

Briefing document:

Disguised remuneration

On 9 December 2010, HM Treasury released new draft legislation to tackle tax efficient remuneration planning ideas involving trusts and other third parties. HM Revenue and Customs (HMRC) terms such plans 'disguised remuneration' and the new rules are draconian in their application in order to effectively terminate many of these planning ideas.

The new rules were surprisingly wide-ranging in their application, however, and turned over some of the 'givens' in the tax world as well as catching many unexpected scenarios. As a result it has been some of the most hotly discussed draft legislation of recent years and following extensive consultation, currently remains a moving feast.

Will the new legislation apply to me?

The legislation will apply where, after 6 April 2011, cash or assets are earmarked (however informally) for employees as part of an arrangement to provide rewards, recognitions or loans for that employee (employee includes former and prospective employees and certain other persons connected with the employee) and by virtue of a step (relevant step) taken by a third party, value leaves the arrangement. This includes the transfer of cash, assets, shares/securities, the making of loans and the grant of certain long leases.

So while this primarily catches arrangements involving the provision of benefits to employees via trusts, it is potentially very wide-ranging including any arrangements involving employer, employee and another person, subject to certain very specific exemptions.

The types of arrangement caught include the making of loans from employee benefit trusts (EBTs), Employer Funded Retirement Benefit Schemes (EFRBS), unapproved pension arrangements, funded incentive plans.

Why is this an issue?

The value of a relevant step is treated as employment income of the employee.

This includes the earmarking of the cash or assets and any subsequent relevant steps and the tax charge on that value stands whether or not the details of the arrangement are known, whether or not any benefit is ultimately enjoyed by the employee and whether or not a loan made to the employee is repaid.

What this means in practice is an upfront tax charge on amounts earmarked for employees in the context of relevant arrangements, with no means of recovery if the employee does not benefit. If the employee does benefit, then there are provisions to ensure that a double tax charge does not apply.

This is clearly an unattractive tax treatment. Where PAYE and National Insurance Contributions (NIC) apply, this will give rise to administrative difficulties if the employee does not receive an amount from which to deduct the tax at the time the charge arises. Therefore it is worth taking the time to ensure that your remuneration plans fall outside the legislation wherever possible.

What is not caught?

There are specific carve outs for HMRC approved share plans, approved pension plans and overseas pensions. The making of loans on the same terms as those made to the public are also ruled out as are transactions under many employee benefit plans (where these are made available to a majority of employees).

Transactions which result in a taxable event under the employment-related securities rules are also generally outside the legislation, but with a key exception where shares are held in a pool with the intention of satisfying awards under a long term incentive plan (LTIP). The same rules apply to cash pools earmarked for use in the satisfaction of deferred cash awards.

The new rules require that the LTIP (cash or share based) must include the following provisions:

- Awards vest within five years
- Performance conditions apply to each award
- If the performance conditions are not met, the award is forfeit
- The award is subject to income tax when it is received by the employee (ie when it vests)
- A main purpose of the plan is not the avoidance of tax or NIC

Residence issues

The draft legislation includes very specific provisions dealing with the taxation of individuals who are not resident in the UK for tax purposes at all times. The provisions deal with what value will be treated as general earnings and determines how that value might be reduced in respect of non-UK duties.

The legislation then goes on to consider what amounts might be considered to be remitted to the UK for tax purposes for those either ordinarily resident in the UK or not resident but undertaking UK duties.

Anti-forestalling provisions

In order to limit 'last minute opportunities' to undertake some of the more aggressive tax planning addressed by the new legislation, certain new 'anti-forestalling' provisions were introduced. The new legislation will take effect from 6 April 2011.

However, if in the period from 9 December 2010 to 6 April 2011, a relevant step is taken such that cash is transferred, a loan is made or broadly security is provided for a loan arrangement (and it would have been caught by the new legislation if made after 5 April 2011), then unless the amount is repaid prior to 6 April 2012, it will be chargeable to tax on 6 April 2012.

What should I do now?

It is important that you review all of your employee benefit and incentive arrangements where not all transactions are direct transfers between the employee and the employer. It may be necessary to amend some benefit policies and the terms of some LTIPs or share plans to ensure that they take advantage of the exemptions from the new legislation.

Remember, however, that any earmarking of cash, assets or other funds which took place or loans which were actually made before 9 December 2010 will be outside the reach of the new legislation.

Keep abreast of the changes in the legislation expected between now and the publication of the Finance Bill at the end of March 2011.

We will be updating our advice as new information is released and will be delighted to assist with the review and amendment of your policies and plans to minimise the impact of the new legislation.

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