Disguised remuneration

Employment Tax

01 April 2017

A tax charge is being introduced on ‘disguised remuneration loans’ outstanding at 5 April 2019. This charge is to be collected via PAYE. Additionally, new ‘disguised remuneration’ rules are being introduced for the self-employed, similar to those currently applying to employees. Finally, corporate deductions for contributions to employee benefit trusts are to be denied unless the associated PAYE/NIC is paid within 12 months of the end of the accounting period.

The CIOT has responded to proposals to change the anti-avoidance rules designed to prevent remuneration being disguised as something else. Finance Bill 2017 consultative clauses 32-35 and Schedules 10-11 provide for a myriad of changes, as well as introducing new anti-avoidance provisions.

The government proposals include a new close companies’ gateway aimed at putting beyond doubt that Part 7A of the Income Tax (Earnings and Pensions) Act 2003 (ITEPA 2003) applies to remuneration of employees and directors who have a material shareholding in a close company. ITEPA 2003 s554C will be amended to put beyond doubt that Part 7A applies to loan transfers, and a further amendment to s554C will result in the write-off, or release, of a disguised remuneration loan being a relevant step under Part 7A.

In addition, as announced at the Budget 2016, a new loan charge will be introduced, effective from the date of Royal Assent, which is to be applied to any disguised remuneration loan, or part of it, made on or after 6 April 1999 and that is outstanding on 5 April 2019.

Legislation is also to be included in the Income Tax (Trading and Other Income) Act 2005 (ITTOIA 2005) to prevent the future use of schemes by the self-employed designed to reduce profits chargeable to income tax. These new provisions for the self-employed will have effect from 6 April 2017 and they introduce similar rules for the self-employed as apply to employees. A loan charge will also be imposed on the self-employed in relation to disguised remuneration loans and this will apply in a similar way as for employees.

Additionally, an employer will be prevented from deducting a contribution into an employee benefit trust (EBT) when computing their taxable profits, unless any associated PAYE/NIC is paid within 12 months of the end of the relevant accounting period (or 12 months of the end of the relevant basis period in the case of a non-corporate employer).

In commenting on the draft legislation the CIOT concentrated on areas where we believe the government’s proposed approach and drafting of the legislation raises wider issues or could result in collateral damage, for example where the legislation could be applied to circumstances where no tax avoidance is intended.

We think that the proposed close company gateway, which is aimed at ensuring that Part 7A applies to individuals with a material interest in a company, is too widely drawn and that this will result in transactions inadvertently being caught where there is no connection with an employment or directorship. For example, a close company (B) was formerly owned by an individual (A) many years ago, when A was a non-UK director, but which he transferred to a family trust (P). P now wishes to purchase a UK property for A, for example following his recent relocation to the UK, and borrows funds interest free from B to do so. There would seem to

be a ‘relevant transaction’, the provision of a benefit to A, and a relevant step by P, but the purchase has nothing to do with A’s former directorship of B.

Also, although certain transaction are excluded by section 554AC (but not if there is a connection with a tax avoidance arrangement), we believe that the definition of ‘excluded transaction’ is unduly restrictive. For example, a director (X) sells his close company (Y) to another individual (S) on terms of £1,000 now and £800 in 6 months’ time. To fund the £800 S borrows it from Y interest free. It would seem that the close company gateway is activated as there is a ‘relevant arrangement’ (X selling Y to S with a resulting payment to X), a ‘relevant transaction’ (the interest free loan from Y to S would seem to fail the test for the exclusion for arm’s length transactions) and a ‘relevant step’ (the subsequent payment of the £800 by S to X).

We therefore suggest an alternative and simpler approach to the proposed rules that are to apply to close companies. This would be to introduce a rebuttable presumption that the rewards, payments or loans are in connection with employment. If this approach were adopted it would then be for the individual concerned to demonstrate that this is not the case by setting out their evidence to this effect.

We welcome the retrospective changes to Part 7A designed to prevent double taxation but suggest that the exclusion for payments to HMRC made by trustees in respect of a tax liability should also be retrospective. Another welcome change to the original proposals that has been made is to exclude loans relating to unlisted employer shares (see paragraph 28 of Schedule 10). This is something that the CIOT requested.

Part 2 of Schedule 10 introduces a new charge on disguised remuneration loans outstanding on 5 April 2019. In effect, these rules will re-characterise such loans as remuneration for tax purposes, often many years after the transaction occurred. We are particularly concerned that this could mean that employers will face a dry tax charge to be met out of its own funds on loans outstanding at 5 April 2019. This is because the charge is to be collected through PAYE but employers may not be able to recoup the PAYE and employee’s NICs from the employee (or, in many cases, former employee). We are also concerned that there does not appear to be any penalty or transfer of liability where the third party provider or individual fails to provide the employer with the relevant information to determine the loan charge.

As regards the proposed new rules for the self-employed, which effectively aim to introduce similar rules as apply to employees, we suggest that the legislation should include provisions to ensure that commercial, arms’ length transactions that have no tax avoidance motive are excluded. Furthermore, we recommend introducing relieving provisions to deal with double taxation where an amount that falls to be taxed as disguised remuneration is already chargeable as income of a self-employed individual.

Finally, we believe that the denial of a deduction to an employer for an employee benefit contribution should not apply where there was no avoidance motive. For example, where an employer has simply misunderstood the rules and made a mistake (for example a share award with an 11 year vesting date instead of 10 years) rather than trying to avoid tax.

The CIOT’s submission can be found on the CIOT website.