



## FINANCE BILL 2011

### CLAUSE 26 AND SCHEDULE 2, EMPLOYMENT INCOME PROVIDED THROUGH THIRD PARTIES (ALSO KNOWN AS THE DISGUISED REMUNERATION RULES)

Parliamentary briefing submitted at Public Bill Committee stage on 12 May 2011 by ICAEW Tax Faculty setting out concerns with the 'disguised employment' provisions published in the Finance Bill 2011

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### CLAUSE 26 AND SCHEDULE 2, EMPLOYMENT INCOME PROVIDED THROUGH THIRD PARTIES (ALSO KNOWN AS THE DISGUISED REMUNERATION RULES)

#### Introduction

1. We understand fully the policy purpose behind these measures, namely to prevent abuse of Employee Benefit Trusts (EBT) and Employer Funded Retirement Benefit Schemes (EFRBS).
2. Clause 26 and Schedule 2 insert a new Part 7A into the Income Tax (Earnings and Pensions) Act 2003 (ITEPA). The new rules create income tax charges where:
  - loans or assets are made to employees by way of a third party;
  - payments of money or transfers of assets are made to employees by a third party not otherwise charged to tax as earnings from the employment; and
  - money or assets are earmarked for the employee by a third party (and in some cases by the employer).
3. The rules are intended to apply from 6 April 2011 but the schedule also includes some anti-forestalling rules so that certain transactions occurring on or after 9 December 2010 (the date on which the original draft schedule was published) but before 6 April 2011 will be taxed on 6 April 2012.
4. The provisions are designed to catch the following sort of situation. An employer sets up an EBT for the benefit of employees. It transfers money to the EBT. The EBT makes payments to the employees which are treated as non-interest bearing loans. However, there is no intention that the loan will ever be repaid. The effect is that the employees have received what is in substance remuneration (disguised remuneration) by way of a third party which is not subject to income tax or national insurance.

#### Problems with these rules

5. It is entirely right that the Government should seek to counter tax avoidance of the type set out above. However, given the other Government statements on the principles that should underlie tax policy (and which support the ten principles of good tax policy that we identified in 1999), we believe anti avoidance legislation needs to pass the following tests – it should be:
  - properly targeted
  - simple to understand and operate
  - not damage the UK's competitiveness; and
  - support the growth agenda.
6. We recognise that in bringing forward anti avoidance legislation there will be some tension between the above principles and that some compromises will inevitably be needed so as to address the identified avoidance.

#### *Properly targeted*

7. Taking the first of these principles, the legislation is not properly targeted. The approach adopted is to start with a 'catch all' provision and then take out by way of 'exclusions' specific transactions where there is no tax avoidance element. The result is that transactions not covered by one of the exclusions where there was no intention of avoiding tax will still be caught, with potentially draconian tax charges arising that may far exceed any actual benefit.

8. Typical examples of the likely problems are:
  - a) Where employers provide employees with free fuel, an income tax charge (the car fuel scale charge) arises under s 149 ITEPA. It appears that another income tax charge under PAYE will arise on the cost of the fuel under the disguised remuneration provisions. The analysis is as follows. A company car driver fills up his tank at a filling station using a fuel card. The fuel card company is a third person, who makes a payment to someone chosen by the employee (the filling station) and who is therefore 'linked' with him. The exemption in s 239 ITEPA should cover this but it is an 'earnings-only' exemption, whereas s 554O gives relief from these provisions only in respect of 'employment income exemptions' and not 'earnings only' exemptions.
  - b) The employer can still be a 'third person' if he acts as a trustee (see s 554A(7)). This is not qualified in any way so an employer that is a trust (something which is common in the charitable and voluntary sector) and which gives an employee a season ticket loan would be caught and the loan subject to tax when advanced even though it will be repaid.
9. We are concerned particularly that tax charges will arise because employers do not realise that 'innocent' arrangements with employees not designed to avoid tax will still be caught by these rules. Unless they realise there is a potential problem and take advice beforehand, employers and employee will be walking into an unexpected trap.
10. We do not think that this is the right approach and we believe that the provisions need to be focussed on transactions where it is clear there is a tax avoidance element. This is one example which we think would benefit from a targeted anti-avoidance provision.

*Simple to understand and operate*

11. Draft clauses were published for comment on 9 December 2010. At that stage, the draft clauses were only 20 pages long. Although we appreciate that HMRC have listened to the concerns raised and made extensive changes to the draft clauses, the fact remains that the legislation in the original Bill has grown to 59 pages. We submitted comments on the earlier draft clauses but the extensive changes made in this latest draft make it difficult to compare with the previous draft.
12. On 10 May 2011 the Government tabled 15 pages of amendments to the Finance Bill provisions. These were published the following day and we have not had time to review them in detail, but our initial reading is that although they make various improvements they will add significantly to the length and complexity of the Finance Bill legislation. While we welcome the fact that HMRC has continued to listen to the many concerns raised, these further extensive amendments confirm that the approach that has been adopted is fundamentally flawed. We doubt these latest amendments will be the end of the changes, and believe that further amendments will be required as further problems emerge. We appreciate that power is given under s 554X to make further exclusions by way of statutory instrument but this is a wholly unsatisfactory way of drafting tax legislation.
13. Further, we have yet to see the promised NIC rules to counter avoidance of NIC on disguised remuneration. If the income tax legislation is anything to go by, the NIC rules will be equally lengthy and complicated.

*Not damage the UK's competitiveness*

14. The UK needs to have a competitive tax system and one element of this is that the rules do not hinder foreign investment and the secondment of overseas staff to the UK. The perception is that the UK is a difficult place to do business and the Chancellor has been at great pains to stress that the UK is 'open for business'. These rules cut across completely the Chancellor's statement and make the secondment of overseas nationals to the UK much

more difficult and expensive than before, if only because exhaustive analysis of employee benefit packages will be needed in order to ensure that these rules do not apply.

*Support the growth agenda*

15. The HM Treasury/BIS published their *Plan for Growth* report on Budget Day, 23 March 2011. This document sets out the Government's ambitions and measurable benchmarks. The first ambition is to have the most competitive tax system in the G20 and the third benchmark of realising that ambition is that the UK should have:

*A simpler, more certain tax system*

16. These highly complicated rules are difficult to understand, highly uncertain in their operation, likely to be very expensive to operate and practically very difficult for HMRC to administer. Further, many employers may find themselves caught by the rules due to ignorance. We believe that this measure therefore fails to meet the Government's own growth agenda benchmark and is likely to hamper rather than support growth.

*Summary*

17. These provisions are highly complicated to understand, will create considerable uncertainty and compliance problems and are likely to damage the UK's competitiveness and growth agendas.

**ICAEW recommendations**

18. We are concerned that these rules are fundamentally flawed and need to be reviewed as a matter of urgency.
19. Our recommendation would be to remove these provisions from the Bill and introduce specifically targeted legislation this year to counter known avoidance schemes and work up a longer term solution that better meets the tests we have set out above.
20. Failing this, the provisions should be recast and simplified to make it clear that they are targeted at transactions where there is a tax avoidance motive and that the tax charge should only be based on the amount of any net benefit received by the employee.
21. We are happy to contribute to this work and help to ensure that any measures meet the Government's policy objectives of tackling the identified avoidance. We would also be happy to provide a more detailed briefing on specific problem areas that members have identified with these provisions.

**Further information**

22. Please contact ICAEW if you require any further information.

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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.com/~media/Files/Technical/Tax/Tax%20news/TaxGuides/taxguide-4-99-towards-a-better-tax-system.ashx> ).