TAXREP 55/11

DISGUISED REMUNERATION – NATIONAL INSURANCE CONTRIBUTIONS

Text of memorandum submitted on 23 September 2011 by ICAEW Tax Faculty in response to the invitation from HM Revenue & Customs to comment on draft National Insurance Contributions regulations published on 25 August 2011

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DISGUISED REMUNERATION

INTRODUCTION

1. Reproduced below is the text of the ICAEW Tax Faculty's comments on draft National Insurance Contributions regulations on which HM Revenue & Customs invited comments on 25 August 2011 at http://www.hmrc.gov.uk/budget-updates/march2011/disguised-remuneration-regs.htm

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 believe that the decision to impose Class 1 NIC on amounts which are taxed on the remittance basis (ss 554Z9 and 554Z10 [ITEPA 2003]) is wrong.

    a. In drafting the tax legislation, it was clearly recognised that while income tax should be charged under these sections on amounts remitted to the UK which arose from "steps" within Part 7A, it was not necessary to impose the further burden on employers of ensuring that PAYE was deducted on those remitted amounts (s.695A(2)(b)). The obvious policy rationale for that decision was that it is plainly unreasonable to expect an employer to obtain all of the necessary information from the employee (and other parties) to identify the amount liable at the time of remittance, given the complexity of both the statutory definition of remittance and the identification rules where remittances are made from mixed funds, etc. Indeed, it is in principle not possible to calculate the amount in question where the funds are held in a "SP1/09" bank account and the taxable amount is capable of being calculated only after the end of the tax year. It would be perverse to provide that while this burden on the employer is not required for PAYE purposes, such an impossible burden is appropriate for NIC purposes.

    b. It is particularly perverse to create this new conflict between PAYE and NIC treatment at a time when the government is conducting a further and separate consultation (launched on

11 July 2011 [and to which we responded on 19 September in TAXREP 55/11]) to integrate the operation of income tax and NIC.

c. Given that Part 7A is not confined to tax avoidance arrangements but equally catches wholly innocent commercial transactions, this measure will compound the complexity and disproportionate burdens on business.

d. The recent imposition of in-year penalties on late paid PAYE and NIC compounds the injustice of this charge.

e. At the very least we suggest that scope for abuse could be more than adequately catered for by making this charge a Class 1A charge instead.

2. Similarly, we believe the decision not to replicate the effect of s.554Z14 is wrong. If tax is imposed on an "earmarking" charge in circumstances where the arrangements involve no tax avoidance motive, and the employer and employee take steps to "un-earmark" the sum or asset in question, the legislation clearly acknowledges that it is unfair for the tax charge to remain, and a refund may be given.

3. We see no policy reason why the corresponding NIC charge should not similarly be refunded. Clearly, in all but the most exceptional circumstances, where s.554Z14 applies, the Class 1 NIC will in effect have been paid (or payable) in error, ie by reason of the failure of the parties to recognise that their actions gave rise to a liability to NIC. Currently, NIC paid in error may be refunded (SI 2001/1004 Regulation 52) and there appears to be no justification for denying the extension of that treatment to S554Z14 cases.

4. There will be cases where steps are taken by third parties which are beyond the control of the employer, may not be in the interests of the employer and of which the employer may not necessarily have any knowledge. A potential acquirer of a company might confidentially approach selected members of its senior management and in emails, draft heads of terms, etc, earmark potentially large sums as being for their benefit if a sale goes ahead, etc. The earmarking triggers PAYE and NIC charges that must be paid by the employer even though the shareholders of the company may reject the proposal upon being informed of it. The NIC charge arising in these circumstances may be substantial and in principle could cause the company to fail. There is even scope for these provisions to be used maliciously as a technique for companies to damage their competitors. This would of course bring the tax system into disrepute. Since the NIC charge falls on the employer and can arise from the actions of others over which he has no control we suggest there should be a further, free standing, NIC relief which does not depend on an "un-earmarking" by the third party, but rather an acceptance by HMRC that the charge would be unreasonable.

5. We suggest consideration be given to express replication of s.554Y (and in particular subsection (4)) ITEPA 2003 for NIC purposes.

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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/taxguid towards-a-better-tax-system.ashx).