



DISGUISED REMUNERATION

Text of comments submitted on 2 September 2011 by ICAEW Tax Faculty in response to HM Revenue & Customs document **Finance Act 2011 - Disguised remuneration legislation - draft guidance** published on 18 August 2011

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DISGUISED REMUNERATION

INTRODUCTION

1. Reproduced below is the text of ICAEW's comments on the document Finance Act 2011 - Disguised remuneration legislation - draft guidance published on 18 August 2011 by HM Revenue & Customs at <http://www.hmrc.gov.uk/budget-updates/march2011/disguised-remuneration.pdf>
2. Information about the Tax Faculty and ICAEW is given below. We have also set out, in Appendix 1, the Tax Faculty's Ten Tenets for a Better Tax System by which we benchmark proposals to change the tax system.

WHO WE ARE

3. ICAEW is a world-leading professional accountancy body. We operate under a Royal Charter which obliges us to work in the public interest. ICAEW's regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the UK Financial Reporting Council. We provide leadership and practical support to over 136,000 member chartered accountants in more than 160 countries, working with governments, regulators and industry in order to ensure that the highest standards are maintained.
4. ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value.
5. The Tax Faculty is the voice of tax within ICAEW and is a leading authority on taxation. Internationally recognised as a source of expertise, the faculty is responsible for submissions to tax authorities on behalf of ICAEW as a whole. It also provides a range of tax services, including TAXline, a monthly journal sent to more than 8,000 members, a weekly newswire and a referral scheme.

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TEXT OF SUBMISSION

1. [We] appreciate that you have asked for "urgent feedback" and [we] shall confine what follows to the points that appear to [us] to be the most important.
2. S.554Z6(3)(c) recognises that there is the potential for an overlap between Part 7A and the IR35 legislation. This section is dealt with in Temp 97. Where an individual's services are supplied through a service company and his relationship with the end user would have been an employment if the contractual relationship had been direct, the service company is deemed to make a payment of earnings for PAYE purposes at the end of the tax year (the "deemed employment payment" referred to in s.554Z6(3)(b)). Because the payer will inevitably be a relevant third person, and because the payment will invariably be "in essence" recognition or reward for the individual's services in the employment, and because the payment will be made to a "linked person" within s.554Z1(1)(b), the payment made by the end user to the service company will be caught by s.554C. Hence the need to allow for a deduction from it for the deemed employment payment. There are two problems on which guidance should be given:-
 - a. The "step" is taken when the client pays the service company but the deemed employment payment will not normally be quantifiable at that time since it results from a formula involving factors that may not be finalised until the end of the year. The guidance should explain what work if any HMRC expect service companies in these circumstances to

perform at the time of receipt of the payment in computing or estimating the deductible deemed employment payment.

- b. There will be many similar cases where services are supplied through a service company but IR35 does not apply (because the relationship under the hypothetical direct contract would not be an employment). Mr A, trading through A Ltd, simply hires out his services as a consultant to client companies and is not caught by IR35. All of the necessary ingredients for a charge under Part 7A appear to be in place (as above), and there is no scope to deduct any “deemed employment” payment. The guidance should state whether HMRC intend that the general position in these cases will be that Part 7A will apply and PAYE/NIC must be paid at the time of receipt by the service company of its fee.
3. The guidance on EFRBS at Temp31 should make clear that on the facts described in the final sentence (the assets and liabilities of a final salary scheme are genuinely separate and pooled), that nothing in the “undertaking” (s.554Z16) given by the employer, nor in the “earmarking” by the employer of a sum to be contributed to the scheme (s.554Z18(1)(a)), nor in the “starting to hold” an amount to be so contributed (s.554Z18(1)(b)), will amount to a “step” for Part 7A purposes. This is because all of these simply identify the amount of a contribution which will or may be made into a plan and which, if it is in fact made, will immediately thereupon lose its connection with the employee in question and it is therefore not possible to say that any benefit will be paid to him “out of” that contribution per se. [HMRC] confirmed to [us] by telephone last week that this is HMRC’s conclusion on the point.
4. If the trustees of an employee benefit trust receive a request from the employing company to make an award of restricted shares to a named employee out of a hitherto unallocated shareholding of the trustees, the trustees meet to consider the request, they agree to the request and immediately complete the documentation to make the award and transfer the shares, will HMRC consider that they have first “earmarked” the shares (bringing Part 7A and its conditional exclusions into play), and in the same instant performed a second relevant act, namely making the award (taxed under Part 7 rules), or will it be accepted that there is no “earmarking” or “starting to hold” in these circumstances, but an event dealt with by Part 7 only? At various stages your policy colleagues appear to have given different answers on this point and a conclusion is needed. The point is important because there are circumstances where the Part 7A charge can and will in practice impose a liability where none would otherwise arise (for example because one of the many conditions for exclusion are not satisfied).
5. The same point arises in relation to employer contributions to EFRBS. S.554Z18 imposes tax on an earmarking by the employer “with a view to the relevant undertaking being performed at a later time”. Temp 27 simply relays this rule but gives no indication of what is meant by “a later time”? If the earmarking and payment are made at the same time does the charge not apply and if that is the case, where is the borderline to be drawn in practice? In the previous draft of the legislation it was explicit that the payment was not caught if the contribution was made immediately. The new wording simply introduces doubt which should be resolved in the guidance.
6. Can the “starting to hold” guidance in Temp16 be expanded to cover two questions:
 - a. Will HMRC take the view that the trustees of a trust will “start to hold” shares and thus take a “step” if shares are earmarked by the employer but the employer does not communicate information concerning the earmarking to the trustees?
 - b. Given the example provided, it would be helpful to explain what position HMRC would take if there were initially a number of potential beneficiaries of an employee benefit trust, but they left and ceased to qualify at different times and the departure of the penultimate employee would apparently, following the logic of the example given, trigger a Part 7A charge on the entire fund on the final employee.

7. In Temp52, you explain that Part 7A will not apply where various exemptions in Part 7 apply but the list (taken from s.554N) does not include the exemption for shares transferred in the course of family and personal relationships (s.421B(3)). The implication is that shares transferred in the normal course of family relationships can be caught by Part 7A, and doubt will now arise given that Part 7A can apply where an award is “wholly or partly” recognition or reward. Can you expand the guidance to say what circumstances will and will not be caught by Part 7A when this part 7 exemption applies (and I suggest cross reference that to your existing guidance on the personal relationship exemption in <http://www.hmrc.gov.uk/manuals/ersmmanual/ERSM20220.htm>)
8. In Temp104 you should explain the practical consequences for the employer. The remittance basis rules generally impose considerable complexity on the individual concerned, but apart from Part 7A impose relatively little burden on the employer (in operating PAYE an employer is not required to know any detail of any employee’s personal remittances to the UK). Under Part 7A, anything that amounts to a remittance of Part 7A income must be subjected to PAYE and NIC at the time of the remittance (with in-year penalties, s.222 charges, etc to penalise non-compliance). This places a new burden on the employer to recognise not only any “step” that might be caught by Part 7A but also any subsequent action taken by any person (such as a friend of the employee bringing a gifted asset into the UK), which might amount to the deemed remittance of that deemed income, and to establish the employee’s cumulative record of remittances from the source in question measured against funds which may be remitted tax free, and to determine the order of priority of remittances where Part 7A taxable amounts and others may be remitted from the same source (on which both the legislation and your guidance appear to be silent). These obligations should be spelled out with greater clarity.
9. S.554A(11) recognises that there may be one arrangement which is not itself a “relevant arrangement”, for example a General Meeting of shareholders, in which a step might be taken, for example voting in favour of a new employee share plan and making initial awards under it to named individuals, which then leads to the establishment of an employee share plan (an arrangement at the other end of a series of arrangements) which is itself a “relevant arrangement” and there is then a “connection” which causes the shareholder’s vote in favour of the plan to be treated as a “step” on which tax is chargeable. Could Temp 8 be expanded to indicate whether HMRC would agree with this example and if not, explain and give examples which illustrate the relevant differences.
10. The guidance remains very unclear on the scope of “reward or recognition” and in particular, in relation to matters dealt with by means of the employment income exemptions in ITEPA. Temp 23 in particular is misleading in failing to give any indication that Part 7A has introduced new charging provisions that can override the existing legislation. If an employee is taken to lunch at a restaurant of his choice by a customer because he has provided a good service the payment by the customer to the restaurant prima facie falls within s.554C. The exemption from income tax in s.265 ITEPA is an “earnings only exemption” (see s.228 ibid) and therefore is not deductible from the s.554C charge (see s.554P). The guidance should be expanded to explain whether HMRC expects employers to apply PAYE/NIC to the costs in these circumstances. Similar considerations apply to many of the other “earnings only” exemptions in Part 4 of ITEPA which may in some circumstances involve elements which are “wholly or partly” “recognition or reward”.
11. Similar considerations also arise in relation to expenses deductions in Part 5 of ITEPA. These remove liability under Part 2 but not under Part 7A but Temp23 ignores the point. If an employee who has performed well is given a prestigious new assignment that involves travelling to serve a customer in an attractive foreign location, his expense claims would be allowable under Part 5 but since they partly represent “recognition or reward” their reimbursement creates a charge under Part 7A. Temp23 draws an extremely simplistic distinction between “normal business expenses” on the one hand and “private expenses” on the other. By remaining silent on the new scope for argument over “reward and recognition”

HMRC needlessly creating doubt over a very wide range of every day transactions. If the policy decision is that exemptions and deductions in Parts 4 and 5 will be applied in practice to Part 7A, the guidance should say so. If it is not, the guidance should expressly say so and tell employers what they should do.

12. It appears that if a transfer of funds is made from an unapproved pension scheme to another and the originating scheme is not of the tax relieved variety dealt with in s.554X, a Part 7A charge will normally arise without any transitional saving for rights accrued before 6 April 2011. Thus very disproportionate tax charges may arise on such a transfer of funds where a lump sum payment would not be caught. If this is correct [we] suggest Temp 89 should make the point clear.

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APPENDIX 1

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.com/~media/Files/Technical/Tax/Tax%20news/TaxGuides/taxguide_towards-a-better-tax-system.ashx)