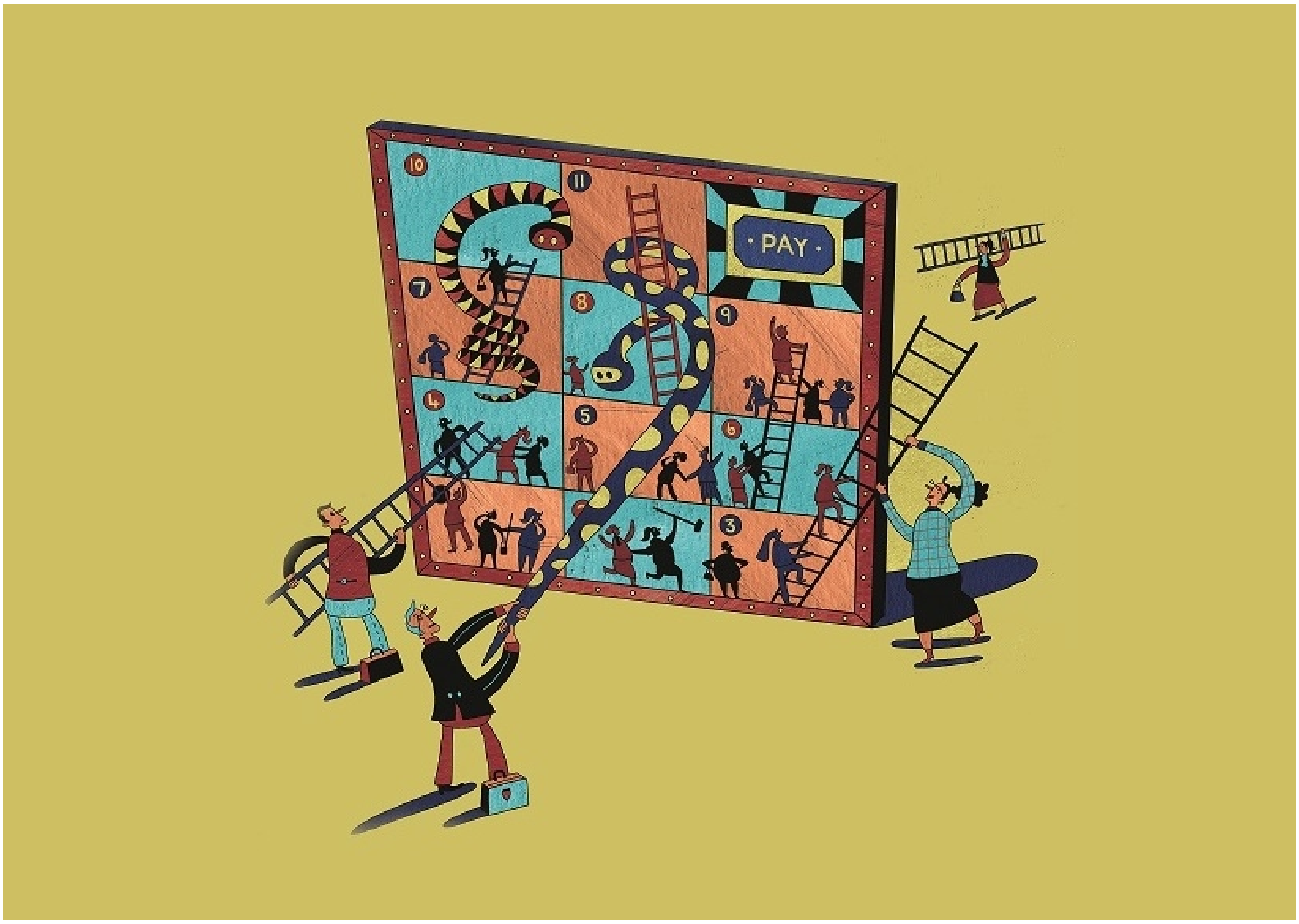
Two steps forward, three steps back?

Employment Tax Personal tax



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Rob Jennings and Rob Pearce consider the impact of the NIC changes to the treatment of share gains for internationally mobile employees

Key Points

What is the issue?

Finance Act 2014 introduced new legislation to change the UK taxation of share income for IMEs. Parallel changes to the NIC treatment of share gains have been enacted by the new para 18 of Part IX, Schedule 3 to Social Security (Contributions) Regulations 2001. Both changes took effect from 6 April 2015 and apply to any chargeable event (eg share vesting and option exercise) that occurs on or after that date

What does it mean for me?

The new rules have the potential to change significantly the UK income tax and NIC treatment of employment related securities for IMEs. All IMEs with share income and their employers will therefore need to consider the impact of the changes

What can I take away?

Under the new income tax rules, any apportionment will be based broadly on UK residence and workdays. However, under the new NIC rules, any apportionment will be based on the periods for which the employee is UK insured. On the whole, NIC costs are likely to increase

In ‘A move in the right direction?’ from February’s Tax Adviser, we discussed some of the changes to the income tax and national insurance (NIC) treatment of share gains for internationally mobile employees (IMEs), which took effect from 6 April 2015.

When the article went to press, the new NIC provisions were still in draft form. They have, however, now been enacted, as drafted. This article is focused on the impact of the NIC changes for employers and employees (the income tax changes having been discussed previously).

Background

As discussed in our February article, under the new income tax rules, any apportionment will be based broadly on UK residence and workdays. Under the new NIC rules, however, any apportionment will be based on the periods for which the employee is UK insured.

UK insurability and tax residence may sometimes be the same; however, this will not always be the case. For example:

- where the IME has moved from the UK to a ‘non-agreement’ country as a secondee, the IME generally remains subject to social security in the UK for an additional 52 weeks (the 52 week rule); and
- where the UK outbound IME is subject to a certificate of coverage or A1 arrangement, they remain within their home social security system, regardless of a change in tax residency, for an extended period, usually up to five years.

Questions for employers

In our experience, having a different basis for income tax and NIC charges causes practical problems – especially in payroll operations – for employers. In addition, the requirement to consider an individual’s UK insurance position over the whole life of an award could be very challenging. There are also a number of technical questions which remain unclear and which will cause compliance headaches for UK employers. These uncertainties remain, despite the publication of HMRC’s guidance on the new NIC rules, which can be found at www.tinyurl.com/pzdr5ca

Charging provision applicable to restricted share units

By restricted share units (RSUs), we mean an incentive arrangement whereby a company will deliver shares to the employee participant after a certain period (the vesting period), if the individual is still in employment and/or performance conditions are met. The employee does not have beneficial ownership of the shares during the vesting period. On vesting, however, the shares are automatically delivered to the employee; that is, the employee does not have a choice on when to crystallise their gain.

For many years, there has been uncertainty with regards to what charging provision should apply to such awards. In particular, should they be taxable under either:

- the ‘securities option’ legislation in ITEPA 2003 Ch 5 Pt 7 (defined in ITEPA s 420(8) as the employee having a ‘right to acquire securities’); or
- ITEPA 2003 s 62?
- HMRC previously insisted that the shares delivered were ‘money’s worth’. Therefore, they held that the s 62 general earnings charge applied where the

securities option treatment did not (eg where employees were non-resident at grant), and this was generally accepted practice.

With effect from 6 April 2015, however, it appears that either charge may apply. There is less of a difference from an income tax perspective, but there are consequential capital gains tax differences. The NIC treatment will also differ depending upon the charging provision:

- If the RSUs are taxed under the securities option legislation, NIC will be apportioned as above, ie based on the period for which the employee was UK insured.
- If the RSUs are taxed under s 62, there will be no NIC apportionment. It will be an ‘all or nothing’ charge, as is generally the case under the legislation that applied before 6 April 2015. (This would also be the case for cash-based plans.)

A detailed analysis of this point is outside the scope of this article. Unfortunately, HMRC’s guidance does not make it clear which charging provision they expect would apply to a ‘normal’ RSU plan. Pending further clarification, companies must decide which provision they will apply to their awards; and then make sure that they apply it consistently for inbound and outbound employees.

Operating payroll in real time

There will be a number of issues connected with payroll reporting in practice. This is shown in ***Example 1***.

Example 1

Let us assume that a UK employee who holds share options moves to Hong Kong (a non-agreement country) as an assignee and remains on the UK payroll.

The employee obtains an NT code for PAYE purposes. Once 52 weeks have elapsed, he ceases to be liable to UK NIC and is therefore given an NIC category X for NIC purposes.

When the employee then realises a share option gain, NIC is due on the apportioned gain. The question is therefore whether (or how) your payroll system can apply a ‘normal’ NIC code. For example, how can your system apply an NIC rate to the relevant portion of the share gain; while at the same time applying the X rate to the employee’s ‘normal’ income?

Our experience is that there is no one size fits all. Different payroll systems will manage this in different ways. Companies will therefore need to discuss this with their individual payroll providers and check that their payroll systems can comply with the relevant requirements.

The sudden switching on of NIC, possibly some years after an individual has left the UK and possibly with no intention to return, may also trigger queries from the impacted individuals. Either payroll or HR will need to be in a position to answer these.

Resolution of potential double charges

During the consultation process, we raised a question with HMRC with regards to what would happen where, as a result of the new UK rules, a double charge to social security would arise, and where the ‘other’ location was an EEA or social security agreement country.

Example 2 is an example which we expect could arise.

Example 2

In this scenario, UK NIC rules would require that NIC is due on the apportioned gain, while the starting point is that the US would expect her to pay US social security upon the full gain, as the employee is US insured at exercise.

Unfortunately, there can be lengthy delays in resolving double contributions. Where this occurs, HMRC have simply advised employers to write to HMRC at an address in the NIC manual. We believe that enhanced guidance is required as regards how the authorities resolve double contribution issues, together with a streamlined procedure for prompt action and follow up with other social security administrations.

Conclusions

As mentioned in our previous article, the income tax and NIC changes are significant and are likely to affect many IMEs holding share awards.

Although the income tax rules have become more simplified and harmonised, challenges will still remain for employers, particularly in relation to NIC. Such challenges may come about because of:

- practical issues around tracking and payroll processes; and
- technical questions around which charging provision to apply to RSUs or how to resolve double charges.

Action Points

1. Ensure that systems are developed to track not just periods of UK residence and workdays, but also periods for which the employee is UK insured.
2. Determine what charging provision should apply to RSU type instruments.
3. Watch for updated guidance from HMRC as to cases where dual liabilities arise. Where a double charge does arise, seek a determination from the competent authorities at the earliest opportunity as to how this should be resolved.
4. Work with payroll to manage the withholding and reporting requirements.
5. Identify employees that will be impacted by the changes and, if appropriate, communicate with them.
6. Analyse where the company’s costs may increase, due to:

   (a) awards held by a tax equalised employee becoming taxable in the UK and/or;

   (b) new or increased NIC charges.
7. If necessary ensure that appropriate provisions are made for the increased costs.
8. Consider the impact of the changes on future reward planning for IMEs.

Further information

Read ‘*A move in the right direction?*’ on IME ERSs from the February 2015 issue of *Tax Adviser*.