TAXREP 14/02

TAX LAW REWRITE: SCHEDULE E INCOME

Memorandum submitted in April 2002 by the Tax Faculty of the Institute of Chartered Accountants in England and Wales in response to draft legislation issued in April 2002 by the Revenue

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TAX LAW REWRITE: SCHEDULE E EMPLOYMENT INCOME

INTRODUCTION

1. We welcome the opportunity to comment on the draft legislation, consisting of minor changes to the Schedule E legislation to be included in Finance Bill 2002 in order to facilitate the first income tax rewrite Bill, and explanatory notes posted to the Revenue website on 4 April 2002.

SCHEDULE 1: MINOR AMENDMENTS TO SCHEDULE E CHARGE [j350s] (reproduced in Annex A)

Paragraph 1

2. We suggested in the response to Q84 in ED12 that the gain on grant of a long-term share option (capable of being exercised more than 10 years after its grant) should, as a policy matter, be deducted from the gain on exercise. In accordance with that suggestion, we can regard the change as acceptable. It is certainly more logical, by splitting the total gain between the grant and exercise stages, assuming that the overall gain is greater than that on grant of the option, and applying the prevailing rates of tax at the grant and exercise dates. The existing set-off of tax on the grant against tax on the overall gain on exercise, which currently includes the 'first slice' of gain on the grant, gives an arbitrary tax result if the tax liability on the 'first slice' at the exercise date differs from the amount of tax arising on the grant (this may arise because of a change in tax rates or the taxpayer's circumstances).

3. However, there are some consequences of the suggested amendment. In principle, as drafted, the proposed deduction could evidently give rise to a loss, where the value of the option on exercise was lower than its value on grant, and it is not clear whether this is intended (we understand that there is currently no relief for any overall overpayment of tax in such circumstances under s 135 ICTA). In accordance with the new approach, we would have thought it was appropriate to recognise such an earnings 'loss', as the taxpayer will otherwise be charged on more than the amount of the actual gain. The question then arises of in which year the 'loss' should be recognised. We would have thought that it would more fairly be recognised by reducing the gain originally taxed on grant but recognise that this may be impractical in a self-assessment context. If the 'loss' was instead relieved in the year of exercise, the existing tax payable distortion could recur, if tax rates or the taxpayer's circumstances had changed between grant and exercise.

4. We would also welcome clarification of what is intended if the taxpayer doesn't exercise his option, for example because it becomes valueless. The amended section as drafted affords no relief in that situation.

Paragraph 2

5. The change proposed by paragraph 2 is not beneficial to the taxpayer, but it is logical, and ensures that the law achieves its intention of taxing the benefit on the employee, where a credit token is provided to a relation and is used by the relative but not by the

employee himself. Section 144(4)(b) ICTA does envisage credit-tokens being provided to the employee's relatives 'for the purposes of s 142', so it is appropriate to accept this change to the effect of s 142(1) ICTA as reflecting the intention of the legislation.

Paragraph 3

6. Paragraph 3 is a consequential amendment to ss 157, 159AA and 159AC ICTA. The latter section is incorrectly described as 'section 159C' in paragraph 3(c); and in paragraph 2 there is a typographical error in new (4A)(a) in that the word 'used' should be 'use').

Paragraph 4

7. Paragraph 4 is beneficial to the taxpayer. It is of course reasonable to treat these benefits the same way for a continuing unchanged employment and one which changes or comes to an end.

Paragraph 5

8. The change in paragraph 5 to s 144A(1) ICTA (payments etc received free of tax) evidently recognises a need to classify unreimbursed tax met by the employer as emoluments, to apply s 167(1)(b) ICTA.

9. We would draw attention to the fact that if s 144A charges become emoluments, then this will prima facie make them liable to Class 1A NIC; we consider that if this amendment is proceeded with, an accompanying NIC exemption should be introduced.

Paragraph 6

10. Paragraph 6 seeks to give s 595 ICTA priority over s 148 ICTA, where sums paid after an employment ends could potentially be charged under both. The Revenue proposal is that the proposed paragraph 6 amendment should be made on the basis that s 595 is a more specific charge than s 148. We note that this seems to be becoming a Revenue argument, and it is not convincing. A main consequence to taxpayers, of course, is that a first £30,000 'slice' exemption applies for s 148, but not for s 595.

11. The Revenue earlier attempted to achieve this in clause 4.22.1(3) of ED11 (Payments into non-approved retirement benefit schemes treated as employment income). In our ED11 response we pointed out that, whilst a charge under s 595 ICTA might be in accordance with Revenue practice, this has not been tested in the courts and that where the payment to a non-approved pension scheme is made in connection with either a significant change in the terms or conditions of an employment or, particularly, with its termination, then there is a case for s 148 ICTA to take priority. We added that, if the Revenue practice is correct, s 595 appears to be the only provision which can catch the same payment as s 148 where the s 148 charge does not take precedence; and that it was difficult to see any logical reason for this. We

reiterate our view that s 148 ICTA should be given priority in circumstances where it is also applicable, thereby allowing the taxpayer access to the £30,000 exemption.

CLAUSE 1: EMPLOYEE SHARE OWNERSHIP PLANS: MINOR AMENDMENTS [j350a] (reproduced in Annex B)

Amendments to Schedule 8 FA 2000 to 'correct minor defects in the way the legislation was drafted and ensure that the provisions work as intended'

12. We have reviewed the proposed minor 'share incentive plans ('SIP') amendments to be included in the forthcoming Finance Bill and have no comments save to point out that in sub-clause (2), first line, the word 'to' is missing before 'plan' in the description of paragraph 94.

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ANNEX A

SCHEDULE 1: MINOR AMENDMENTS TO SCHEDULE E CHARGE [j350s]

Share options

1 In section 135 of the Taxes Act 1988 (gains by directors and employees from share options), for subsection (5)(a) substitute-
"(a) the amount so charged shall be deducted from any amount which is chargeable under subsection (1) above by reference to the gain realised by the exercise, assignment or release of that right; and".

Credit-tokens and non-cash vouchers

2 In section 144 of the Taxes Act 1988 (supplementary provisions relating to vouchers and credit-tokens), after subsection (4) insert-
"(4A) Section 142(1) has effect as if-
(a) use of a credit-token by a relation of an employee were used of the token by the employee, and
(b) money, goods or services obtained by a relation of an employee by use of a credit-token were money, goods or services obtained by the employee by the employee's use of the token."

3 In each of the following provisions of the Taxes Act 1988-
(a) section 157 (cars available for private use),
(b) section 159AA (vans available for private use),
(c) section 159C (heavier commercial vehicles available for private use),
in subsection (3)(b) after "him" insert "or a relation of his (within the meaning of section 144)".

Benefits in connection with termination of employment or change in duties or emoluments

4. In section 148 of the Taxes Act 1988 (payments and other benefits in connection with termination of employment, etc), for subsection (2) substitute-
"(2) For the purposes of this section "benefit" includes anything which, disregarding any exemption-
(a) would be an emolument of the employment, or
(b) would be chargeable to tax as an emolument of the employment,
if received for the performance of the duties of the employment.
(2A) But subsection (1) does not apply-
(a) to any payment or other benefit received in connection with any change in the duties or, or emoluments from, a person's employment to the extent that it is a benefit which, if received for the performance of the duties of the employment, would fall within paragraph 1(1) of Schedule 11A, or
(b) to any payment or other benefit received in connection with the termination of a person's employment-
(i) that is a benefit which, if received for the performance of the duties of the employment, would fall within section 155(1) or (5), 155AA, 156A, 157(3), 159AA(3), 159AC(3), 200B(2)(b), 200E(2)(b), 588(1), 589A or 643(1), or
(ii) to the extent that it is a benefit which, if so received, would not be included in the emoluments of that person by virtue of section 200D(1)."

Taxation of benefit where income received free of tax

5 In section 144A(1) (payments etc received free of tax), for the words from "income of the employee" to the end substitute "emoluments of the employment and charged to income tax under Schedule E for the tax year in which the date mentioned in paragraph (c) above falls".

Priority between charges under sections 148 and 595 of the Taxes Act 1988

6 In section 595 of the Taxes Act 1988 (charge to tax in respect of certain sums paid by employer etc), in subsection (1)(a) after "if" insert "(disregarding section 148) it is".

ANNEX B

1 EMPLOYEE SHARE OWNERSHIP PLANS: MINOR AMENDMENTS [j350a]

(1) Schedule 8 to the Finance Act 2000 (c.17) (employee share ownership plans) is amended as follows.

(2) In paragraph 94 (PAYE: shares ceasing to be subject plan), for ",subsection (3) of section 203F of the Taxes Act 1988 (PAYE: tradeable assets)" substitute-
"(a) section 203F of the Taxes Act 1988 (PAYE: readily convertible assets) shall have effect as if the participant were being provided with assessable income in the form of those shares-
(i) at the time the shares cease to be subject to the plan, and
(ii) in respect of the relevant employment in which the participant was engaged immediately before that time, and
(b) subsection (3) of that section".

(3) In paragraph 127 (jointly owned companies), at the end insert-
"(4) A company controlled by a jointly owned company may not-
(a) be a participating company in more than one group plan, or
(b) if the jointly owned company or any other company controlled by it is a participating company in a group plan, be a participating company in a different group plan."

(4) In paragraph 128(2) (meaning of "readily convertible asset"), after "this Schedule" insert "(and that section in its application in relation to shares which cease to be subject to a plan)".

(5) This section has effect for the year 2002-03 and subsequent years of assessment.

(6) However, nothing in subsection (3) prevents a company continuing to be a participating company in a group plan in which it was a participating company immediately before the passing of this Act (and for the purposes of this subsection "participating company" and "group plan" have the same meaning as in Schedule 8 to the Finance Act 2000).