

Enterprise management incentives: qualification for capital gains tax entrepreneurs' relief

Who is likely to be affected?

Individuals who have received share options under the enterprise management incentives (EMI) scheme and have capital gains.

General description of the measure

This measure extends capital gains tax entrepreneurs' relief in relation to gains accruing on the disposal by an individual of shares acquired through the exercise of an EMI qualifying option.

Policy objective

The measure aims to help small and medium enterprises (SMEs) recruit and retain high calibre employees by extending the tax advantages available to employees granted share options under the scheme.

Background to the measure

This measure was announced at Budget 2012 as part of a package of changes to EMI.

Detailed proposal

Operative date

This measure will have effect for eligible shares acquired on or after 6 April 2012 that are disposed of on or after 6 April 2013.

Current law

Entrepreneurs' relief is provided for at Chapter 3 (sections 169H to 169S) of Part V of the Taxation of Chargeable Gains Act 1992. The relief allows gains accrued on the disposal of shares in a trading company to be taxed at the reduced rate of 10 per cent provided that the disposal is by an individual who, throughout the year ending on the date the shares are sold, has worked for the company and owned at least 5 per cent of the ordinary shares in the company. The relief also applies to the sale of shares in the holding company of a trading group. Entrepreneurs' relief is subject to a lifetime limit on the first £10 million of gains.

Proposed revisions

Legislation will be introduced in Finance Bill 2013 to remove, for shares acquired through the exercise of a qualifying EMI option, the requirement for entrepreneurs' relief that the person must hold 5 per cent or more of the ordinary share capital in the company. The normal 12 month minimum holding period requirement will include the period the option is held.

Summary of impacts

| Exchequer impact (£m) | 2012-13 | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 |
|---|--|---------|---------|---------|---------|---------|
| | | | | | | |
| This measure is expected to reduce receipts by approximately £15 million per annum from 2013-14. The final costing will be subject to scrutiny by the Office for Budget Responsibility, and will be set out at Budget 2013. | | | | | | |
| Economic impact | The measure is not expected to have any significant economic impacts. | | | | | |
| Impact on individuals and households | In 2009-10 approximately 17,000 employees were awarded EMI options. This measure will benefit those individuals with capital gains above the Annual Exempt Amount. Those benefiting from the measure may face new compliance costs as a result of the need to track and report the gains on their EMI shares separately from non-EMI shares. | | | | | |
| Equalities impacts | No equalities impact is expected. | | | | | |
| Impact on business including civil society organisations | This measure is expected to have no impact in terms of administrative burdens on businesses or civil society organisations. The changes should increase the ability of qualifying start-ups/SMEs to recruit and retain high calibre employees. | | | | | |
| Operational impact (£m) (HMRC or other) | A negligible impact is expected. | | | | | |
| Other impacts | <p><u>Small firms impact test:</u> this measure is likely to have a positive effect on small firms as it aimed at supporting qualifying SMEs to recruit and retain high calibre employees.</p> <p><u>Competition assessment:</u> EMI aims to address a well-defined market failure faced by small and medium enterprises looking to recruit and retain high calibre employees. It is unlikely that any businesses will face adverse competition consequences as a result of this measure.</p> <p>Other impacts have been considered and none have been identified.</p> | | | | | |

Monitoring and evaluation

The measure will be kept under review through regular communication with affected taxpayer groups.

Further advice

If you have any questions about this change, please contact Alan McGuinness on 020 7147 2766 (email: alan.mcguinness@hmrc.gov.uk).

1 EMI options and entrepreneurs' relief etc

Schedule 1 makes provision about the treatment for capital gains tax purposes of shares acquired under options which are qualifying options under the EMI code.

S C H E D U L E S

SCHEDEULE 1

Section 1

EMI OPTIONS AND ENTREPRENEURS' RELIEF ETC

Entrepreneurs' relief to apply to shares acquired under EMI option

- 1 (1) In Chapter 3 of Part 5 of TCGA 1992 (entrepreneurs' relief) section 169I (material disposal of business assets) is amended as follows.
 - (2) In subsection (5) for "or B" substitute ", B, C or D".
 - (3) After subsection (7) insert—

"(7A) Condition C is that—

 - (a) the assets disposed of are relevant EMI shares,
 - (b) the option grant date falls before the beginning of the period of 1 year ending with the date of the disposal, and
 - (c) throughout that period—
 - (i) the company is either a trading company or the holding company of a trading group, and
 - (ii) the individual is an officer or employee of the company or (if the company is a member of a trading group) of one or more companies which are members of the trading group.
- (7B) Condition D is that—
- (a) the assets disposed of are relevant EMI shares acquired by the individual before the cessation date,
 - (b) the option grant date falls before the beginning of the period of 1 year ending with the cessation date,
 - (c) the conditions in paragraph (c) of subsection (7A) are met throughout that period, and
 - (d) the cessation date is within the period of 3 years ending with the date of the disposal.
- (7C) In subsections (7A)(a) and (7B)(a) "relevant EMI shares"—
- (a) means shares of a company acquired by an individual on or after 6 April 2013 as a result of the exercise of a qualifying option within the meaning given by section 527(4) of ITEPA 2003 (enterprise management incentives) in circumstances where section 530 or 531 of that Act (exercise of option to acquire shares) applies, but
 - (b) does not include anything comprised in an asset resulting from the application of section 127 (company reorganisation: equation of original shares and new holding).

- (7D) Subject to what follows, in subsections (7A)(b) and (7B)(b) “the option grant date” means the date on which the qualifying option in question was granted.
- (7E) Subsections (7F) and (7G) apply if the qualifying option is a replacement option for the purposes of the EMI code (see paragraph 41 of Schedule 5 to ITEPA 2003).
- (7F) In subsections (7A)(b) and (7B)(b) “the option grant date” means –
 - (a) the date on which the old option was granted, or
 - (b) if the old option was also a replacement option, the date on which the earlier old option was granted,and so on.
- (7G) In relation to any time during the currency of an old option taken into account under subsection (7F), in subsection (7A)(c) references to the company are to be read as references to the company whose shares were the subject of the old option.
- (7H) In subsection (7B) “the cessation date” means the date on which the company –
 - (a) ceases to be a trading company without continuing to be or becoming a member of a trading group, or
 - (b) ceases to be a member of a trading group without continuing to be or becoming a trading company.”

Identification of shares acquired under EMI option

- 2 Chapter 1 of Part 4 of TCGA 1992 (general provision relating to shares etc) is amended as follows.
- 3 In section 105 (disposal on or before day of acquisition of shares etc) after subsection (3) insert –
 - “(4) Subsection (5) applies if an individual –
 - (a) acquires shares (“the relevant shares”) of the same class, on the same day and in the same capacity, and
 - (b) some of the relevant shares are relevant EMI shares (as defined in section 169I(7C)).
 - (5) This section has effect as if –
 - (a) paragraph (a) of subsection (1) required the relevant EMI shares to be treated as acquired by the individual by a single transaction separate from the remainder of the relevant shares (which are also to be treated by virtue of that paragraph as acquired by the individual by a single transaction), and
 - (b) subsection (1) required the relevant EMI shares to be treated as disposed of after the remainder of the relevant shares.”
- 4 (1) Section 106A (identification of securities for capital gains tax purposes) is amended as follows.
 - (2) In subsection (5) –
 - (a) omit the “and” after paragraph (a),
 - (b) after paragraph (a) insert –

- “(aa) with securities acquired by him within that period which are not relevant EMI shares, rather than with securities acquired by him within that period which are relevant EMI shares; and”, and
 - (c) at the beginning of paragraph (b) insert “subject to paragraph (aa),”.
- (3) After subsection (6) insert –
- “(6A) Subject to subsections (4) and (5) above, a company’s shares which are disposed of shall be identified –
 - (a) with relevant EMI shares, rather than with other shares, and
 - (b) with relevant EMI shares acquired at an earlier time rather than with relevant EMI shares acquired at a later time.
 - (6B) No shares identified with relevant EMI shares by virtue of subsection (6A)(a) or (b) above shall be regarded as forming part of an existing section 104 holding or as constituting a section 104 holding.”
- (4) In subsection (10), before the definition of “securities”, insert –
 “relevant EMI shares” has the meaning given by section 169I(7C),”.
- Commencement and transitional provision*
- 5 (1) The amendments made by paragraphs 1 to 4 above have effect in relation to disposals of shares on or after 6 April 2013.
- (2) In the case of the amendments made by paragraphs 2 to 4 above, sub-paragraph (1) is subject to paragraph 6(4) below.
- 6 (1) This paragraph applies if, during the tax year 2012-13, an individual acquires shares of a class in a company (“the relevant shares”) which would be relevant EMI shares were the reference to 6 April 2013 in section 169I(7C)(a) of TCGA 1992 (as inserted by paragraph 1 above) a reference to 6 April 2012 instead.
- (2) If the individual makes no disposals of shares of that class in that company during that tax year, the relevant shares are to be treated as if they were relevant EMI shares.
- (3) If the individual disposes of shares of that class in that company during that tax year, the individual may elect for the relevant shares to be treated as if they were relevant EMI shares.
- (4) If the individual makes an election under sub-paragraph (3) –
 - (a) the amendments made by paragraphs 2 to 4 above also have effect, in the case of the individual, in relation to disposals of shares of that class in that company during that tax year, but
 - (b) for this purpose, the amendment made by sub-paragraph (5) has effect instead of the amendment made by paragraph 4(3) above.
- (5) In section 106A of TCGA 1992 after subsection (6) insert –
- “(6A) Subject to subsections (4) and (5) above, a company’s shares which are disposed of shall be identified –

- (a) with shares which are not relevant EMI shares, rather than with relevant EMI shares, and
 - (b) with relevant EMI shares acquired at a later time rather than with relevant EMI shares acquired at an earlier time.
- (6B) No shares identified with relevant EMI shares by virtue of subsection (6A)(b) above shall be regarded as forming part of an existing section 104 holding or as constituting a section 104 holding.”
- (6) An election under sub-paragraph (3) may not be made or revoked after 31 January 2014 (and paragraph 3(1)(b) of Schedule 1A to TMA 1970 does not apply in relation to such an election).
- (7) For the purposes of this paragraph shares in a company are not to be treated as being of the same class unless they are so treated by the practice of a recognised stock exchange or would be so treated if dealt with on a recognised stock exchange.
- (8) “Recognised stock exchange” has the meaning given by section 1005 of ITA 2007.

EXPLANATORY NOTE

**ENTERPRISE MANAGEMENT INCENTIVE OPTIONS AND
ENTREPRENEURS' RELIEF ETC**

SUMMARY

1. This clause and Schedule extend entrepreneurs' relief to the disposal by an employee or officer of a company, on or after 6 April 2013, of shares in that company or a company in the same trading group when the shares meet the requirements of the enterprise management incentive (EMI) scheme, they were acquired on or after 6 April 2012 as a result of that person exercising a qualifying option over them, and the qualifying option had been granted at least one year before the date of the share disposal. The individual disposing of the shares must have been an employee or officer of the company (or a company in the same trading group) throughout the year ending with the date of disposal. The relief is also extended to similar disposals that take place within three years of the company ceasing to be a trading company.

DETAILS OF THE SCHEDULE

2. Paragraph 1 of the Schedule widens section 169I of the Taxation of Chargeable Gains Act (TCGA) 1992, which, amongst other things, defines the conditions when the disposal by an individual of an asset consisting of (or consisting of interests in) shares in or securities of a company is a "material disposal" that qualifies for entrepreneurs' relief. There are currently two conditions, A and B, provided in subsections (6) and (7) of section 169I.
3. New subsection (7A) of section 169I provides for an additional Condition C that must be met for there to be a material disposal for the purposes of section 169I(2)(c).
4. New subsection (7B) provides for an additional Condition D that must be met for there to be a material disposal for the purposes of section 169I(2)(c).
5. New subsection (7C) defines "relevant EMI shares" for the purposes of subsections (7A)(a) and (7B)(a).
6. New subsection (7D) defines "the option grant date" for the purposes of subsections (7A)(b) and (7B)(b) as the date on which the qualifying option was granted.

7. New subsections (7E) to (7G) deal with the replacement of a qualifying option as part of a company reorganisation.
8. New subsection (7E) states that subsections (7F) and (7G) will apply where the option is a “replacement option” as defined in the EMI code.
9. New subsection (7F) provides a ‘look-through’ to the earliest option granted, where the qualifying option is a replacement option, in order to arrive at the “option grant date”.
10. New subsection (7G) requires that in any time period of an “old option” that is taken into account in new subsection (7F), “the company” in new subsection (7A)(c), is the company whose shares were the subject of the old option.
11. New subsection (7H) defines “the cessation date”, for the purposes of subsection (7B).
12. Paragraphs 2 to 4 of the Schedule amend the share identification rules at sections 105 and 106A of TCGA 1992.
13. Paragraph 2 introduces the amendments.
14. Paragraph 3 introduces the following additional subsections to section 105 of TCGA 1992, which deals with acquisitions and disposals of shares on the same day.
15. New subsection 105(4) applies new subsection 105(5) where an individual acquires shares of the same class on the same day and only some of those are “relevant EMI shares”.
16. New subsection 105(5) sets out the treatment of the relevant EMI shares separate from other relevant shares.
17. Subparagraph 4(1) introduces amendments to section 106A of TCGA 1992 which makes general provision for share identification for capital gains tax purposes.
18. Subparagraph 4(2) amends the rule in subsection 106A(5) that matches share disposals with share acquisitions within a 30 day period following the disposal, known as the “bed and breakfast rule”. New subsection 106A(5)(aa) means that shares that are not relevant EMI shares are to be identified first when applying the rule in section 106A(5) and in conjunction with the conditions in paragraphs (a) and (b).
19. Subparagraph 4(3) introduces two additional subsections to section 106A of TCGA 1992.

20. New subsection (6A) provides that on disposal of a company's shares any relevant EMI shares are to be regarded as being disposed of before other shares and the relevant EMI shares are to be regarded as being disposed of on a "first in, first out" basis.
21. New subsection (6B) provides that those shares identified with relevant EMI shares by virtue of subsection (6A) shall not be regarded as forming part of an existing holding, or constituting a holding, that is regarded as a single asset for the purposes of the TCGA.
22. Subparagraph 4(4) amends subsection 106A(10) of TCGA 1992 to define "relevant EMI shares" in the same way as section 169I(7C).
23. Paragraph 5 of the Schedule provides that the amendments made by paragraphs 1 to 4 have effect in relation to disposals of shares on or after 6 April 2013, subject to paragraph 6(4).
24. Paragraph 6 applies the changes in the preceding paragraphs to disposals on or after 6 April 2013. The changes may apply earlier where the transitional provisions set out in paragraph 6 apply.
25. Subparagraph 6(1) applies the changes for shares acquired during the 2012-13 tax year that would have qualified as "relevant EMI shares" if acquired on 6 April 2013.
26. Subparagraph 6(2) treats such shares as "relevant EMI shares" where the individual makes no disposals of shares of that class in the 2012-13 tax year.
27. Subparagraph 6(3) provides that where the individual does make a disposal of such shares in that period, they may elect for them to be treated as "relevant EMI shares".
28. Subparagraphs 6(4) and 6(5) provide for the treatment of the timing of disposals of any relevant EMI shares.
29. Subparagraphs 6(6) provides that the election must be made (or revoked after it has been made) by 31 January 2014.
30. Subparagraphs 6(7) and (8) provide that shares in a company are not to be treated as being of the same class unless they would be treated as such by a relevant stock exchange (as defined in section 1005 Income Taxes Act 2007).

BACKGROUND NOTE

31. Since 23 June 2010 capital gains tax for individuals has been charged at the rate of either 18 per cent or, for those paying the higher rate of income tax, 28 per cent.
32. Individuals may claim entrepreneurs' relief, under which qualifying chargeable gains are taxed at 10 per cent, on gains on disposals of shares in or securities of a company provided that throughout the period of one year immediately preceding the disposal (a) the claimant held a minimum five per cent stake in the company, (b) the company was either a trading company or the holding company of a trading group, and (c) the claimant was an officer or employee of the company or of one or more companies of a trading group to which the company is a member. There is a lifetime limit to the relief, which was increased to £10 million from 6 April 2011.
33. Entrepreneurs' relief is also available on the disposal of shares of a business where the conditions (a) to (c) at paragraph 32 above were met throughout the period of one year immediately preceding the company ceasing to be a trading company without continuing to be or becoming a member of a trading group, or ceasing to be a member of a trading group without continuing to be or becoming a trading company and that date is within the period of three years immediately preceding the disposal. The relief may apply, for example, to the deemed disposal by a shareholder of his interest in shares when he receives a capital distribution on the liquidation or winding-up of a trading company.
34. The Enterprise Management Incentives (EMI) scheme provides tax and National Insurance contributions advantages for qualifying share options granted by companies with gross assets not exceeding £30 million, to help them recruit and retain employees. In addition to the gross assets test, EMI is limited to companies or groups which are independent and whose trade does not consist in excluded trading activities.
35. Budget 2012 announced the Government's intention to allow EMI shares to qualify for Entrepreneurs' Relief on disposal by the employee/officer. A number of representations were made to Government that the ER rule, which requires ownership of the qualifying shares for one year prior to disposal, would limit the ability of EMI shares to qualify. This was because EMI options would typically be exercised just before the employing company was taken over, meaning that they would then not be owned by the employee for one year.

36. The Budget further announced that the measure would apply to shares acquired under the EMI scheme from 6 April 2012, but the one year share holding period meant it would have no effect for disposals made before 6 April 2013.
37. The legislation similarly applies to shares acquired on or after 6 April 2012 and disposed of on or after 6 April 2013 but allows the period the share option is held to be included towards the one year holding period requirement.
38. The legislation includes rules that modify the usual operation of the share identification rules in order to treat shares issued under the EMI scheme separately.
39. The inclusion of shares acquired from 6 April 2012 will affect the computation of gains on any disposal of shares of the same class during the 2012-13 tax year. Therefore the new legislation will apply where there were such disposals only on the making of an election.
40. If you have any questions about this change, or comments on the legislation, please contact Alan McGuinness on 020 7147 2766 (email: alan.mcguinness@hmrc.gsi.gov.uk).