

**DRAFT LEGISLATION FOR FINANCE BILL 2011 ON DISGUISED  
REMUNERATION – FREQUENTLY ASKED QUESTIONS**

**Introduction**

Draft provisions were published on 9 December 2010 to allow comment on the legislation that the Government is introducing to tackle arrangements used for the purposes of disguising remuneration in order to avoid or defer income tax or national insurance contributions (NICs). These arrangements are also used to save beyond the annual and lifetime allowances in registered pension schemes.

HM Revenue & Customs (HMRC) has received over 50 formal responses to the consultation, and has actively engaged with interested parties throughout the consultation period. We are grateful for all the comments and contributions made, many of which were detailed, and we appreciate the time and effort taken by respondents. All representations on the main themes have been carefully considered.

As a result of the consultation process, we have identified a number of areas where the Government recognises the need to make refinements to the legislation. We have prepared this FAQ document to provide answers to common questions received by HMRC, to clarify the policy intention in a number of areas where the application of the draft legislation as published has raised concerns with external commentators, and to explain areas where the Government intends to make amendments. The primary aim of this legislation remains to protect the Exchequer. While we wish to refine the legislation in order to limit impacts on employers and individuals where it is possible to identify arrangements that cannot be used for avoidance purposes, the relatively complex nature of many vehicles used in this sphere means that the legislation is also necessarily comprehensive.

The FAQs pick up the main themes raised by respondents during the consultation. We have not given answers to all questions asked by respondents about the draft provisions because, due to the volume of responses received, we are still giving them our consideration. Further FAQs will be published as appropriate in due course.

These FAQs are not definitive guidance on the proposed legislation which will be subject to approval by Parliament. In particular the draft legislation is subject to amendment as indicated below.

## Scope of legislation

- 1. As drafted, the legislation will bring forward an income tax charge in genuine deferred remuneration arrangements, including those arrangements put in place to meet the requirements of the FSA's recently published Remuneration Code. Where deferred remuneration arrangements are entered into to meet the FSA requirements, or otherwise as good business practice or for reasons associated with corporate governance, is it the policy intention that the new legislation will apply?**

As drafted, Part 7A is capable of applying in some of the scenarios put to us involving deferred cash or shares bonus arrangements at the time of the deferral, depending on how the arrangements were structured.

The policy intention is that the new rules should apply to arrangements involving a third party to reward employees and directors which seek to avoid, defer or reduce income tax and NICs and also to arrangements that are used as a tax-advantaged way to save for retirement, using an employer financed retirement benefit scheme (EFRBS) as an alternative to, or to top up, savings in a registered pension scheme. However, it is not the policy intention that the new rules should apply to deferred rewards which are subject to a specified vesting date and on which income tax under PAYE and NICs will be due, particularly where the reward is subject to meaningful and time-specific conditions which there is a realistic chance will not be met.

To address this concern, the intention is to amend Part 7A so that deferred remuneration arrangements which have the following characteristics do not give rise to a charge on earmarking at the time that the remuneration is deferred.

- The deferred reward must be subject to conditions which, if not met, will mean that there will be no possibility of the employee (or a person linked with the employee or chosen by the employee) receiving the full reward or retaining any form of current or future entitlement to the reward they do not receive.
- The arrangement must specify a date for the vesting of the reward. This vesting date must be at most five years from the date of grant. Where this condition is fulfilled, if vesting does not take place within five years of the date of grant, a Part 7A charge will arise unless an event has happened which means there is no possibility of the employee (or a person linked with the employee or chosen by the employee) receiving the reward.
- The nature of the deferred reward must be such that if it is provided on or before the vesting date, it will be chargeable to tax as employment income.
- The deferral or avoidance of tax must not be the main purpose, or one of the main purposes, of entering into the arrangement.

- 2. Does Part 7A only apply where the arrangements involve an employee benefit trust (EBT) or an employer financed retirement benefit scheme (EFRBS)?**

No, the rules are not restricted to arrangements involving EBTs and EFRBS, but many of the responses to these FAQs refer to EBTs and EFRBS as they are commonly used in the arrangements at which Part 7A is directed.

- 3. It appears that including group companies in the definition of a “relevant third person” will catch many transactions which are entered into wholly for commercial purposes but which may not meet the strict qualifying conditions for the exclusions in sections 554F and 554G. Is this correct and, if so, is it intended?**

As drafted, Part 7A could have that consequence. The intention is to amend Part 7A so as to address this concern about group companies; the changes will be subject to an anti-avoidance rule. We are also considering whether structures similar to groups should be treated in the same way as group companies.

- 4. The legislation appears to catch construction industry holiday pay schemes (HPS) which have been in existence for many years and involve sums of money being allocated and paid to individual employees by third parties. Is it intended that the proposed legislation will apply to HPS?**

Part 7A is not intended to apply to genuine HPS. The intention is to amend it so that genuine HPS are not caught.

- 5. If a shares transaction is caught by the new rules, it appears that any subsequent dividend payment will be a payment within section 554C. Suppose, for example, that a public limited company makes an offer of shares to the public, some of its employees subscribe for shares in their employer, and these employees receive dividends on their shares. The employer company would then have to account for PAYE. Is that correct?**

It is not the policy intention that a dividend payment that simply happens to follow a shares transaction will normally be caught by the new rules. We are considering whether any amendment is required to the draft legislation to clarify this point.

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- 6. The wide definition of “trustee” in section 554A(8) means that there doesn’t need to be third-party involvement. Accordingly, a direct employer/employee transaction will be caught if the employer is holding a sum of money as part of an arrangement.**

We agree that, as drafted, Part 7A would have this unintended consequence. The intention is therefore to narrow the definition of “trustee” in section 554A(8).

- 7. Where there is a change of trustees of a trust does HMRC agree that this should not itself trigger any charges under new Part 7A?**

A change of trustees will not in itself give rise to any charge under new Part 7A.

- 8. What does the term “substantially similar” in section 554D(1)(a) mean? For example, would the normal provision of a company car under a lease agreement or the occasional use of a holiday home be capable of meeting the test in section 554D(1)(a)?**

The test in section 554D(1)(a) is intended to cover circumstances that are, in essence, the same as the way in which the employee could have benefited from the asset had the employee been the outright owner. This requires more than the asset simply being at the employee’s disposal or being available for the employee’s private use. Examples of the “something more” that would point to the employee being able to benefit from an asset in much the same way as the outright owner include:

- where the employee (in their capacity as an individual) can directly influence decisions about whether to sell or replace an asset;
- where it is clear that the employee is likely to benefit from any eventual disposal proceeds of an asset (for example, because they will be ploughed back into the employee’s sub-trust).

The normal provision of company cars on short term leases to employees for their private use or the occasional non-exclusive use of a holiday home while in employment would not be a relevant step under section 554D(1)(a).

We are also considering whether section 554D needs to be amended in order to qualify the meaning of “substantially similar”.

- 9. What is the meaning of “substantial proportion” in new section 554G(1)(c) which excludes certain transactions under employee benefit packages where they are available to a “substantial proportion” of the employer's employees?**

We would expect to apply a similar approach as is used to applying the “substantial proportion” test in section 176 of ITEPA. Following that approach, we would accept that the test in new section 554G(1)(c) is satisfied where the benefits package is available to at least 50% of employees.

- 10. New section 554G(4) requires that there be no tax avoidance purpose; what is the position in relation to salary or bonus sacrifice arrangements involving a third party where the third party allocates tax exempt/favoured benefits in return for the sacrifice?**

We would accept that on its own, sacrificing salary in favour of provision of tax-exempt or tax-advantaged benefits does not constitute tax avoidance. However, we would not rule out the possibility that particular salary sacrifice arrangements could involve tax avoidance so we cannot say that there is never a tax avoidance purpose in the context of salary sacrifice arrangements.

- 11. Section 554O only allows credit for consideration given where an employee purchases an asset. It doesn't allow for consideration where an employee sells an asset to a third party. This is unfair, particularly in cases where assets are sold at market value. Is this intended?**

The Government accepts that not allowing credit for consideration given where an employee sells an asset will produce some unintended consequences. The intention is that Part 7A will be amended to include a provision allowing credit for the market value of the asset sold by the employee against the sum paid for it by the third party.

- 12. If income or gains arising on contributions to a trust are earmarked for particular employees or their families, will the earmarked income or gains be subject to an employment income charge under Part 7A?**

As drafted, the effect of Part 7A would have been that any income or gains arising on funds or assets already earmarked for a particular employee (for example held within a sub-trust for a particular employee) would be subject to a tax charge under section 554B (earmarking).

The Government has listened to representations on the administrative implications of an earmarking charge on the accrual of income and gains within a trust and accepts that such a charge is disproportionate to achieving the intended policy outcome. The intention is therefore to amend the

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legislation so that the accrual of income and gains does not, in itself, give rise to a charge on earmarking. However, relevant steps under section 554C or 554D will still apply where they are funded by income or gains on the original contribution.

### Loans

**13. The scope of Part 7A is very wide in relation to loans. It appears that any loan made by any third party to the employee on or after 9 December 2010 will be caught by Part 7A. Is this intentional?**

Yes. If a loan is made by a relevant third person (as defined in section 554A(7)) on or after 9 December 2010 under an arrangement to which section 554A applies, it is within the scope of Part 7A. Unless the loan meets the test for the “commercial transactions” exclusion in section 554F, or it meets the test for the exclusion for employee benefits packages at section 554G, the making of the loan will be a relevant step to which Chapter 2 of Part 7A applies.

Part 7A is not targeted at particular types of intermediary (e.g. EBTs and EFRBS). This is intentional; targeting particular types of intermediary would simply encourage the use of alternative vehicles for tax avoidance purposes. Similarly, excluding loans made by particular types of intermediary would inevitably result in the structuring of loan arrangements through excluded third parties.

The Government accepts that including group companies in the definition of a “relevant third person” will give rise to a situation whereby a variety of transactions (including the making of loans), entered into for commercial and otherwise innocent purposes, but which may not meet the strict qualifying conditions for the exclusions in sections 554F and 554G, would be caught by the proposed legislation. The intention is that Part 7A will be amended to address this concern about group companies and the changes will be subject to an anti-avoidance purpose test.

We are also considering whether certain short-term loans applied to specific transactions should be excluded from a Part 7A charge. Any such exclusions would be subject to an anti-avoidance purpose test.

**14. There don't appear to be any relieving provisions if a loan is repaid. What is the tax position where a loan, which has been subject to PAYE on the full amount advanced, is repaid in full?**

The anti-forestalling rules allow credit for repayment of any part of a loan made in the period from 9 December 2010 to 5 April 2011 (inclusive). Where such a loan is made the Part 7A charge will be based on the amount of the loan less any repayments made before 6 April 2012.

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However, there is no provision for credit to be given for the repayment of any loan made by a third party on or after 6 April 2011.

### Pensions

**15. Will Part 7A apply to genuine EFRBS where funds are being held and invested to provide for a specific employee's retirement without any loan arrangements being entered into?**

Yes. Like other intermediary vehicles, EFRBS have been used to provide loans and to avoid tax. In any case, new and extensive use of EFRBS to provide retirement benefits is not in keeping with the principle of creating a more affordable pensions tax regime. Without action, EFRBS providing pensions and other retirement benefits would be more tax advantaged than registered pension schemes for pension savings beyond the new, reduced annual and lifetime allowances.

Section 554E(1)(g) does not provide an exemption for genuine EFRBS. The provision applies only where the sole purpose of an arrangement is to make payments to or in respect of a member and the payments are deemed by statute to be paid by a registered pension scheme (although not actually paid by such a scheme). The most common example is where a registered pension scheme provides a pension by purchasing an annuity from a life insurer for payment to the member. The exclusion does not apply where the payments under the arrangement **would have been** authorised payments if they had been paid by a registered pension scheme but are not so paid nor treated as so paid for the purpose of Finance Act 2004.

**16. Will Part 7A apply to unfunded unapproved retirement benefits schemes?**

Part 7A will not create tax charges for wholly unfunded unapproved retirement benefit schemes.

However, it is apparent from representations made since the draft legislation was published on 9 December 2010 that a number of arrangements exist whereby the employer promises to provide retirement benefits through a relevant third person. Instead of the employer paying contributions at the time of giving the promise, under the arrangements employers give employees various levels of security, backed by assets held by the employer. These arrangements are neither funded upfront nor wholly unfunded. The intention is that Part 7A will be amended to address such arrangements.

If an employer earmarks a sum or asset with a view to a relevant third person paying a pension or other relevant benefits, the intention is that this earmarking will be a relevant step.

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The intention is that there will be two exceptions to this rule.

First, this rule will not apply if the relevant third person is:

- a registered pension scheme;
- an overseas pension scheme; or
- a scheme in respect of contributions to which the employer may claim either transitional corresponding relief under article 15 of SI 2006/572 (the Taxation of Pension Schemes (Transitional Provisions) Order 2006) or relief under double taxation arrangements.

Second, this rule will not apply if the earmarking is carried out with the sole purpose of actually paying an immediate contribution.

The Government has also said that pursuant to the reductions in the annual and lifetime allowances for registered pension schemes it will continue to monitor changes in patterns of pension savings behaviour and will be ready to act if necessary to prevent additional fiscal risk in this area. (Paragraph 2.31 of “Restricting pensions tax relief through existing allowances: a summary of the discussion document responses” published on 14 October 2010.)

**17. What if an unfunded unapproved retirement benefits scheme promise is (a) recorded as a balance sheet liability of the employer or (b) secured by a letter of credit provided by a bank which is itself secured by a floating charge over all the employer’s assets?**

It is probable that neither of those arrangements would, on its own, count as the earmarking of assets held by the employer. However, this will depend on the facts of the case.

**18. Will a charge arise under Part 7A where there is a transfer from one unregistered pension scheme to another?**

As drafted, Part 7A would apply to all transfers from one unregistered pension scheme to another. The intention is that Part 7A will be amended so that transfers between corresponding overseas schemes will be exempted from a charge to the extent that the transfer value is referable to contributions before 6 April 2006.

**19. Will lump sums and retirement benefit arrangements that would previously have been exempt be taxed?**

As drafted, Part 7A would tax lump sums and retirement benefit arrangements (including annuity purchase and section 615 trusts) that would previously have been exempt, for example under Extra Statutory Concession A10. The intention is that Part 7A will be amended to keep the exemptions,



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but only to the extent that the benefits provided are referable to contributions or rights accrued before 6 April 2011.

### **20. Would the tax charge under Part 7A of ITEPA apply in priority to the tax charge on pension income under Part 9 of that Act?**

As drafted, the Part 7A tax charge would apply in priority to the tax charge on pension income under Part 9 of ITEPA.

The intention is that Part 7A will be amended so that pension payments will be subject to tax under Part 9 as pension income in priority over Part 7A, including pensions paid by corresponding overseas schemes. As a result, the remittance basis and the 10% abatement for foreign pensions given under Part 9 will continue to apply where appropriate.

All pension schemes not excluded under section 554E will, however, be liable to the Part 7A charge on any new earmarking on or after 6 April 2011, with credit given against the Part 9 charge for earlier Part 7A charges.

### **21. To the extent that other payments under retirement benefit plans might come within the ambit of new Part 7A, would they also retain their character as pension/retirement income under the UK's double tax treaties?**

The draft legislation does not alter the character of pension/retirement income under double taxation treaties. It would not therefore change the way the UK's treaties allocate taxing rights.

### **22. When a Part 7A tax charge has arisen in respect of a relevant arrangement that is an EFRBS, either because the EFRBS has earmarked money or other assets for, or has provided benefits to, a present or former employee, would there also be a tax charge on the receipt of relevant benefits under section 394 of ITEPA?**

Section 394 of ITEPA will be consequentially amended to prevent the double taxation of benefits received under EFRBS. See paragraph 13 of the draft Schedule. Broadly speaking, relevant benefits will be subject to tax under section 394 only to the extent that the value of the benefits exceeds amounts charged to tax in respect of the relevant arrangement either as earnings or under Part 7A.

## Employee share schemes

### **23. Where shares are allocated to named employees to meet future liabilities under an employee share plan or a long term incentive plan (LTIP), will a charge arise under the disguised remuneration measure?**

Under Part 7A as drafted, a charge could arise under such circumstances. However, our policy objective is to tackle arrangements established for the purposes of tax avoidance, and it will be necessary to achieve this in a proportionate and well-targeted way.

To address this concern, the intention is that the legislation will be amended so that arrangements which have the following characteristics do not give rise to a charge on earmarking at the time that the shares are earmarked.

- The payment of the shares must be subject to conditions which, if not met, will mean that there will be no possibility of the employee (or a person linked with the employee or chosen by the employee) receiving the shares or retaining any form of current or future entitlement to the amount they do not receive.
- The arrangement must specify a date for the vesting of the shares. This vesting date must be at most five years from the date of grant. Where this condition is fulfilled, if vesting does not take place within five years of the date of grant, a Part 7A charge will arise unless an event has happened which means there is no possibility of the employee (or a person linked with the employee or chosen by the employee) receiving their benefit from the plan.
- The nature of the arrangements must be such that, if vesting does occur on or before the vesting date, there will be a charge to tax on employment income.
- The deferral or avoidance of tax must not be the main purpose, or one of the main purposes, of entering into the arrangement.

### **24. Where shares or funds to acquire shares are put into an EBT to meet future requirements of an employee share plan or a long term incentive plan (LTIP), but are not earmarked in relation to named employees, will this give rise to a charge under Part 7A?**

No, this transaction on its own will not give rise to a charge under Part 7A because there is no earmarking in relation to specified employees.

### **25. Where an EBT buys back shares at or below market value from employees who are leaving the company, does a charge arise under Part 7A?**

The intention is that Part 7A will be amended to include a provision corresponding to section 554O allowing credit for the market value of the asset sold by the employee.

**26. Where a charge to tax on earnings arises when shares are transferred to an employee, will there also be a charge under Part 7A?**

No. Where a relevant step gives rise to “*relevant earnings*” (which include earnings under section 62 of ITEPA – see section 554N) for a tax year, then the value of the relevant step is reduced by the amount of the relevant earnings, but not below zero. If the amount taxable under section 62 as earnings is less than the amount that is taxable in relation to the relevant step, then the difference will be charged under Part 7A. However, in practice, there should rarely be a difference.

**Residence and domicile**

**27. It appears that a tax charge could arise under Part 7A after the employee has left the employment and has been resident outside the UK for a number of years. Surely this can't be intended?**

A tax charge could arise under Part 7A if a relevant step is taken in a tax year in which the employee is non-resident. The value of the relevant step is attributed to the periods that it would have been “for” if it had been earnings from the employment. If the employee was resident, or performing the duties of the employment, in the UK in a period to which the value of a relevant step has been attributed, that value is chargeable to tax under Part 7A in the tax year in which the relevant step is taken, regardless of whether the individual is non-UK resident at that time.

Where a relevant step is taken in a year before the employment has started or after it has ceased and the value can't be attributed to a particular period, the full value of the relevant step is treated as being “for” the first or last tax year in which the employment was held. If the individual was UK resident in the tax year which the value of the relevant step is “for” it is chargeable to tax under Part 7A in the tax year in which the relevant step is taken, whether or not the individual is non-UK resident at that time.

This is essentially no different from the position where an employee receives earnings in a tax year in which they are not resident in the UK.

**28. If an arrangement involving an EBT gives rise to a relevant step, the value of which relates to non-UK duties of an individual who is not domiciled in any part of the UK, will the remittance basis apply to any value eventually remitted to the UK?**

For non-UK domiciliaries who claim the remittance basis in any of the years related to the relevant step the value of the relevant step is apportioned to the appropriate tax years under the provisions of section 554L.

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The person must then check if they paid tax under the remittance basis for any of those years. If so, any amount for that year which is not in respect of duties performed in the UK is not taxable until or unless it is remitted to the UK. It is then taxable in the year it is remitted unless the amount is remitted before the relevant employment starts when it is taxable in the year the employment begins.

### Commencement of the new rules and anti-forestalling provisions

#### **29. Will the continued provision after the date from which the legislation applies of an asset or loan made available before the legislation applies count as a relevant step because it's continuing?**

No. Loans which were paid and assets made available before the legislation applies are outside the scope of Part 7A. But, for example, if an asset provided before 6 April 2011 is subsequently reallocated to somebody else, this will trigger a new charge under section 554C or 554D as appropriate.

However, some of the types of transaction which are only within the scope of this measure from 9 December 2010 or from 6 April 2011 (as applicable) are not accepted by HMRC as effective in avoiding tax under existing law. Such transactions include the earmarking of funds held in a discretionary trust before 6 April 2011 as well as other transactions where a realistic view of the facts is that earnings have been paid. HMRC will continue to challenge such transactions under the existing law, including in litigation where necessary.

#### **30. Do the anti-forestalling provisions apply to loans made before 9 December 2010 which are still outstanding on 6 April 2011?**

No. Only loans made between 9 December 2010 and 5 April 2011 (inclusive) will be within the scope of the anti-forestalling provisions.

However, the anti-forestalling provisions do apply to loan arrangements entered into before 9 December 2010 if the loan is actually paid on or after that date. For example, if a loan arrangement was entered into before 9 December 2010 but the loan was not paid before that date, the loan is not excluded from the anti-forestalling provisions simply because the agreement to make the loan was entered into before 9 December 2010.

#### **31. Does Part 7A apply to money or assets in a sub-fund of an employee benefit trust established before 9 December 2010 despite remaining undistributed (including by way of a loan) on 6 April 2011?**

Yes, to the extent that a relevant step under sections 554C or 554D occurs on or after 6 April 2011 (or on or after 9 December 2010 if the anti-forestalling provisions apply), Chapter 2 of Part 7A will apply no matter when the sub-fund was established.

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Chapter 2 will also apply to new acts of earmarking (under section 554B) in relation to the sub-fund on or after 6 April 2011.

**32. Where a loan is made by a third party but subsequently repaid before 6 April 2012, will a tax charge arise under the proposed legislation?**

If the loan is advanced between 9 December 2010 and 5 April 2011 inclusive and is subject to the anti-forestalling provisions, a Part 7A charge will only arise if the loan is not repaid in full before 6 April 2012.

However, where the making of a loan on or after 6 April 2011 gives rise to a relevant step, a tax charge will arise at the time of payment whether or not the loan is subsequently repaid by 6 April 2012.

**33. It appears from section 554C(2) that *any* reinvestment by a trustee at the suggestion of the employee will represent a payment within section 554C, and that this will be subject to the anti-forestalling rules if it occurs in the forestalling period. Is that correct and, if so, is it intended?**

We agree that, as drafted, Part 7A would have this unintended consequence.

The intention is to amend Part 7A to make it clear that section 554C(1)(a) only applies where value leaves the arrangement in favour of the employee.