

CSOPs and SAYE Option Schemes: General Requirements

COMPANIES WHICH CAN ESTABLISH CSOPs OR SAYE OPTION SCHEMES

Statutory requirements

16.1 Factors such as which companies can establish approved schemes or, within a group of companies, which companies' employees can participate and what shares can be used, are all determined by statutory rules. These are broadly similar in the case of SAYE Option Schemes and CSOPs and are respectively set out in ITEPA 2003 Schs 3 and 4.

In the case of both types of approved share option scheme the requirements must be met throughout the life of the scheme. The form of declaration to be submitted by the company secretary with the application for approval (see 16.36) must relate to the position as at the time the declaration is made and further declarations are required to be made each year on the form of annual return to be submitted by companies with approved schemes.

Exceptionally, HMRC may entertain an application for approval of a scheme on the basis that, although there may be no qualifying shares at that time, shares will be appropriated, or options granted, only when qualifying shares exist. This might, for example, be the case where shares in a company are intended to be listed and options are to be granted at flotation only after the requirements are met.

Shares to which schemes can apply

16.2 The shares to be put under option must form part of the ordinary share capital of:

- (a) the company which has established the scheme (“the scheme organiser”);
- (b) a company which has control of the scheme organiser; or
- (c) a company which either is, or has control of, a company which is a member of a consortium owning either the scheme organiser or a company having control of the scheme organiser.

This means, in effect, that a company cannot establish an approved share option scheme using shares in its subsidiary. The shares must either be its own shares or, if those shares would not meet the requirements described at 16.4, e.g. because the company in question is itself a subsidiary, shares in a parent company which do meet those requirements. The situation where the company establishing an approved share option scheme is owned by a consortium is considered further at 16.9.

Meaning of “ordinary share capital”

16.3 For these purposes “ordinary share capital” is defined (CTA 2010 s.1119) as:

“all the company’s issued share capital (however described), other than capital the holders of which have a right to a dividend at a fixed rate but have no other right to share in the company’s profits.”

In other words, it includes all shares other than fixed-rate preference shares. For these purposes a dividend expressed as either “5 per cent of nominal value” or, say, “10p per share” is at a fixed rate whereas “5 per cent of profits” is not.

Where fixed-rate preference shares carry a right of conversion into ordinary shares, HMRC practice is to consider them as not forming part of the “ordinary share capital” until conversion. In the editors’ opinion the better view is that such shares do count as part

of the ordinary share capital from the outset and not only from the time of conversion.

HMRC distinguish between:

- (a) shares which merely confer a right to convert and
- (b) shares which, by their terms, carry a right to share in profits arising from conversion.

In practice HMRC at present take the view that the following form part of the “ordinary share capital”:

- (a) shares with a “tiered” right to dividends, for example 7 per cent for one year, 8 per cent for the second year, 9 per cent for the third and 10 per cent thereafter. This is on the basis that the exclusion from ordinary share capital refers only to shares with a dividend at a fixed rate;
- (b) shares which carry a right to the greater of a specified sum or the dividend paid in respect of another class of shares;
- (c) shares with no dividend rights; and
- (d) Swiss bearer participation certificates (BPCs).

Deferred shares

Deferred shares may form part of “ordinary share capital” whether or not by their terms they will in future carry a right to dividends. Such deferred shares are sometimes created by private companies for shareholder tax planning reasons.

HMRC interpretation

HMRC has published in HMRC Brief 54/2007 on August 6, 2007 its interpretation of ICTA 1988 s.832 (which was replaced by CTA 2010 s.1119) and its application to shares (etc.) in companies incorporated outside the UK.

Requirements as to independence or listing

16.4 The shares to be put under option must be:

- (a) shares in a company which is not under the control of another company; or
- (b) shares of a class listed on a recognised stock exchange; or
- (c) (in relation only to SAYE options or to CSOP options granted before March 24, 2010) shares in a company which is under the control of a company whose shares are listed on a recognised stock exchange (but not such a listed company which is, or would if UK resident, be a close company for UK tax purposes).

This requirement means that, within a group of companies, the shares which can be used for a CSOP must either be listed on a recognised stock exchange or be shares in the ultimate group holding company.

The fact that an independent company could subsequently be the subject of a takeover bid by an unlisted company can cause difficulties as the scheme shares would then cease to satisfy this test (see Chapter 14) and the options would then no longer qualify for relief from income tax and NICs.

As to the meaning of “recognised stock exchange,” see 16.6.

Meaning of “control”

16.5 For these purposes “control” is defined in ITA 2007 s.995 as:

the power of a person to secure:

- (a) by means of the holding of shares or the possession of voting power in or in relation to that or any other body corporate; or
- (b) by virtue of any powers conferred by the articles of association or other document regulating that or any other body corporate,

that the affairs of [the company] are conducted in accordance with [that person’s] wishes

The articles of association of a company commonly provide that, subject to the Companies Acts and any express provisions in the

memorandum and articles of association, responsibility for the management of the business of the company is delegated to the directors who may exercise all the powers of the company (see, for example, the Companies Act 2006 Model Articles art.3 (SI 2008/3229). In these cases, the test is who has control of the board.

Note that the tests in (a) and (b) are in the alternative. It follows that where control of a company can be exercised only by means of both the exercise of shareholder voting power *and* control of the board, there will be no control for these purposes (see *Irving v Tesco Stores (Holdings) Ltd* (1982) 58 T.C. 1).

Recognised stock exchange

16.6 The term “recognised stock exchange” is defined in ITA 2007 s.1005, as:

- (a) any market of a recognised investment exchange (per FSMA 2000 s.285) which is designated as a recognised stock exchange by order of the Commissioners for HMRC; and
- (b) any market outside the UK which is so designated.

The lists of those exchanges which HMRC has so designated per (a) above is to be found at www.hmrc.gov.uk/fid/rse.htm. That document also includes, in Table 2, the jurisdictions in which stock exchanges within the laws of that jurisdiction meet recognised stock exchange status.

The phrase “listed on a recognised stock exchange” is defined in s.1005(3) as shares and securities which are both:

- (a) admitted to trading on that exchange; and
- (b) included in the official UK list maintained by the FSA (as the UK Listing Authority) or are officially listed in a qualifying country outside the UK in accordance with provisions corresponding to those generally applicable in EEA states.

Tables 1 and 2 on that website page identify the markets considered by HMRC to meet its definition of “listed”.

Securities dealt in on the Alternative Investment Market (AIM) are *not* treated as quoted (the term used for the purposes of the CGT share valuation rules—see 12.22) or listed on a recognised stock exchange for tax purposes (see IR Press Release, February 20, 1995).

Subsidiary companies

16.7 An approved share option scheme cannot normally be operated using shares in a subsidiary company. This is subject to the exception that an approved SAYE Option Scheme can use shares in a subsidiary of a company whose shares are listed on a recognised stock exchange and which is neither a close company nor a company that would be a close company if resident in the United Kingdom.

Until March 24, 2010 this exception was also applicable to CSOPs. This allowed some companies to structure CSOPs using shares in a subsidiary of a listed company which entitled the holders to disproportionate growth in value of the subsidiary (and could be exchanged for shares in the listed holding company). To stop such abuse, the law was changed with effect from September 24, 2010 in relation to options granted on or after that date (and subject to transitional provisions—see FA 2010 s.39(4)–(9)) so that the shares which may be acquired upon the exercise of a CSOP option cannot be shares in a company under the control of another company. For this purpose, “close company” has the meaning given in CTA 2010 s.439 et seq.—see 16.28.

The reason why shares in subsidiaries of listed companies were ever permitted to be the subject of an approved scheme is not clear. It does however mean that a UK subsidiary of an overseas listed (non-close) company may establish an approved SAYE Option Scheme using shares either in the UK subsidiary or in the overseas parent company.

For example, a subsidiary of a non-close listed company could establish an approved SAYE Option Scheme in conjunction with its parent company, under which options to purchase existing shares in the subsidiary are granted by the parent company. The parent company could set aside, say, up to 10 per cent of the issued share

Plan, the decision of the Committee shall (except as regards any matter required to be determined by the Independent Advisers) be final and binding upon all persons.

3. ADMINISTRATION

- 3.1 The Committee shall be responsible for setting the overall policy and principles relating to the operation of this Plan. The Directors may from time to time make and vary such rules and regulations not inconsistent with the rules of this Plan and establish such procedures for its administration and implementation as they think fit.
- 3.2 In any matter in which they are required to act in connection with this Plan, the Independent Advisers shall be deemed to be acting as experts and not as arbitrators and the Arbitration Act 1996 shall not apply.
- 3.3 The Company shall bear the costs of the administration and implementation of this Plan.

4. RIGHTS ATTACHING TO SHARES

- 4.1 The issue or transfer of any Shares under or for the purposes of this Plan shall be subject to the Company's Memorandum and Articles of Association and to any necessary consents of any governmental or other authorities (whether in the UK or otherwise) under any enactments or regulations from time to time in force.
- 4.2 The Awardholder shall comply with any requirements to be fulfilled in order to obtain or obviate the necessity of any such consent.

PART B: MAKING OF AWARDS

5. ELIGIBILITY

- 5.1 Subject to the following provisions of this Rule 5, the Committee shall have absolute discretion in determining the criteria for selecting those individuals to whom Awards may be made.
- 5.2 An Award may only be made to an Eligible Employee.
- 5.3 An Award shall not be made to any Eligible Employee within the period of 6 months ending with the date on which that person is bound to retire in accordance with his contract of employment.
- 5.4 An Award shall not be made by any person other than the Company without the prior approval of the Directors.
- 5.5 An Award shall not be made to any Eligible Employee who is a director of the Company without the agreement of the Committee.

6. FORM OF AWARDS

- 6.1 An Award may take the form of:
 - 6.1.1 a Nil-Cost Option Award;
 - 6.1.2 a Contingent Share Award; or
 - 6.1.3 an award of Forfeitable Shares.
- 6.2 A Nil-Cost Option Award or a Contingent Share Award intended to be satisfied by a transfer of Shares by the Trustee shall not be made without the prior agreement of the Trustee.

7. TIMING OF AWARDS

- 7.1 An Award may only be made during the period of:
 - 7.1.1 42 days beginning with the fourth Dealing Day following an Announcement;
 - 7.1.2 28 days immediately after the person to whom it is made first becomes an Eligible Employee;
 - 7.1.3 subject to the Model Code, at any other time but only if, in the opinion of the Committee, the circumstances are exceptional; or
 - 7.1.4 subject to the Model Code, 28 days immediately after an Eligible Employee is promoted to a grade in respect of which an Award or additional Award is merited.
- 7.2 If the Grantor is restricted by statute, order or regulation (including any regulation, order or requirement imposed on the Company by the UK Listing Authority or any other regulatory authority) from making an Award within any period as mentioned in Rules 7.1.1, 7.1.2 or 7.1.3 the Grantor may make an Award within the period of 42 days (or, in the circumstances referred to in Rule 7.1.2, 28 days) after all such restrictions are removed.
- 7.3 No Award may be made in breach of the Model Code.
- 7.4 No Award may be made after [tenth anniversary of approval of shareholders].

8. OVERALL LIMITS ON THE ISSUE OF NEW SHARES TO SATISFY AWARDS

- 8.1 Subject to the following provisions of this Rule 8 and Rule 48, the Company may issue Shares (as new Shares or out of treasury) for the purposes of satisfying Awards and may do so on such terms, as to subscription price or otherwise, as the Directors may determine.

- 8.2 The number of Shares in respect of which rights to subscribe for Shares may be granted pursuant to, or for the purposes of, this Plan on any day, when added to:—
- 8.2.1 the number of Shares in respect of which rights to subscribe for Shares have previously been granted (and which, if not exercised, have not ceased to be exercisable) for the purposes of this Plan; and
- 8.2.2 the number of Shares issued, or in respect of which rights to subscribe for Shares have previously been granted (and which have not been exercised and have not then ceased to be exercisable), in the period of 10 years ending on that day pursuant to, or for the purposes of, any other discretionary executive share incentive scheme established by the Company shall not exceed 5 per cent of the Ordinary Share Capital on that day.
- 8.3 The number of Shares in respect of which rights to subscribe for Shares may be granted pursuant to, or for the purposes of, this Plan on any day, when added to:—
- 8.3.1 the number of Shares in respect of which rights to subscribe for Shares have previously been granted (and which have not been exercised and have not ceased to be exercisable), for the purposes of this Plan; and
- 8.3.2 the number of Shares issued, or in respect of which rights to subscribe for Shares have previously been granted (and which have not been exercised and have not then ceased to be exercisable), in the period of 10 years ending on that day pursuant to, or for the purposes of, any other employees' share scheme shall not exceed 10 per cent of the Ordinary Share Capital on that day.
- 8.4 For the purposes of this Rule 8, "year" means a calendar year.
- 8.5 For the purposes of this Rule 8 references to rights to subscribe for Shares shall, if so required in accordance with guidance issued by the Association of British Insurers, be taken to include references to rights to acquire Shares issued or to be issued out of treasury.
- 8.6 For the avoidance of doubt, if Shares issued to the trustee of any employees' trust established by the Company have been counted for the purpose of this Rule 8, they shall not also be counted when they are used to satisfy an Award (or a right granted under any other employees' share scheme of the Company).
- [8.7 For the purposes of Rules 8.2 and 8.3, shares in respect of which rights to subscribe for new shares were granted before [] (flotation of the Company)] shall be left out of account.]

9. INDIVIDUAL LIMITS ON THE MAKING OF AWARDS

- 9.1 Subject to the application of Rule 9.2, and save in circumstances which are considered by the Committee to be exceptional, the aggregate Market Value (as at the respective Award Dates) of Shares in respect of which Awards are made to an Eligible Employee in any Year shall not be greater than [100] per cent of the amount of such Eligible Employee's Salary at the Date of Grant.
- 9.2 If, in relation to an Award, the Awardholder is required (as mentioned in Rule 13.1) to bear the cost of Employer's NICs payable on any NIC Award Income, the number of Shares in respect of which such Award is granted may (notwithstanding the limit imposed by Rule 9.1), be increased by such number of Shares as the Committee shall determine to be appropriate (having regard to the expected rate of Employer's NICs) for the purpose of compensating the Awardholder for assuming, or agreeing to assume, the burden of such Employer's NICs.

10. AWARD CERTIFICATE

As soon as practicable after an Award has been made the Company shall procure the issue to the Awardholder of an Award Certificate (which may be by e-mail) which specifies:

- 10.1.1 the type of Award
10.1.2 the Grantor;
10.1.3 the Award Date;
10.1.4 the number of Award Shares;
10.1.5 the applicable Performance Condition;
10.1.6 that it is a condition of exercise of the Award that the Awardholder agrees to indemnify the Grantor and the Awardholder's Employer in respect of any Award Tax Liability;
10.1.7 (if appropriate) that, if the Awardholder is a participant in a Corporate Nominee Facility, the Award Shares may be issued or transferred and delivered directly to the Corporate Nominee for the Awardholder's account.

11. ACCEPTANCE OF AN AWARD

- 11.1 The provisions of Rule 11.2 shall only apply in relation to an Award if the Grantor determines that the Awardholder will be required to accept his Award.

- 11.2 If the Awardholder does not, within 30 days after the Award Date (or such later time as the Grantor may notify to the Awardholder), deliver to the Grantor a duly completed Form of Acceptance in relation to such Award, then at the end of that period:
- 11.2.1 if the Award is a Nil-Cost Option Award, it shall lapse and cease to be exercisable;
 - 11.2.2 if the Award is a Contingent Share Award the Awardholder shall not become entitled to any Shares pursuant to that Award; and
 - 11.2.3 if the Award is a Forfeitable Share Award, all of the Award Shares in respect of which it has been made shall be forfeited.

12. TAX INDEMNITY

- 12.1 It shall be a term and condition of every Award that the Awardholder indemnifies the Awardholder's Employer against any Award Tax Liability.

13. TRANSFER OF BURDEN OF EMPLOYER'S NICs

- 13.1 Unless the Grantor determines otherwise, it shall be a term and condition of every Award that the Awardholder shall, if and when required by the Grantor, agree with and undertake to the Company and, if different, the Awardholder's Employer that:
- 13.1.1 the Awardholder's Employer may recover from the Awardholder, the whole or any part of any Employer's NICs payable in respect of any NIC Award Income; and
 - 13.1.2 if required to do so, the Awardholder shall enter into a joint election with the Awardholder's Employer (in a form approved by the Inland Revenue under paragraph 3B of Schedule 1 to the SSCBA) for the transfer to the Awardholder of the whole, or such part as the Company may determine, of any liability of the Awardholder's Employer to Employer's NICs on any NIC Award Income.

14. DATA PROTECTION

It shall be a term and condition of every Award that an Awardholder agrees and consents to:

- 14.1 the collection, use, processing and transfer of his Personal Data by any member of the Group or any Associated Company and, if it is

- not the Company, the Grantor and any Trustee or third party administrator of the Plan and any broker through whom Shares are to be sold on behalf of an Awardholder;
- 14.2 members of the Group, any Associated Company and, if it is not the Company, the Grantor and any Trustee or third party administrator of the Plan, transferring the Awardholder's Personal Data amongst themselves for the purposes of implementing, administering and managing this Plan and the grant of Awards and the acquisition of Shares pursuant to Awards;
- 14.3 the use of Personal Data by any such person for any such purposes; and
- 14.4 the transfer to and retention of Personal Data by third parties including any Trustee or third party administrator of the Plan (whether or not any such third party is situated outside the European Economic Area) for or in connection with such purposes.

15. RELATIONSHIP WITH CONTRACT OF EMPLOYMENT

- 15.1 The making of an Award shall not form part of the Awardholder's entitlement to remuneration or benefits pursuant to his contract of employment.
- 15.2 The existence of a contract of employment between any person and the Company or any present or past Subsidiary or Associated Company, does not give such person any right or entitlement to have an Award made to him in respect of any number of Shares or any expectation that an Award might be made to him, whether subject to any conditions or at all.
- 15.3 The rights and obligations of an Awardholder under the terms of his contract of employment with the Company or any present or past Subsidiary or Associated Company shall not be affected by the making of an Award or his participation in this Plan.
- 15.4 The rights or opportunity granted to an Awardholder on the making of an Award shall not give the Awardholder any rights or additional rights to compensation or damages in consequence of the loss or termination of his office or employment with the Company or any present or past Subsidiary or Associated Company for any reason whatsoever (whether or not the termination is ultimately held to be wrongful or unfair).
- 15.5 An Awardholder shall not be entitled to any compensation or damages for any loss or potential loss which he may suffer by reason of being unable to acquire or retain Shares, or any interest in Shares pursuant to an Award in consequence of the loss or termination of his office or employment with the Company or any present

or past Subsidiary or Associated Company for any reason whatsoever (whether or not the termination is ultimately held to be wrongful or unfair).

16. NON-TRANSFERABILITY OF AWARDS

16.1 An Award is personal to an Awardholder and may not be transferred during his lifetime.

16.2 If an Awardholder:

16.2.1 transfers, assigns, mortgages, charges or otherwise disposes of an Award or of any interest in or right to acquire any Award Shares (other than to his Personal Representatives);

or

16.2.2 is adjudged bankrupt or an interim order is made because he intends to propose a voluntary arrangement to his creditors under the Insolvency Act 1986 (or any other provision of the laws of any jurisdiction outside the UK which is intended to have similar effect or purpose); or

16.2.3 makes or proposes any other plan or arrangement, in relation to his debts, with his creditors or any section of them; or

16.2.4 is otherwise deprived (except on death) of the legal or beneficial ownership of an Award or of any interest in or right to acquire any Award Shares, whether by operation of law or by doing or omitting to do anything which causes him to be so deprived

the Awardholder shall immediately cease to have any right or entitlement to any Award Shares which have not then become Vested Award Shares and shall immediately forfeit all Shares held under any Forfeitable Share Award.

17. LAPSE OF AWARDS

If or insofar as Award Shares do not become Vested Award Shares in consequence of a Performance Condition not being satisfied in full, the Award shall lapse in respect of the balance of such Award Shares.

PART C: NIL-COST OPTION AWARDS**18. STRUCTURE OF A NIL-COST OPTION AWARD**

- 18.1 The Trustee (acting on the recommendation of the Company), or the Company, may from time to time grant to any Eligible Employee a right to acquire such maximum number of Shares as the Company shall specify and which is exercisable only subject to and in accordance with the terms of this Plan.
- 18.2 The exercise of a Nil-Cost Option Award shall be subject to a Performance Condition.
- 18.3 No amount shall be payable by the Awardholder for the acquisition of Shares pursuant to such right.
- 18.4 A Nil-Cost Option Award shall be made by the Grantor executing a deed.

19. EXERCISE OF A NIL-COST OPTION AWARD

- 19.1 Subject to Rule 20 and Rule 21, a Nil-Cost Option Award may only ever be exercised in respect of Vested Award Shares.
- 19.2 A Nil-Cost Option Award may not be exercised after:
- 19.2.1 the Tenth Anniversary or such earlier date as may be specified at the time of grant; or, if earlier
- 19.2.2 the end of the period of 12 months beginning with the Leaving Date, or the end of the period of 12 months from the satisfaction of that Performance Condition, if later.
- 19.3 Except as otherwise provided in Rule 20 or Rule 21, a Nil-Cost Option Award may not be exercised at any time unless the Awardholder then holds office or employment with a member of the Group.

Exercise procedure

- 19.4 A Nil-Cost Option Award shall be exercised only by the Awardholder serving a notice on the Grantor (or otherwise as the Grantor may direct) which specifies the number of Shares in respect of which such Nil-Cost Option Award is exercised on that occasion which shall not exceed the number of Vested Award Shares in respect of which such Nil-Cost Option Award subsists and which have not been specified for this purpose in an earlier notice of exercise.
- 19.5 A Nil-Cost Option Award shall not be exercised on any occasion if such exercise would not be in accordance with the Model Code.

C

HM REVENUE AND CUSTOMS Extra-Statutory Concessions, Statements of Practice, Press Releases and Other Material

Extra-Statutory Concessions

A68 Payments out of a discretionary trust which are emoluments taxable as employment income

Employee trusts are discretionary trusts created by funds provided by employers for the benefit of their employees, past, present or future, or for the benefit of any dependants or relations of such employees. Where a payment made by the trustees in exercise of any discretion is treated as being assessable to tax as employment income, TA 1988, s.687(2) does not operate to give the recipient credit for the tax at the rate suffered by the trustees. This means the payment is effectively taxed twice.

Subject to a claim by the trustees and the conditions set out below, a payment will be made to them equal to the lesser of—

- tax on the total payments made in any year of assessment which are treated as employment income in that way; the rate of tax being the rate applicable to trusts in force for that year; and
- the total tax which the trustees would have available under s.687(3) to set against any payments made in that year to which s.687(2) applied (so far as not already allowed), the "tax pool".

The conditions are that the trustees must—

- have submitted, for each year for which tax has entered the "tax pool", a return of all trust income received and all payments made to beneficiaries;
- supply evidence that they have paid (by deduction or otherwise) tax of at least the amount to be paid to them; and
- agree that the "tax pool" should be reduced by the amount to be paid.

As the payment is compensation for the lack of a credit to the employees under s.687(2)(a), no repayment supplement will be added to it.

A103 Armed Forces Reservists : Revenue Approved Share Schemes and Enterprise Management Incentives (EMI)

Where a reservist is called up for service under the Reserve Forces Act 1996, the Inland Revenue by concession will treat the employment with the Ministry of Defence (MOD) as fulfilling the employment conditions for Inland Revenue approved employee share schemes*

By concession, employers and scheme providers will also be allowed to take such action as is necessary to maintain a reservist's participation in an approved employee share scheme, for the period they are away serving with the MOD and this action will not compromise the approval of the scheme.

*For the purposes of this ESC Inland Revenue approved employee share schemes include, Company Share Option Plans, Share Incentive Plans, Save as you Earn Schemes and Enterprise Management Incentives. The concession applies from 7th January 2003.

GUIDANCE FOR EMPLOYERS WHO OPERATE APPROVED EMPLOYEE SHARE SCHEMES OR ENTERPRISE MANAGEMENT INCENTIVES (EMI) AND HAVE EMPLOYEES WHO ARE ARMED FORCES RESERVISTS WHO HAVE BEEN CALLED UP TO ACTIVE SERVICE

The purpose of this guidance

1.—During discussions with share scheme administrators in the course of developing Extra Statutory Concession (ESC)—A103, we were asked to provide some general guidance on possible approaches that could be used to preserve a reservist's position under the cover of the ESC.

2.—The number of individuals affected is likely to be relatively small and we want to provide employers with as much flexibility as possible, whilst also offering sample approaches to dealing with the administration, to make it simpler.

3.—The examples outlined in this note are not prescriptive or exhaustive. They benefit from comments from share scheme administrators involved in the day to day practicalities of running employers' share schemes. The examples are only a guide to what steps may be taken in

preserving reservist's participation in an employee share scheme on their return to work. They may be particularly helpful where an employer has only one or two employees affected, and rather than commit time to developing their own solution, they may simply follow one of the approaches set out in the examples.

4.—Of course some of the issues particularly relating to a reservist's physical absence, could possibly be overcome if the reservist before departure put in place a power of attorney or authorised someone to deal with their affairs and act on their behalf in their absence. Where this is the case those arrangements do not need to be disturbed. However, where this is not the case, it may be simpler to take corrective action on the employee's return from service.

5.—The action taken to preserve the reservist's participation in the scheme should be decided between the employer and employee. As long as this action does no more than maintain a reservist's participation for the period they are away on permanent service with the MOD, and reflects what it would have been but for their absence, it will be covered by ESC A103. Employers should ensure that the ESC is applied on equal terms to all the reservists called up from their employment.

6.—If in doubt employers and administrators may contact the Employee Share Schemes Unit if they would like to discuss a scenario not covered by this guidance note and check their proposed action will be covered by ESC A103.

SCENARIOS COVERED BY THE ESC

Share Incentive Plan (SIP)

7.—A reservist on leaving the employment of their civilian employer may decide to remove their SIP shares from the plan and not to participate in the SIP for the period of his/her active service as a reservist. Where this is the case, on their return to their employment with their civilian employer they can decide whether they want to begin to participate once more from a future date, as is the case with any new employee joining the company.

8.—Alternatively, ESC A103 will enable a reservist to agree with their employer to leave their SIP shares in the Plan, until their return and accept any free shares awarded. Similarly, the reservist and employer may agree arrangements to enable the reservist to continue to purchase partnership shares and in turn be awarded matching shares during the period of their active service (see example C).

9.—Where a reservist does not make arrangements to continue to purchase partnership shares whilst away on active service and on return

he/she would like to catch up on the partnership share payments they missed (and any associated matching shares), ESC A103 will make this possible (see examples A & B).

Example A

10.—A reservist prior to their call up for active service with the MOD is participating in their employers SIP and purchases #100 of partnership shares per month. On their call up no arrangements are put in place to enable the reservist to continue to purchase partnership shares whilst away on active service. On the reservists return 9 months later the reservist would like to make catch up payments in respect of the partnership share payments missed.

First months salary on return from active service £2,000

Usual monthly partnership share payment before call up £100 Period of active service in months 9 X £900

11.—Employer pays employee's £900 partnership share payment to SIP administrator, along with other employee partnership share payments that month, explaining that £900 relates to a reservist wishing to make catch up payments.

12.—To determine the price of the partnership shares, an average price for the period of absence may be taken for ease of administration. Alternatively, the market price at the time of the partnership share purchase may be used, or the market price at the time of the partnership share purchase in respect of each month of absence. ESC A103 will cover whatever approach is agreed between the employer and reservist.

13.—Say the average market price of shares during the period of absence is taken and this is £5 per share, this will enable 180 partnership shares to be purchased. In addition under the SIP the employer may offer 2 matching shares for each partnership share. So in total the reservist will be awarded 540 shares.

14.—The tax free holding period for the first 20 partnership shares and 40 matching shares can be taken as running from the first month following call up and similarly for the next batch of 60 shares the tax free holding period can be taken as running from the second month following call up, and so on.

15.—In addition if during the period of absence the reservist received £100 in dividends from SIP shares, 20 dividend shares could also be purchased on the reservists return, and the tax free holding period could be

on the reservists return. Where this occurs and the employer pays a nominal salary advance of say £125 per month to cover the monthly purchase of partnership shares and agrees to recover the salary advance on the employees return from their gross salary, this will be covered by ESC A103.

Employer introduces a new SIP or a new SIP invitation whilst the reservist is on active service

23.—If whilst a reservist is on active service an employer puts in place a new SIP scheme, or issues a new SIP invitation, and the employee due to their physical absence is unable to take up the invitation, it will be acceptable for the reservist to take up the invitation on their return. Where this occurs the reservist may be allowed to make catch up payments as outlined in examples A & B.

Save as You Earn (SAYE)

24.—If on call up to active service with the MOD the reservist agrees with their employer that he/she will continue to make regular payments into the SAYE scheme, the reservist could arrange for their monthly SAYE payments to be made by direct debit rather than from salary. At the same time the employee could arrange a power of attorney or nominate someone to act on his/her behalf if there is a SAYE invitation or the SAYE bonus is paid and a decision needs to be made regarding whether to exercise the SAYE option.

25.—Under the existing SAYE rules there already exists the option to take a break of six months payments without the SAYE contract coming to an end. However, there may be cases where a reservist is absent for longer than 6 months. If on call up to active service the reservist does not put into place any arrangements to continue to make payments into their employers SAYE scheme, then if on their return, the reservist would like to catch up on the SAYE payments they missed, this will be acceptable under ESC A103.

Employer introduces a new SAYE or a new SAYE invitation whilst the reservist is on active service

26.—If whilst a reservist is on active service an employer puts in place a new SAYE scheme, or issues a new SAYE invitation, and the employee due to their physical absence is unable to accept the invitation, it will be acceptable

taken as the date they would have otherwise been purchased but for the reservists absence.

16.—Share scheme administrators when we discussed this point with them advised that a one off correction of the type in example A was likely to be the simplest administratively, as it kept communications simple and the number of actions required to a minimum.

Example B

17.—Details as for example A, but employee's monthly salary £1,000. Average partnership share purchase before call up still £100, 10% of salary. On the reservists return if £900 for partnership shares was taken from £1,000 monthly salary payment, it would leave the employee with salary of just £100, which would then be subject to tax and NICs.

18.—In this circumstance the employer for administrative ease may still want to pay over the £900 partnership share catch up payment to the scheme administrator, but limit recovery from the employee to say £300 each month for 3 months, until the full £900 of partnership share catch up payments have been recovered. This type of arrangement will be acceptable under ESC A103 in the special circumstances of reservists called up for service.

19.—Again, as for example A the tax free holding period for shares could be backdated to the time the partnership share payments would have been made but for the reservists absence.

Records

20.—If a corrective action such as the one outlined in examples A and B occurs within a tax year, the annual return should be annotated to indicate the entry that relates to a reservist. Alternatively, a supplementary note explaining the action taken in respect to the reservist will be provided.

21.—If corrective action such as in examples A and B spans a closed tax year, it will be sufficient to write to the Inland Revenue Employee Shares Schemes Unit, with an amendment to the closed year return.

Example C

22.—On call up to active service with the MOD the reservist could agree with their employer that he/she will continue to make regular payments in respect of partnership shares, rather than corrective action being taken