: Social security pensions: increases in respect of children

2557. This section applies to a social security benefit, taxed as pension income, if the benefit is increased because the recipient is responsible for a child. It derives from section 617(1)(b) of ICTA and ESC A24.
2558. *Subsection (2)* defines “social security pension”. *Paragraph (a)* derives from section 617(1)(b) of ICTA. *Paragraph (b)* derives from ESC A24.

Section 646: Former miners etc: coal and allowances in lieu of coal

2559. This section applies to free coal and payments in lieu of free coal given to retired miners and their widow or widower. It gives statutory effect to an extension to ESC A6 published in paragraph SE 66695 of the Inland Revenue’s Schedule E manual. See *Change 69* in Annex 1.
2560. *Subsection (2)* limits the scope of the exemption to the provision of free coal, or the payment of cash in lieu, of an amount that represents a reasonable level of personal consumption. But *subsection (3)* assumes that this condition is met unless the Inland Revenue can show that it is not. The purpose of these two subsections is to reproduce the restriction that applies to all ESCs - a concession will not be given where an attempt is made to use it to avoid tax.
2561. *Subsection (4)* gives the definition of “former colliery worker”. The definition is the same as that in section 306.

Chapter 18: Exemptions: Non-UK resident taxpayers

Overview

2562. This Chapter exempts certain pensions paid to non-residents in respect of government service overseas.

Section 647: Introduction and meaning of “foreign residence condition” etc.

2563. This section describes the foreign residence condition that must be satisfied if the exemptions identified later in the Chapter are to apply. It also expands the meaning of pension. It derives from section 615 of ICTA.
2564. *Subsections (2) and (3)* deal with the foreign residence condition. The taxpayer must make a claim to the Board to be non-resident.
2565. *Subsection (4)* identifies various payments that are also treated as pension income for the purposes of this Chapter. It derives from the definition of pension in section 615(7) of ICTA.

Section 648: The Central African Pension Fund

2566. This section exempts pensions paid from the Central African Pension Fund. It derives from section 615(2)(f) of ICTA.

Section 649: Commonwealth government pensions

2567. This section exempts pensions paid by various Commonwealth governments from funds established in the United Kingdom. It derives from section 615(2)(b) of ICTA.
2568. *Subsection (2)* defines “Commonwealth government”. The exemption does not apply to all the countries that are current members of the Commonwealth. But the term is

not inaccurate because the section applies only to countries that have a former colonial connection to the United Kingdom.

2569. *Subsections (3), (4) and (5)* set out a number of other definitions used to establish the meaning of “Commonwealth government”. The reference to “colony” in section 615(2) (b) of ICTA has been rewritten as “British overseas territory”. This incorporates the change introduced into Schedule 1 to the Interpretation Act 1978 by section 1(3) of the British Overseas Territories Act 2002. Any reference to “colony” is now interchangeable with “British overseas territory”.

Section 650: Oversea Superannuation Scheme

2570. This section exempts pensions paid under the Oversea Superannuation Scheme. It derives from section 615(2)(c) of ICTA, and corrects a small error in ICTA, which refers to this scheme as the “Overseas Superannuation Scheme”.
2571. *Subsection (2)* cross-refers to the legislation under which the pensions must be paid. The schemes are now operated under the Overseas Pensions Act 1973.

Section 651: Overseas Pensions Act 1973

2572. This section exempts pensions paid under section 1 of the Overseas Pension Act 1973. It derives from section 615(2)(d) of ICTA.
2573. *Subsection (2)* prevents the exemption applying to any part of the pension paid under the Pensions (Increase) Acts. It derives from section 615(4) of ICTA. These increases have always been paid by the United Kingdom government and have always been taxed under Schedule E as United Kingdom pensions.

Section 652: Overseas Service Act 1958

2574. This section exempts pensions paid under the Overseas Service Act 1958. It derives from sections 615(2)(e) of ICTA.
2575. *Subsection (4)* cross-refers to the legislation under which the pensions must be paid. These schemes are now to be operated under the Overseas Pensions Act 1973.
2576. *Subsection (5)* requires the pensions to be paid in accordance with schemes made under the Overseas Pensions Act 1973. These are schemes that the Secretary of State certifies as corresponding to the 1958 Act. This subsection derives from section 615(8)(c) of ICTA.
2577. *Subsections (6) and (7)* give the conditions that must be satisfied for a person to be treated as employed in the service of an overseas territory. They are derived from section 615(9) and (10) of ICTA.

Section 653: Overseas Service Pensions Fund

2578. This section exempts pensions paid out of the Overseas Service Pensions Fund. It derives from section 615(2)(g) of ICTA.
2579. *Subsection (3)* extends the meaning of “pension” to include any gratuity or other sum payable in respect of ill health. It derives from the definition of “pension” in section 615(7) of ICTA.

Section 654: The Pensions (India, Pakistan and Burma) Act 1955

2580. This section exempts pensions paid under the Pensions (India, Pakistan and Burma) Act 1955. It derives from section 615(2)(a) of ICTA.
2581. In *subsection (2)(b)(ii)* “correspond to the provision made under the 1955 Act” is a reference to the provision for pensions to be paid.

2582. *Subsection (3)* prevents the exemption applying to any part of the pension that is paid under the Pension (Increase) Act 1971. These increases have always been paid by the United Kingdom government and have always been taxed under Schedule E as United Kingdom pensions.

Part 10: Social security income

Overview

2583. This Part identifies the income that is taxed as social security income. It derives mainly from section 617 of ICTA. It also derives from other provisions of the Income Tax Acts that deal with the taxation of social security income.
2584. Section 617 of ICTA contains the main rules and charges United Kingdom social security benefits to tax under Schedule E. It sets out in narrative form the various social security benefits that are charged to tax. It also identifies the benefits that are not charged to tax. And it provides that some of those benefits are not to be treated as income for any income tax purpose.
2585. Subsections (3) and (4) of section 617 of ICTA deal with whether social security contributions may be deducted for tax purposes. The sections in this Part deal only with the charging of benefits. So the rules about deductions are not rewritten here.
2586. The aim of the social security income Part is to set out all the rules charging or exempting benefits payable under the social security Acts. The approach is to list the benefits in two tables. One table lists the taxable benefits and the other lists the non-taxable benefits.
2587. The Part also sets out the charging and exemption rules that apply to foreign benefits.

Chapter 1: Introduction

Overview

2588. This Chapter sets out the structure of the social security income Part.

Section 655: Structure of Part 10

2589. This is the only section in the Chapter. It is new.
2590. *Subsection (1)* lists the other Chapters in the Part. It identifies the different Chapters that deal with United Kingdom and foreign social security benefits. In each case, different Chapters deal with the benefits that are charged to tax and those that are exempt.
2591. *Subsection (2)* is a signpost to three rules that apply to government payments but which are not dealt with in this Part. The rules are not rewritten in this Part because they may apply more widely than to social security income alone. For instance, a Treasury order under section 151 of FA 1996 may require that a benefit is taxed as a business receipt.

Chapter 2: Tax on social security income

Overview

2592. This Chapter imposes the charge on “net taxable social security income” and explains how to calculate “net taxable social security income”. There are four steps in the process:
- **Step one** - identify the income as social security income;
 - **Step two** - exclude any exempt income;
 - **Step three** - calculate the amount of “taxable social security income”; and

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- **Step four** - calculate “net taxable social security income” by allowing any payroll giving deductions from “taxable social security income”.

2593. These steps are carried out separately for each United Kingdom and foreign social security benefit.

2594. The Chapter includes a signpost to the provisions that identify the person liable to pay any tax charged on United Kingdom and foreign social security benefits.

Section 656: Nature of charge to tax on social security income

2595. This section explains that the charge on social security income does not extend to income that is exempt from tax. It is new.

2596. Exempt income is included in the definition of social security income but is not taxed. The definition of “exempt income” applies for the purposes of the social security income Part. In particular, the expression is used in section 681(1) (taxable and other foreign benefits: exemptions).

Section 657: Meaning of “social security income”, “taxable benefits” etc.

2597. This section introduces the terms which are used to identify the benefits that are taxable and to arrive at the amount of income that is charged to tax. It is new.

2598. *Subsection (2)* makes it clear that the expression “social security income” (used in section 656) includes both taxable benefits and those that are exempt.

2599. *Subsection (4)* ensures that the four statutory payments listed in section 660(2) are not included in social security income if they are charged to tax as employment income.

Section 658: Amount charged to tax

2600. This section imposes the charge to tax. It is new.

2601. The section explains how relief for payroll giving is allowed against social security income. The rules for the relief are in Part 12. Those rules depend on a definition of “taxable social security income” from which the payroll giving deduction (“PGD”) is subtracted to arrive at the “net taxable social security income”. That lower amount is the amount on which tax is charged.

2602. Each taxable benefit is treated separately in the calculation of net taxable social security income.

Section 659: Person liable for tax

2603. This section is a signpost to the sections later in the Part where the person liable for the tax is identified for United Kingdom and foreign benefits. It is new.

Chapter 3: Taxable UK social security benefits

Overview

2604. This Chapter sets out the rules for taxing United Kingdom social security benefits.

2605. The charge on United Kingdom social security benefits in ICTA is under Schedule E. The charge is under paragraph 5 of Schedule E (section 19(1) of ICTA):

“...any other provision of the Tax Acts directing tax to be charged under this Schedule ...

2606. Section 150(a) of ICTA charges allowances under Job Release schemes. The last Order under the Job Release Act 1977 extended the effect of the Act to 29 September 1988. So

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this Act does not rewrite paragraph (a) of the section (or section 191 of ICTA). The other paragraphs, which charge statutory adoption pay, statutory maternity pay, statutory paternity pay and statutory sick pay, are rewritten in this Act - see paragraph 2608.

2607. The Chapter sets out the income chargeable. It also identifies the basis of assessment and the person chargeable.

Section 660: Taxable benefits: UK benefits – Table A

2608. This section sets out the United Kingdom benefits that are taxable. It derives from section 617(1) of ICTA. That subsection deals with most United Kingdom benefits (some of which are taxed in Part 9 as pensions). The table in this section also lists other benefits that are not within section 617:

- statutory adoption pay, statutory maternity pay, statutory paternity pay and statutory sick pay, from section 150 of ICTA;
- income support, from section 151 of ICTA;
- jobseeker’s allowance, from section 151A of ICTA; and
- incapacity benefit, from section 139 of FA 1994.

2609. *Subsection (1)* is the first of the tables (“Table A”). This table lists the taxable UK benefits. The second table (“Table B”) is in section 677 – see paragraph 2682.

2610. The table identifies each benefit by the section of the social security Act under which it is paid. The table also identifies the corresponding Northern Ireland provision if it has been enacted. The suspension of the Northern Ireland Assembly has prevented the enactment of some proposed Northern Ireland provisions. Those provisions are described rather than identified in the table.

2611. The table arranges the benefits in alphabetical order. This means that a particular benefit should be easy to find. And it should be easy to maintain the clarity of the table because it will be easy to insert any new benefit into the table in the right place.

2612. Incapacity benefit is included in the table of taxable benefits. See *Change 143* in Annex 1.

2613. *Subsection (2)* is a special rule for statutory adoption pay, statutory maternity pay, statutory paternity pay and statutory sick pay. It derives from the opening words “if they would not otherwise be (chargeable)” in section 150 of ICTA.

2614. In most cases these payments are earnings from an employment and charged to tax under the employment income Parts of this Act. This subsection ensures that a charge under the employment income Parts takes precedence over a charge under the social security income Part.

2615. In other cases the payments are made by the government. Then there is no charge to tax on them as earnings and they are charged as social security income.

Section 661: Taxable social security income

2616. This section sets out the basis of assessment for some United Kingdom social security benefits. It derives from section 41(2) of FA 1989, which applies only to the benefits (and pensions) mentioned in section 41(1) of FA 1989.

2617. Incapacity benefit is explicitly brought within the rule in section 41 of FA 1989 by section 139(3) of FA 1994.

2618. Five benefits in Table A are not covered by the rule in section 41 of FA 1989. They are statutory adoption pay, statutory maternity pay, statutory paternity pay statutory sick pay (all charged to tax by section 150 of ICTA) and jobseeker’s allowance (charged

to tax by section 151A of ICTA). There is no statutory basis of assessment for these benefits in ICTA.

2619. So the section applies only to the first four benefits listed in Table A.

Section 662: Person liable for tax

2620. This section identifies the person chargeable. It is new.

2621. The rule in this section applies only to United Kingdom social security income. But an identical rule applies to foreign social security income – see section 680.

2622. The social security income Part includes income that ICTA taxes under Schedule E and income that ICTA taxes under Schedule D. For income taxed under Schedule D section 59(1) of ICTA identifies the person chargeable as the person “receiving or entitled” to the income.

2623. There is no equivalent of section 59(1) of ICTA for social security benefits that ICTA taxes under Schedule E. It would be inconsistent to identify a person chargeable for some but not all social security income. The social security income Part avoids this inconsistency. It makes the person liable for tax on social security income the person receiving or entitled to the income in all cases where ICTA does not specify the person chargeable. See *Change 135* in Annex 1.

Chapter 4 Taxable UK social security benefits: exemptions

Overview

2624. This Chapter sets out the partial exemptions that apply to the taxable benefits listed in Table A. It derives from sections 151, 151A and 617 of ICTA and section 139 of FA 1994.

2625. One exemption applies generally. That is the exemption for any part of a benefit that is in respect of a child. The other exemptions relate to part of the following benefits:

- incapacity benefit;
- income support; and
- jobseeker’s allowance.

2626. This Chapter deals with the benefits that are sometimes taxable. Chapter 5 deals with the benefits that are never taxable.

2627. Section 617(2) of ICTA provides that payments within the subsection “shall not be treated as income for any purpose of the Income Tax Acts”. In order to make the exemptions simple and consistent the phrase “no liability to income tax arises” is used throughout this Act to express exemption from tax. See *Note 28* in Annex 2.

Section 663: Long-term incapacity benefit: previous entitlement to invalidity benefit

2628. Long-term incapacity benefit is usually taxable. But this section exempts long-term incapacity benefit from tax in some circumstances. The section derives from section 139(2) and (5) of FA 1994.

2629. *Subsection (1)* exempts long-term incapacity benefit from tax if it relates to a period of incapacity for work that started before 13 April 1995. On 13 April 1995 incapacity benefit replaced sickness benefit and invalidity benefit.

2630. This provision has a limited life because no new claimants will be entitled to the exemption. But a significant number of claimants remain entitled to the exemption.

2631. *Subsection (2)* contains the definition of invalidity benefit. This was the expression used to describe invalidity pension and invalidity allowance. Neither sickness benefit nor invalidity benefit was taxable.

Section 664: Short-term incapacity benefit not payable at the higher rate

2632. This section limits the charge to tax on short-term incapacity benefit. It relies on definitions in the social security legislation. It derives from section 139(1)(a) of FA 1994.
2633. The charge on incapacity benefit in section 139 of FA 1994 excludes “benefit payable for an initial period of incapacity”. That period is defined as a period for which short-term benefit is payable other than at the “higher rate”.
2634. *Subsection (1)* restricts the charge to tax on short-term incapacity benefit so that it is taxable only if it is payable at the “higher rate”.
2635. *Subsection (2)* cross-refers to the definition of “higher rate” in the social security legislation. The phrase is construed in accordance with section 30B(5) of the Social Security Contributions and Benefits Act 1992. That section refers to the rates of benefit set out in Schedule 4 to the Act. The benefit is payable at the “higher rate” after the first 196 days of a period of incapacity for work.
2636. As noted in paragraph 2608, incapacity benefit is charged to tax by section 139 of FA 1994. So it is logical for the benefit to be excluded from the charge in section 617 of ICTA. A free-standing charge was set up by section 139 of FA 1994 in case section 617(1) was not effective in taxing a new benefit – an explicit charge was thought to be safer.
2637. When incapacity benefit replaced sickness benefit and invalidity benefit in 1995, the references to the older benefits were not removed from section 617(1) of ICTA (some publishers have updated the text to help the reader). Instead, section 13(2) of the Social Security (Incapacity for Work) Act 1994 treats the references to sickness benefit and invalidity benefit in section 617(1)(a) as references to incapacity benefit. So incapacity benefit appears to be excluded from the charge in section 617 by subsection (1)(a).
2638. A consequence of exclusion from the section 617(1) charge would be that the benefit is not regarded as income for income tax purposes because of section 617(2)(c). This was overlooked when section 139 of FA 1994 set up the free-standing charge. So the benefit is apparently disregarded by section 617 of ICTA but clearly taxed by section 139 of FA 1994.
2639. This Act clarifies the law, to bring it into line with the clear, undisputed, policy objective (to tax incapacity benefit) and generally accepted practice. See *Change 143* in Annex 1.

Income support

Section 665: Exempt unless payable to member of couple involved in trade dispute

2640. This section derives from section 151(1)(b) of ICTA.
2641. It contains the basic rule that income support is taxable only if it is payable to a member of a couple and the claimant but not the claimant’s partner is on strike. (Section 151 of ICTA refers to Part 5 of the Social Security Act 1986. In accordance with the Social Security (Consequential Amendments) Act 1992 that reference is to be read as being to section 126 of the Social Security Contributions and Benefits Act 1992. Some publishers have updated the text to help the reader). If both are on strike, there is no benefit “in respect of the relevant couple” (see paragraph 2651 and section 668) and nothing is taxable. There is a similar rule for jobseeker’s allowance in section 673 (see paragraph 2671).

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2642. Sections 666 to 668 (see paragraphs 2645 to 2656) contain other limitations to the charge on income support.
2643. The section includes no reference to the rule in section 151(1)(a) of ICTA because, in the circumstances described in that paragraph (the application of the “available for work” test), income support is no longer payable. The claimant would now be entitled to jobseeker’s allowance instead.
2644. So this Act does not rewrite the rule in section 151(1)(a) of ICTA which is no longer needed.

Section 666: Child maintenance bonus

2645. This section sets out the first restriction to the charge on income support. It derives from section 617(2)(ad) of ICTA.
2646. It deals with the exemption from tax for a child maintenance bonus paid under the Child Support Act 1995. That Act provides that the bonus is to be treated as income support (or jobseeker’s allowance). So the exemption appears in this section. The corresponding exemption for a bonus treated as jobseeker’s allowance is in section 670 – see paragraph 2659.

Section 667: Amounts in excess of taxable maximum

2647. This section deals with the second restriction to the charge on income support. It derives from section 151(3) of ICTA.
2648. *Subsection (1)* sets out the restriction. No more than the “taxable maximum” of the benefit is taxable. This term is used in section 151(3) of ICTA. The section retains it as a useful and clear label for the amount that has to be calculated by applying the rules in section 668.

Section 668: Taxable maximum

2649. This section sets out how to calculate the “taxable maximum”, which is used in applying the restriction in section 667(1). The section derives from section 151(5) and (7) of ICTA. Those subsections tax only the part of the benefit that is attributable to the person involved in the strike.
2650. The rules are complicated because they have to deal with:
- amounts of income support that are attributable to persons other than the person involved in the strike; and
 - benefit payable for a period of less than a week.
2651. *Subsections (1) and (2)* set out how to calculate the “taxable maximum” for a week. Subsection (1) is the rule for the simple case where the amount of income support derives from the circumstances of the couple alone. Subsection (2) is the rule for the case where the benefit includes amounts for other people, such as children or adult dependants.
2652. In either case the section restricts the tax charge to one half of the amount of the benefit attributable to the couple.
2653. The charge on income support is in section 151 of ICTA rather than section 617 of ICTA. So the general exemption for an increase in benefit for a child in section 617(1) (b) does not apply. But the definition of “taxable maximum” in section 151 ensures that any such increase is never taxed.
2654. Income support is included in the table of taxable United Kingdom benefits (section 660). So the general exemption for any increase in the benefit for a child applies

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(section 676). The sections exempt this increase twice: once in subsection (2) of this section in calculating the “taxable maximum” for income support, and again (generally) in section 676. This double exemption does not present any difficulties.

2655. *Subsection (3)* gives the method for calculating the “taxable maximum” if the benefit is payable for a period of less than a week. The section uses a method statement and a formula to make the rule easier to understand.

2656. It is not clear why a fraction of one-sixth is used in section 151(5) of ICTA. It was probably carried forward from the days of supplementary and unemployment benefit. The section uses one-seventh as the fraction. This brings the section into line with both the relevant social security regulations: regulation 73 of [SI 1987 No 1967](#) (income support) and regulation 150 of [SI 1996 No 207](#) (jobseeker’s allowance). See *Change 144* in Annex 1

Section 669: Interpretation

2657. This section contains the meanings of the expressions used in sections 667 and 668. It is new.

- “Married couple” means a man and woman who are married to each other and are members of the same household.
- “Unmarried couple” means a man and woman who are not married to each other but are living together as husband and wife.

Jobseeker’s allowance

Section 670: Child maintenance bonus

2658. This section sets out the first restriction to the charge to tax on jobseeker’s allowance. It derives from section 617(2)(ad) of ICTA.

2659. The section deals with the exemption from tax for a child maintenance bonus paid under the Child Support Act 1995. That Act provides that the bonus is to be treated as jobseeker’s allowance (or income support). So the exemption appears in this section. The corresponding exemption for a bonus treated as income support is in section 666 – see paragraph [2646](#).

Section 671: Amounts in excess of taxable maximum

2660. This section deals with the second restriction to the charge to tax on jobseeker’s allowance. It derives from section 151A of ICTA.

2661. *Subsection (1)* sets out the restriction. No more than the “taxable maximum” of the benefit is taxable. This term is used in section 151A(2) of ICTA. The section retains it as a useful and clear label for an amount that has to be calculated by applying the rules in sections 672 to 674.

2662. There are two types of jobseeker’s allowance: income-based and contribution-based. The amount of a contribution-based allowance is determined simply by the claimant’s age. But a couple may also qualify for an income-based addition to a contribution-based allowance, to bring the allowance up to the amount of income support.

2663. In the case of a couple, the taxable maximum is based on what would have been payable to the couple as an income-based allowance.

2664. The rules are complicated because they have to deal with:

- the difference between an income-based allowance and a contribution-based allowance;

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- amounts of jobseeker's allowance that are attributable to persons other than the claimant;
- a person involved in a strike being prevented from claiming the allowance; and
- an allowance payable for a period of less than a week.

Section 672: Taxable maximum: general

2665. This section sets out how to calculate the "taxable maximum", for use in section 671. It derives from section 151A(3) of ICTA.

Section 673: Taxable maximum: income-based jobseeker's allowance

2666. This section sets out how to calculate the "taxable maximum" for a week in the case of an income-based allowance. It derives from section 151A(4), (6) and (8) of ICTA.

2667. *Subsection (2)* sets out the rule for a single person. The taxable maximum is based on the amount of the contribution-based allowance which would have been payable to the person, excluding any amount of the allowance that is for other people such as children or adult dependants.

2668. *Subsection (3)* sets out the general rule for a member of a couple. The taxable maximum is the "applicable amount", excluding any amount of the allowance that is for other people such as children or adult dependants.

2669. The charge on an income-based jobseeker's allowance is in section 151A of ICTA rather than section 617 of ICTA. So the general exemption for an increase in benefit for a child in section 617(1)(b) does not apply. But the definition of "taxable maximum" in section 151A ensures that any such increase is never taxed.

2670. Jobseeker's allowance is included in the table of taxable United Kingdom benefits (section 660). So the general exemption for any increase in the benefit for a child applies (section 676). The sections exempt this increase twice: once in subsection (3) of this section in calculating the "taxable maximum" for jobseeker's allowance, and again (generally) in section 676. This double exemption does not present any difficulties.

2671. *Subsection (4)* sets out the special rule that applies if one member of a couple is involved in a strike. There is a similar rule for income support (see section 665).

Section 674: Taxable maximum: contribution-based jobseeker's allowance

2672. This section sets out how to calculate the "taxable maximum" for a week in the case of a contribution-based allowance. It derives from section 151A(5) and (7) of ICTA.

2673. *Subsection (2)* sets out the rule for a single person. The taxable maximum is based on the amount of the "age-related amount" applicable to the person, excluding any amount of the allowance that relates to other people such as children or adult dependants.

2674. *Subsection (3)* sets out the general rule for a member of a couple. The taxable maximum is based on the amount of the income-based allowance which would have been payable to the person, excluding any amount of the allowance that relates to other people such as children or adult dependants.

2675. The charge on a contribution-based jobseeker's allowance is in section 151A of ICTA rather than in section 617 of ICTA. So the general exemption for an increase in benefit for a child in section 617(1)(b) does not apply. But the definition of "taxable maximum" in section 151A ensures that any such increase is never taxed.

2676. Jobseeker's allowance is included in the table of taxable United Kingdom benefits (section 660). So the general exemption for any increase in the benefit for a child applies (section 676). The sections exempt this increase twice: once in subsection (3) of this

section in calculating the “taxable maximum” for jobseeker’s allowance, and again (generally) in section 676. This double exemption does not present any difficulties.

Section 675: Interpretation

2677. This section contains the meanings of the expressions used in the rules in sections 671 to 674.
- The “applicable amount” is the “age-related amount”, less some earnings and pension receipts. It is usually the level to which income is made up by income support.
 - A “contribution-based jobseeker’s allowance” is one based on the claimant’s Class 1 contributions in the two years before the year of claim.
 - An “income-based jobseeker’s allowance” is one based on the claimant’s income.
 - “Married couple” means a man and woman who are married to each other and are members of the same household.
 - “Unmarried couple” means a man and woman who are not married to each other but are living together as husband and wife.

Section 676: Increases in respect of children

2678. This section exempts the part of a benefit that is for a child. It derives from section 617(1)(b) of ICTA.

Chapter 5: UK social security benefits wholly exempt from income tax

Overview

2679. This Chapter sets out the United Kingdom benefits that are not charged to tax.
2680. This Chapter deals with the benefits that are never taxable. Chapter 4 deals with the benefits that are sometimes taxable.

Section 677: UK social security benefits wholly exempt from tax: Table B

2681. This section introduces and sets out the table (“Table B”) of exempt benefits. It derives from section 617(1)(a) and (2) of ICTA.
2682. *Subsection (1)* introduces the second of the tables (“Table B”). This table lists the exempt United Kingdom benefits. The first table (“Table A”) is in section 660 – see paragraph 2609.
2683. In order to make the exemptions simple and consistent the phrase “no liability to income tax arises” is used throughout this Act to express exemption from tax. See *Note 28* in Annex 2.
2684. Part 1 of the table identifies each benefit by the section of the social security Act under which it is paid. Part 2 of the table identifies the benefits that are paid under regulations. The table also identifies the corresponding Northern Ireland provisions.
2685. The table arranges the benefits in alphabetical order. This means that a particular benefit should be easy to find. And it should be easy to maintain the clarity of the table because it will be easy to insert any new benefit into the table in the right place.
2686. Disabled person’s tax credit and working families’ tax credit are abolished by section 1(3) of the Tax Credits Act 2002. They are not taxable. The exemption is preserved by paragraph 88 of Schedule 7 to this Act.

2687. *Subsection (2)* is a signpost to the special treatment of industrial death benefit. This benefit is part of industrial injuries benefit, which appears in Table B and is not generally taxable. But industrial death benefit is a pension and is charged to tax in the pension income Part.

Chapter 6: Taxable foreign benefits

Overview

2688. This Chapter sets out the rules for taxing foreign social security benefits.
2689. There is no explicit charge on foreign social security benefits in ICTA. But the benefits arise from rights under foreign social security law and those rights are “possessions out of the United Kingdom” (section 18(3) of ICTA). So the income is assessable under Schedule D Case V.
2690. This Act includes an explicit charge to tax on foreign social security benefits. See *Change 145* in Annex 1.

Section 678: Taxable benefits: foreign benefits

2691. This section identifies the foreign benefits that are taxable. The section is new. The taxable foreign benefits are part of “taxable benefits” (section 657(3)).
2692. *Subsection (1)(a)* uses words similar to those used in section 318(2)(c) of ICTA (war pensions) to identify the foreign benefits that are taxable. *Subsection (1)(b)* reproduces the territorial restriction in paragraph (a)(i) of Schedule D (section 18(1) of ICTA). A foreign social security benefit is charged to tax only if it is payable to a United Kingdom resident.
2693. *Subsection (2)* is a boundary rule. It provides that a foreign social security benefit that is also a pension is taxed only once, in the pension income Part. United Kingdom benefits that are pensions are identified in the pension income Part and do not appear in Table A. So there is no overlap. But it is theoretically possible for a foreign benefit within this section to take the form of a pension. In that case, the boundary rule ensures that the benefit is charged as a pension and qualifies for the one-tenth deduction in section 65(2) of ICTA.

Section 679: Taxable social security income

2694. This section deals with the basis of assessment. It identifies the amount of taxable social security income, which feeds into the computation of net taxable social security income in section 658. The section invokes sections 65, 68, 584 and 585 of ICTA.
2695. In ICTA the basis of assessment for a foreign social security benefit is given by the rules of Schedule D Case V. The social security income Part does not repeat those rules but cross-refers the reader to them. The rules are in section 65 of ICTA and include the remittance basis. Section 65 is modified by the rules for Irish income in section 68 of ICTA. Sections 584 and 585 of ICTA are also relevant. Section 584 gives relief for income taxed on an arising basis if that income cannot be remitted to the United Kingdom. Section 585 gives relief for income taxed on a remittance basis if the remittances are delayed.

Section 680: Person liable for tax

2696. This section provides that the person chargeable is the person receiving or entitled to the income. It derives from section 59(1) of ICTA.
2697. Paragraph 2689 explains that the charge on foreign social security benefits in ICTA is under Schedule D. So section 59(1) of ICTA applies to charge the person receiving or entitled to the income.

Chapter 7: Taxable and other foreign benefits: exemptions

Overview

2698. This Chapter sets out the foreign benefits that are not charged to tax. It is new.

Section 681: Taxable and other foreign benefits: exemptions

2699. The section derives from ESC A24. This Act legislates the ESC that exempts certain foreign benefits from tax. In practice the ESC is applied not only to the benefits set out in the ESC but to all foreign benefits that correspond to exempt United Kingdom benefits. The section reflects this. See *Change 146* in Annex 1.

2700. In order to make the exemptions simple and consistent the phrase “no liability to income tax arises” is used throughout this Act to express exemption from tax. See *Note 28* in Annex 2.

2701. *Subsection (1)* deals with foreign benefits that correspond to the taxable UK benefits listed in Table A. It exempts the foreign benefits to the same extent that the United Kingdom benefits are exempt income because of one of the rules in Chapter 4. The definition of “exempt income” is in section 656(2).

2702. *Subsection (2)* deals with the foreign benefits that correspond to the exempt UK social security benefits listed in Table B (in Chapter 5). These foreign benefits are not substantially similar to the taxable UK benefits listed in Table A. So they are not covered by subsection (1). But they are wholly exempt from tax. The phrase “no liability to tax” removes not only a charge under this Part but any charge to income tax.

Part 11: Pay As You Earn

Overview

2703. Part 11 provides for the Pay As You Earn system (generally known as “PAYE”). Under PAYE tax is deducted at source from payments made by employers and others. PAYE is the primary means of collecting income tax on PAYE income (broadly employment income, most pension income and social security income). The details are left for regulations made by the Board of Inland Revenue. This Part of the Act:

- provides the powers to make PAYE regulations and issue tax tables;
- extends PAYE to some persons and payments not otherwise covered; and
- allows alternatives to PAYE in some circumstances.

2704. *Chapter 1* introduces the Part and gives the meaning of “PAYE income”.

2705. *Chapter 2* requires the Board of Inland Revenue to make regulations for the assessment and collection of income tax on PAYE income. These “PAYE regulations” may (among other things) require employers and others to deduct tax from payments of PAYE income.

2706. *Chapter 3* is the first of two Chapters dealing with special provisions. It covers sections which deal with special types of payer or payee.

2707. *Chapter 4* is the second Chapter dealing with special provisions. It deals with PAYE on the provision to employees of vouchers or of assets readily convertible into money, and the proceeds arising from share schemes.

2708. *Chapter 5* allows the PAYE regulations to provide for “PAYE settlement agreements” (PSAs) between employers and the Inland Revenue. Under these, employers can agree to meet the income tax liabilities of their employees on some

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expenses and benefits in kind. The agreement replaces the normal processes of PAYE and assessment.

2709. *Chapter 6* contains miscellaneous and supplemental material.