

## TAXREP 13/05

### EMPLOYEE SECURITIES: ANTI-AVOIDANCE

*Memorandum submitted in March 2005 by the Tax Faculty of the Institute of Chartered Accountants in England and Wales in response to an invitation to comment issued in February 2005 by the Revenue*

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# Tax Representation

## EMPLOYEE SECURITIES: ANTI-AVOIDANCE

### INTRODUCTION

1. We welcome the opportunity to comment on the draft legislation to amend Part 7, Income Tax (Earnings and Pensions) Act 2003 ('ITEPA') with explanatory notes published on 3 February and on the Revenue's website at <http://www.inlandrevenue.gov.uk/pbr2004/draft-schedule.pdf> (draft legislation) and <http://www.inlandrevenue.gov.uk/pbr2004/en-clause204.pdf> (explanatory notes).

### KEY POINT SUMMARY

2. The legislative provisions here are very wide. We anticipate that the Revenue will attempt to limit the scope of the law in order not to frustrate the underlying existing objective that employers should be able to incentivise employees by offering them shares in their (employer) company. Applying the law by reference to guidance is an example of taxing by law but untaxing by concession. As noted in our letter dated 10 February to the Paymaster General (TAXREP 8/05), we consider that tax law needs *inter alia* to be certain. The proposals as they stand are not certain and do not comply with the Tax Faculty's Ten Tenets for a Better Tax System (reproduced in the Annex). In this case, the risks for employers and employees of being considered to be the wrong side of the avoidance line are so great as to make it likely that commercial incentive arrangements of the type that it is government policy to encourage will not be entered into.

### WHO WE ARE

3. The Institute of Chartered Accountants in England and Wales ('ICAEW') is the largest accountancy body in Europe, with more than 128,000 members. Three thousand new members qualify each year. The prestigious qualifications offered by the Institute are recognised around the world and allow members to call themselves Chartered Accountants and to use the designatory letters ACA or FCA.
4. The Institute operates under a Royal Charter, working in the public interest. It is regulated by the Department of Trade and Industry through the Accountancy Foundation. Its primary objectives are to educate and train Chartered Accountants, to maintain high standards for professional conduct among members, to provide services to its members and students, and to advance the theory and practice of accountancy, including taxation.
5. The Tax Faculty is the focus for tax within the Institute. It is responsible for tax representations on behalf of the Institute as a whole and it also provides various tax services including the monthly newsletter 'TAXline' to more than 11,000 members of the ICAEW who pay an additional subscription.

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## GENERAL COMMENTS

6. We are concerned that this legislation goes further than is necessary to curb the avoidance at which it is apparently targeted. It creates uncertainty for companies and will distort commercial practice by preventing them from introducing share incentive arrangements that do not involve that avoidance.
7. Many of the provisions create new income tax charges where the avoidance of tax or national insurance contributions is one of the main purposes of the arrangements in question. We are concerned that this is a highly subjective test and employers will not be prepared to rely on published guidance and concessions by the Inland Revenue.
8. For example, an employer may establish a restricted share scheme involving forfeitable shares. His aim would be to allow employees to choose between paying income tax on the unrestricted value of the award at the outset and then enjoying capital gains tax treatment for future growth (in effect, normally subject to taper relief which reduces the effective rate of tax to 10%), or, if the employee prefers, paying no income tax at the outset but suffering a charge on the market value of the shares on the date when the risk of forfeiture lifts.
9. No employer is likely to establish a forfeitable share scheme without regard to the tax treatment and the choice open to employees. We do not see by reference to the draft legislation how it can be argued that one of the main purposes of this scheme is not to enable the employee to avoid either the income tax charge at the date of the award or the income tax charge when the risk of forfeiture lifts. Accordingly, the employee must be deemed to make the election in all cases and all of the legislation dealing with later chargeable events is otiose.
10. We expect that the Revenue intends that guidance will be published to indicate that the legislation will not be applied in that way, and that provided an income tax charge arises on one or other of the relevant occasions in the circumstances described above, the new provisions will not apply. This is not good enough. If the law does not clearly remove the charge in the above circumstances we do not accept that taxpayers should have to rely on a concession by the Revenue to avoid it.
11. We are also aware of the Revenue's view of the meaning of the 'main benefit' test in the tax avoidance disclosure guidance. We assume that similar principles will apply here but in view of the importance of this matter more detailed provisions are needed to make the boundaries clear. In any event, we do not accept that it is sufficient to leave the relief from these new tax charges to be dealt with in published guidance only. The tax avoidance disclosure regulations involve a maximum penalty of £5,000. Here we are dealing with a potential liability of PAYE at up to 40%, employer NIC at 12.8%, employee NIC of up to 11%, a section 222 ITEPA charge of another 40% on the tax, a class 1A NIC charge and interest and penalties on top of that. In some circumstances, such as where the company in question is a subsidiary, the employer would also be denied a corporation tax deduction under Schedule 23 Finance Act 2003 by virtue of paragraph 4(3) Schedule 23. In other words, if the

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employer makes an incorrect judgement on the main purpose, the main benefit of the arrangement goes to the Revenue.

## DETAILED COMMENTS

12. We have the following further comments on specific provisions.
13. We do not accept that it is reasonable for redeemable securities to be brought into the restricted securities regime with retrospective effect.
14. The new tax charges imposed by section 446UA will result in double taxation. First, there appears to be no allowance of the amount of this charge in the base cost for capital gains tax. Secondly, once the tax has been paid, the employee may 'make good' the amount of the notional loan, for example by paying up the outstanding part of the subscription price of the shares, but will obtain no credit for the tax paid (s.446U and s.446UA).
15. The extension of the scope of section 447 is unreasonable. Where a sole trader incorporates his business and thus receives "employment related securities", and subsequently decides to pay a dividend on those shares in order to avoid a national insurance charge, he may be taxed both under s.447 and under the dividend rules.

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### THE TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM

The tax system should be:

1. **Statutory:** tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.
2. **Certain:** in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.
3. **Simple:** the tax rules should aim to be simple, understandable and clear in their objectives.
4. **Easy to collect and to calculate:** a person's tax liability should be easy to calculate and straightforward and cheap to collect.
5. **Properly targeted:** when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.
6. **Constant:** Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.
7. **Subject to proper consultation:** other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.
8. **Regularly reviewed:** the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.
9. **Fair and reasonable:** the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.
10. **Competitive:** tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

These are explained in more detail in our discussion document published in October 1999 as TAXGUIDE 4/99; see [http://www.icaew.co.uk/taxfac/index.cfm?AUB=TB2I\\_43160,MNXI\\_43160](http://www.icaew.co.uk/taxfac/index.cfm?AUB=TB2I_43160,MNXI_43160).