

Employee share schemes: NIC elections

Employment Tax

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The government has proposed stopping employers and employees entering into joint NIC elections to transfer secondary class 1 contributions to employees that arise on a gain from exercising particular employment-related securities options. Difficulties with digitalising the process was cited as one reason to withdraw the elections. The CIOT noted fundamental legal and accounting differences between elections and NIC agreements, and recommended keeping the elections. We also suggested a simplified process if digitalisation was a problem.

The CIOT has responded to a government consultation on whether there is a continued need for a National Insurance contributions (NIC) election. We believe a withdrawal of NIC elections will reduce certainty for taxpayers, and thus do not support it.

A liability to secondary class 1 NIC arises when an employee makes a gain from exercising an employment-related securities (ERS) option (or some other chargeable event occurs under s 479 of ITEPA 2003), the shares are readily convertible assets and the circumstances relate to a non-tax advantaged share scheme. Although this secondary NIC is normally borne by the employer, it can instead be borne by the employee if either an NIC agreement or an NIC election is in place.

The consultation document proposes the removal of NIC elections (NIC agreements would be retained) for three reasons. First, in the move to digitalisation this would save HMRC resources (NIC elections require HMRC approval and developing a digital process for this would apparently be expensive). Second, there are said no longer to be any accounting issues requiring NIC elections. Third, although under NIC agreements the secondary class 1 liability is still enforceable against the employer, in practice the employer can deduct the sum from the employee through the payroll at the point of exercise.

In our view, there is a fundamental difference between NIC agreements and NIC elections. An NIC election gives an employer added protection because the secondary NIC is legally transferred to, and becomes the liability of, the employee. For NIC agreements the employer only has a right of recovery against the employee and is subject to the right to enforce. NIC elections are therefore important to employers that wish to be certain that there is no recourse to them for the amount of the secondary class 1 NIC.

The movement of the legal responsibility has also resulted in the accounting effect of NIC elections and NIC agreements to be different. With an election there is no liability for the company and therefore no need to reference any liability in the accounts. Under an agreement there has been a need for a matching debit and credit, so neutralising the liability in overall terms but recognising each separately and subject to the company being able to enforce the arrangement with the employee. Accordingly, the NIC election has served a purpose in simplifying the accounting treatment. This may or may not continue to be the case under UK, US and International Accounting Standards. However, we thought that the point ought to be considered carefully as regards, for example, accounts prepared in accordance with other national accounting standards before a decision is made to withdraw NIC elections.

In addition, NIC elections allow for an automatic income tax deduction for the amount of the gain on which the employee pays the employers' secondary class 1 NICs. With NIC agreements the employer needs to recover the

secondary contributions within 90 days of the end of the relevant tax year for the income tax relief to be available. Again, we thought that this ought to be considered.

We were also surprised that HMRC thought its digital strategy would be unable to accommodate the submission of an NIC election. In our opinion the strategy should be capable of accommodating the submission of all sorts of elections, including NIC elections. To aid digitalisation, we suggested that HMRC adopt a slightly different approach to NIC elections by amending the legislation so that it simply stores the elections received without having to agree them. This would preserve employers' flexibility to make such elections while saving HMRC '225 person hours per year'.

In conclusion, we considered that the facility for employers to make a NIC election should be retained to give them certainty that they have no liability to secondary class 1 contributions. If it is difficult for HMRC to adapt the new digital process to respond to requests to agree NIC elections consideration should be given to amending the legislation to allow employers to simply notify the Revenue – in a prescribed form – that one has been made.