Disguised Remuneration

Employment Tax | Tax voice



12 March 2019

Lewin Higgins-Green provides an update on the April 2019 Loan charge

Legislation designed to combat perceived tax avoidance through “disguised remuneration” has been in place since 2011. One common result was to bring arrangements which replaced salary with an interest free loan made to an employee (that might never be repaid) by a third party (such as an employee benefit trust) into the charge to employment tax and National Insurance contributions (NIC). Since then HMRC have used a number of measures to encourage settlement for any outstanding arrangements.

The Finance Act (No 2) 2017 introduced new legislation which will tax the value of any pre-existing loans (dating back to 6 April 1999) which are outstanding on 5 April

2019 – this is generally known as the April 2019 “loan charge”. The amount of outstanding loans within the scope of the legislation (which includes the amount of any loan which has been written off, rather than repaid) will be considered employment income and create a liability for tax and NIC in 2018-19 insofar as the amount has not previously been subject to tax.
For the unprepared this could be a large and unexpected liability – in total, HMRC expect this legislation to raise £3.2 billion and that up to 50,000 individuals will be affected.

However, a House of Lords report (“The Powers of HMRC: Treating Taxpayers Fairly”) published in December 2018 was critical of the 2019 loan charge, particularly highlighting the retrospective effect of the legislation and the fact that many employees joined schemes after assurances from their employers and whilst being open with HMRC about their use.

Following the report, a cross-party group of MPs included an amendment to the current Finance Bill which requires the Treasury to review the loan charge legislation by the end of March. However, given the severe lack of time between the outcome of any such review and the date the of the charge (5 April 2019) it is extremely important that any users of these schemes review their position immediately, if they have not already done so – see also the article by Tina Riches in the issue of Employment Taxes Voice.

What is a disguised remuneration loan?

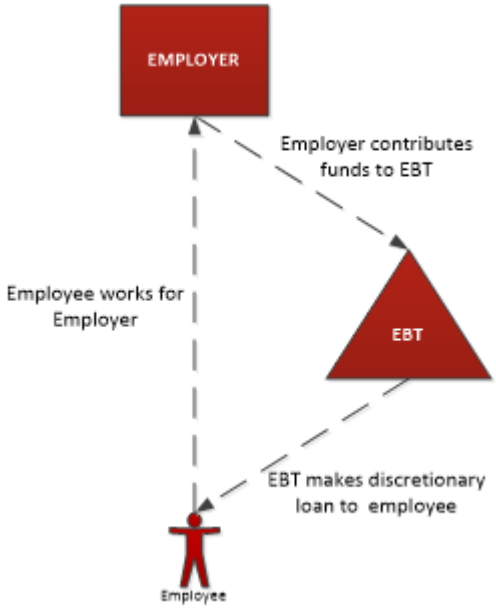
Broadly speaking, loans that were made to employees in lieu of, or in addition to, their salary are considered. The most usual situation is that the loans would be made by an employee benefit trust (EBT) which would be funded by the employer. This diagram below shows the usual structure.

Whilst the legislation is not straightforward, effectively it will catch a loan made on or after 6 April 1999:

- by a “relevant third person” (generally any person who is not the employee, employer, or another member of the same group of companies as the employer – most often an employee benefit trust); and
- to a “relevant person” (normally the employee, but which also covers others who are linked to employee in a variety of ways).

The legislation operates by treating a “relevant step” as having been made on 5 April 2019 (or later in very limited circumstances) – this results in the outstanding amount of the loan becoming subject to tax and NIC in 2018-19.

Image



What is the outstanding amount of the loan?

The amount subject to tax and NIC in 2018-19 is the “outstanding amount” of the loan. Broadly, this is the original amount of the loan less any amounts actually repaid and not written off.

The new measures were announced on 17 March 2016 and any repayments of an affected loan since that date must be made by the relevant person and be in money. Before 17 March 2016 it may have been possible for the repayment to be made in other forms and by other people.

As one would expect, there are anti-avoidance provisions which act to disregard any repayments connected with tax avoidance arrangements.

What exceptions are there?

There are a number of, rather narrowly drawn, exceptions to loans that will be caught by the April 2019 loan charge. Most notably, and all subject to specific conditions:

- loans made in the course of a normal commercial transaction on ordinary commercial terms;
- situations where an employment-related loan of no more than £10,000 has been transferred from one employer to another;
- loans made under employee benefit packages (and which are in the ordinary course of business of a lender whose business involves making similar loans to the public);
- loans made solely to allow an employee to exercise an employment-related securities option;
- loans made to allow employees to acquire unlisted employment-related securities.

Overlaps with previous tax charges

Generally speaking, if there have been other events which have caused the loan amount to become taxable already, there should be a reduction in the amount subject to the 2019 loan charge. The amount subject to the loan charge will be reduced by the amount of income already taxed.

The most common example will be where a loan has previously been written off – this will normally cause a taxable event under the general earnings provisions (s.62 ITEPA 2003) or the beneficial loan charge (s.188 ITEPA 2003).

What are the next steps?

HMRC has been running a settlement scheme for employers and employees who used these arrangements – although it was originally necessary to register an interest to settle by 31 May 2018 and to send HMRC all the requirement information by 30 September 2018, HMRC are still inviting people to contact them and settle their affairs before 5 April 2019 in order to avoid the loan charge. It may not be too late but, given the very short time until 5 April 2019, employers and employee may wish to consider if they can easily provide the information to HMRC in a very short timescale.

Employers will need to urgently review any loans that have been made to employees since 6 April 1999 in order to determine if any amount will be treated as outstanding. If any such loans are identified employers will want to ensure that the relevant individuals are made aware of the situation, and their responsibilities, as

quickly as possible.

Individuals who have received a loan and have an outstanding amount subject to the charge will need to report the loan to HMRC before 1 October 2019 – if they do not, they will receive a £300 fixed penalty and further daily penalties (of up to £60 per day, for up to 90 days).
Employers will need to process any outstanding amounts subject to the charge through payroll for tax and NIC, ensuring that the PAYE tax and NIC reaches HMRC by 22 April 2019.

As the loan charge is considered a “notional payment” s.222 ITEPA 2003 means that employers will need to ensure they recover the tax from individuals by 4 July 2019 otherwise a further tax and NIC liability will arise on the value of the tax that has not been recovered.