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Review

Taxation & Benefits

New tax rules on disguised remuneration – the latest position

Following the release in December of draft legislation to tax disguised remuneration arrangements, HM Revenue & Customs (HMRC) has now published a list of frequently asked questions (FAQs) in respect of the legislation. The FAQs attempt to address some of the consultation responses HMRC has received from interested parties, including Squire Sanders Hammonds.

The legislation imposes a new, earlier tax charge where perceived abusive remuneration arrangements have been implemented by employers or intermediaries. As well as catching many arrangements involving unapproved pension arrangements (EFRBS) and Employee Benefits Trusts (EBTs), the legislation as drafted also potentially catches some commercial employee share incentive and cash bonus arrangements. For example, it potentially imposes a tax charge on the employee at the time shares are “earmarked” for the employee, even if this is before he or she becomes entitled to receive the shares. However, based on the responses to the consultation, HMRC have clearly accepted that there are a number of problem areas with the first draft of the legislation.

The good news

There are a number of instances in which HMRC accept that the legislation catches innocent transactions and normal commercial arrangements that do not have a tax avoidance motive, and that these transactions and arrangements should not be within the scope of the new tax charge. For example, the draft legislation will be altered in the following areas:

- Deferred share awards or cash bonus arrangements will not generally be subject to the new charge where they are subject to performance conditions and the benefits of the award or bonus will vest within five years.
- Assets purchased from an employee for market value or less than market value will not be caught by the new rules. This should allow EBTs to continue to be used as a warehousing mechanism to purchase shares from departing employees without giving rise to the new charge.
- The use of EBTs to warehouse shares to meet general obligations under an employee share scheme or long term incentive plan will not be caught by the new rules as “earmarking” of the shares, provided the shares are not allocated to specific employees at that time.
- Wholly unfunded unapproved retirement benefit schemes will not be subject to the new charge, provided there are no arrangements in place to give employees any form of security. Unfortunately, the question as to whether any type of “security” might still be acceptable where this does not amount to an earmarking of assets is likely to be a testing one.

The bad news

Although the draft legislation is very wide in scope, it appears that there are some areas in which the Government is not willing to give any ground. In particular, it appears that the rules on the use of funded EFRBS and loans to employees will not be altered (other than possibly a limited exemption for certain short-term specific purpose loans) as the use of these arrangements is perceived as potentially abusive in all instances.

In some places this gives rise to injustices in the legislation that will not be corrected. For example, where a loan is made by a third party to an employee on or after 6 April 2011 and is subject to the new tax charge, when that loan is repaid the employee will not be able to claim back the tax they have paid. Consequently, employers planning on using loans and funded EFRBS to remunerate their employees should review their arrangements carefully. In addition, deferred share awards and cash bonus arrangements may still need to be looked at very carefully to ensure that they do not trigger a premature tax charge for the employee.

The Government concessions for the operation of normal commercial employee share schemes are quite narrow so it seems that there is still a risk that some perfectly normal and legitimate arrangements will still be caught by the new legislation. It remains to be seen if the final legislation will address this concern.

Conclusion

At this stage all we have is the FAQs and a statement of intent to alter the draft legislation. As HMRC are still in the process of reviewing all the responses to the consultation further FAQs may be published in due course. However, we do not expect many substantial additional concessions to be made by HMRC prior to the legislation becoming effective in April. Employers and intermediaries should therefore consider their existing remuneration arrangements now to ensure that such arrangements do not fall foul of the new regime.

FURTHER INFORMATION

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