Tackling disguised remuneration

Employment Tax

01 November 2016

The CIOT has responded to HMRC's technical consultation document on draft legislation to amend ITEPA 2003 Pt 7A and introduce a PAYE and NIC charge on 'disguised remuneration loans' outstanding on 5 April 2019

After amendments to ITEPA 2003 Pt 7A ('Disguised Remuneration') in Finance Act 2016 aimed mainly at tackling a particular scheme, on 10 August HMRC published a technical consultation on draft legislation making further changes to Pt 7A, which will be included in Finance Bill 2017.

In particular, changes are proposed to:

- put beyond doubt that all loans or debts from a Disguised Remuneration (DR) which result in a loan or other debt being owed by an employee to a third party are within the DR rules;
- broaden HMRC's transfer of debt powers, contained in the PAYE Regulations, so that in specific circumstances a DR liability can be transferred from the employer to the employee (or former employee);
- impose a bar to a corporation tax (CT) deduction for contributions to DR schemes made on or after 6 April 2017; and
- impose a new charge on outstanding DR loans so that they will be subject to PAYE and NIC as earnings if they haven't already been fully taxed or repaid on or before 5 April 2019.

In our response we commented that while the CIOT has no issues, in principle, with government targeting artificial avoidance arrangements this is subject to the proviso that (a) there is no collateral damage to normal commercial arrangements and (b) the legislation is clear, easy to follow and necessary. In this instance what is proposed is to revisit historic transactions – legacy loans – and tax them differently (the legislation effectively imposes a retrospective tax charge on events that happened in the past). Consequently, we think extreme care is required to

distinguish between the good and the bad, so that the new legislation does not catch ‘desirable’ arrangements. For example, where legacy loans support share plans for employees employed by unlisted companies and which the Government has hitherto encouraged.

Part 7A is to be amended to put beyond doubt that DR schemes where the employee becomes indebted to the third party, but in circumstances where the employer makes the initial loan, are to be treated in the same way as if the third party made the loan. For example, the amendment is intended to catch arrangements where the employer makes the initial loan and then enters into an arrangement with a trust with the result that the employee owes the trust and not the employer.

Part 7A is also to be amended to introduce a new close companies’ gateway aimed at arrangements whereby it is claimed that payments to an employee or director of a close company is not in connection with their employment. The CIOT does not believe that a new close company gateway is needed given the breadth of the current legislation. If a new gateway is introduced, we think that the currently proposed gateway is too wide as by taking away any linkage to a payment being in connection with the recipient being an employee or director potentially leaves wholly commercial/capital transactions at risk of being caught by Part 7A. We therefore suggest an exclusion for capital transactions in connection with the sale or reorganisation of the share capital of the close company be included. We also raise concerns around other transactions which the new gateway could, potentially, entrap such as the provision of medical cover.

In response to the proposed bar on the CT deduction, we raise concerns around including commercial arrangements where there is fiscal symmetry. For example, where bonuses are paid into a trust for later allocation and distribution to employees once bonus-sharing ratios have been decided and which are fully subject to tax and NIC deductions at the time of allocation/payment. We are also concerned that the change could penalise inadvertent errors. Consequently, we are not convinced by the government’s argument for a bar to a CT deduction and suggest that CT relief should be available at the point when an employment income charge arises.

A number of proposals are put forward by HMRC for changes to the transfer of liability rules, which would make it is easier for HMRC to pursue the individual who has benefited from a DR scheme for PAYE and NICs payable by the employer/DR Scheme. The CIOT questioned whether new legislation is required when PAYE can be

recovered from the entity for whom the individual works under Section 689 ITEPA 2003. We said that if an entity is an inadvertent/unknowing victim of the DR scheme and HMRC wants the option to pursue the individual instead, Regulation 72(3) and Condition A (reasonable care/error made in good faith) should cover this situation. We thought that if new powers are introduced then safeguards are necessary to protect, for example, lower paid workers who may have little or no understanding of the arrangements they have been entered into.

Finally, the government has decided to act against legacy loans from employee benefit trusts and change the historic treatment from income tax and NIC on a benefit-in-kind to PAYE and NIC on any loans outstanding at 5 April 2019. Given that the decision to impose the charge has already been taken the CIOT's main concern is to ensure that there is a carve out for cases where legacy loans are supporting behaviour that government would endorse, for example bona fide employee share plans where there are loans to employees to purchase shares in their employing company (or parent company). The change creates a PAYE and NIC liability for the employing company (and in certain cases the former employing company) and we raise concerns as to what happens where the employer cannot (for whatever reason) recover the tax arising in April 2019 from the employee (or former employee) or from the employee benefit trust. We suggest that the liability created should instead be an income tax, rather than PAYE, liability assessable through the self-assessment return.

The CIOT's response can be read in full on the CIOT website.