

Disguised remuneration: Technical Note and Legislation

(Lecture B1058 – 17.57 minutes)

The majority of the changes to strengthen the disguised remuneration legislation (Part 7A ITEPA 2003) and prevent the future use of disguised remuneration schemes have already been enacted.

Two further changes are included in Finance Bill 2017-18:

1. introducing the close companies' gateway;
2. a clarification of when Part 7A applies.

The technical note published on 8 December also includes information on the changes to ensure the tax and NIC from a disguised remuneration (DR) employment income charge are collected from the appropriate person.

FA 2017 contained comprehensive double taxation relief provisions to ensure no scheme user pays tax twice on the same underlying income. There are currently provisions to relieve liability for overlapping NIC in the Social Security (Contributions) Regulations 2001.

The government intends to introduce further provisions to clarify how double NIC relief is given in "more complicated fact patterns". The draft legislation (not discussed further in these notes) is wholly relieving and will apply from the introduction of Part 7A in the same way as the tax rules.

HMRC will apply the principles of the draft NIC provisions in practice where multiple NIC charges arise.

Close company gateway

Some schemes claim that the DR received by a director/employee is not derived from the employment. The proposed legislation previously had no requirement for the employment to exist at or around the same time as the relevant transaction and relevant step, whereas the material interest test had to be met within 12 months of the relevant transaction.

The changes are:

- The employment must have existed within the preceding three years of the relevant transaction;
- The time period in the material interest condition has been extended from 12 months to 3 years so that the two tests align.

The 'avoidance purpose' test

The avoidance purpose test has now been amended to take account of when the relevant transaction and the relevant step occurred. This will ensure that the purpose of entering into an arrangement (e.g. setting up a trust) many years before the scheme was used will not be taken into consideration.

Potential double charges

There are comprehensive double taxation relief provisions in Chapter 2 of Part 7A, and paragraph 59 of Schedule 2 to FA 2011, so that no-one has to pay tax twice on the same underlying income, even if there are overlapping tax charges.

However, the government has decided to amend Part 7A, to put beyond doubt that it applies regardless of whether contributions to DR schemes should previously have been taxed as employment income. This change is effective from 22 November 2017.

Transfer of liability – update following the 2016 consultation

There are three scenarios where the government was concerned it would not be possible to collect the tax and NIC arising from the measure.

1. There is a non-UK employer set up for the purposes of the DR scheme and the employee provides services to a UK person;
2. The employer exists at the time the Part 7A charge arises but is unable to meet the liability;
3. The employer no longer exists at the time the Part 7A charge arises.

Example - Non-UK employer

An employee, Andrew, is employed by an offshore company, 'B'. He provides services to a UK-based end-client, Host Ltd.

The offshore company invoices Host Ltd for Andrew's services, either

- Directly; or
- via an intermediary or an agency based in the UK.

£10,000 is contributed to a trust by 'B' and the trust subsequently loans £10,000 to Andrew.

Analysis

The loan to Andrew is a relevant step so a Part 7A charge arises.

'B' is outside the scope of the PAYE regulations so s.689 ITEPA 2003 will apply to make Host Ltd, or the agency, responsible for operating PAYE on the Part 7A charge arising on the loan.

Where there is a Non Resident employer and a charge arises because a loan is outstanding loan at 6 April 2019, the employee is liable for the tax. S.689 will not apply to require a UK entity to operate PAYE in respect of the loan charge.

Example 2

An employee, Amber, is employed by an offshore company, 'B'. She provided services to a UK-based end-client, Host Ltd, in 2008.

The offshore company invoiced Host Ltd for Amber's services, either

- directly, or
- via an intermediary or an agency based in the UK.

'B' contributed £10,000 to a trust and the trust subsequently loaned £10,000 to 'A' in 2009 and remains unpaid on 5 April 2019.

Analysis

The outstanding loan triggers a loan charge relevant step so a Part 7A charge arises.

'B' is outside the scope of the PAYE regulations, and s.689 does not apply to the loan charge relevant step. As there is no UK entity required to operate PAYE, Amber must report the income and pay the tax to HMRC directly.

Note: The government will also introduce secondary legislation in relation to NIC, which will mean the end-client and the employee are not liable for Class 1 NIC.

Employer unable to pay

HMRC has decided that this is covered by existing powers and will use regulation 81 of the PAYE regulations to transfer the outstanding liability to the employee, where the employer is unable to pay.

Broadly, a regulation 81 direction can be made if either Condition A or B is met. Condition B allows a transfer of liability if the unpaid tax is in relation to a notional payment, which covers all Part 7A tax charges, including the loan charge.

The regulation 81 direction only transfers the tax liability. The employer will remain liable for any Class 1 NIC due.

How will this work in practice?

- Using existing procedures, HMRC will assess the employer's ability to pay. HMRC will consider time to pay (TTP) arrangements, especially where employers are in scope of the loan charge;
- Where these options are exhausted, and it is clear that the employer is unable to pay the outstanding liability, HMRC will issue a regulation 80 determination in respect of the unpaid tax included in their Real Time Information (RTI) return;
- Once this determination has been unpaid for 30 days, HMRC will use regulation 81 to direct the liability on to the employee. The unpaid tax will then be collected from the employee directly.

The government expects employers who have used DR schemes to include all Part 7A charges in their RTI/PAYE submissions, regardless of their ability to pay. This will prevent any inaccuracy, or failure to notify, penalties.

Where the employer does not include Part 7A liabilities in their RTI submission, HMRC will issue a regulation 80 determination. Once the determination is final, HMRC will make an assessment of whether or not the employer has the ability to pay the outstanding liability. Where appropriate a regulation 81 direction will be made.

Dissolved employer

As the third party in a DR scheme exists independently from the employer, it is possible for a Part 7A charge to arise where the employer has been dissolved or no longer exists.

Under sections 7, 8 and 9 of the TMA 1970, the employee is responsible for reporting the income and paying the tax to HMRC. The employee will not be liable for any Class 1 NIC due.

Loan charge additional information

Every employee who has an outstanding DR loan on 5 April 2019 will have to provide information to HMRC. This will allow HMRC to ensure the loan charge is complied with. This is in addition to the duty to provide information to the employer, contained within paragraph 36 of schedule 11 of Finance (No. 2) Act 2017.

The government has also extended the scope of the duty to provide information to HMRC to include self-employed users of DR schemes.

Contributed by Kevin Read