Practice guide

The disguised remuneration regime unpacked

Speed read

HMRC has, for many years, sought to ensure that the rewards gained from employment are properly subject to income tax and NICs deducted by employers through the pay as you earn (PAYE) system. The disguised remuneration legislation, found in ITEPA 2003 Part 7A, was a warning to employers and promoters of tax avoidance schemes that the use of employee benefit trusts (EBTs) and other contrived remuneration structures to avoid, defer or reduce income tax and NICs liabilities would be strongly challenged. This article looks at the structure of the rules, the tax treatment which applies and the impact that the legislation has had on EBTs and remuneration planning.

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When the rules apply: the gateways

There are two gateways under Income Tax (Earnings and Pensions) Act (ITEPA) 2003 Part 7A:

- the 'main gateway', which has been in force since the legislation was introduced; and
- the 'close companies gateway', which was introduced from 6 April 2018.

Where an arrangement passes through a gateway, a Part 7A charge arises (see 'The charge to tax' below).

The main gateway

The main gateway applies where the following conditions are met:

- There is a 'relevant' arrangement which relates to an existing, former or prospective employee or a relevant person 'linked' to the employee. Employee for these purposes includes non-executive directors and office holders. The definition of a 'relevant linked person' is broad, and includes any person who is, or has been, connected with the employee (including spouses and cohabitees, as well as family members), any close company of which the employee is a participator and any company controlled by the employee (ITEPA 2003 ss 554A(1)(a) and (b) and s 554Z1, and Income Tax Act 2007 s 993).
- The arrangement is, 'in essence', wholly or partly a means of providing rewards, recognition or loans in connection with an employee or linked person (ITEPA 2003 s 554A1(c)).
- The relevant third person operating the arrangement takes a 'relevant step' (ITEPA 2003 s 554A(1)(d)).
- It is reasonable to suppose that, 'in essence', the step is pursuant to the arrangement or there is some other connection (direct or indirect) between them (ITEPA 2003 s 554A(1)(e)).

The definition of 'arrangement' is extremely wide and covers an 'agreement, scheme, settlement, transaction, trust or understanding'. Informal arrangements which are not legally binding are also caught, including those that the employee may not have agreed to, or even been made aware of (ITEPA 2003 s 554Z(3)).

It is interesting to note the use of terminology such as 'rewards' and 'recognition', which are not replicated in other parts of the tax legislation or defined in Part 7A, so their meaning remains uncertain and is largely untested by the courts. The requirement for it to be 'reasonable to suppose' that the relevant step is taken in pursuance of the arrangement echoes the language and tenor of *WT Ramsay Ltd v IRC,* [1981] UKHL 1, which established the *Ramsay* doctrine – a principle that requires consideration of the transaction as a whole to get to its underlying purpose. HMRC has used the *Ramsay* principle to successfully pursue a number of employment income tax avoidance schemes.

The close companies gateway

The close companies gateway was introduced in 2018 to target arrangements financed by a close company (or a company that would be close for tax purposes if it were UK resident), where the main purpose is the avoidance of income tax, NICs, corporation tax or charges under the loans to participator rules.

Its aim was to counter situations where rewards were provided to an individual, not as a result of the employment relationship, but in their capacity as a shareholder, and therefore did not pass through the main gateway. The close company gateway operates in a similar way to the main gateway, so there must be a relevant arrangement relating to an employee or director (including a shadow director) who holds a material interest in a company (broadly a 5% interest or more) which is in essence a means of providing 'A-linked' payments, benefits or loans. However, in addition, the close company must enter into a relevant transaction pursuant to the arrangement (ITEPA 2003 s 554AA). The definition of relevant transaction is once again broad and includes the payment of a sum or asset, the making or release of a loan, and making assets available (ITEPA s 554AB).

Where a loan arrangement passes through the close companies gateway but is also caught by the loans to participators charge under CTA 2010 s 455, this takes priority over the Part 7A charge, provided the appropriate corporation tax returns are filed and payment is made by the relevant due date (ITEPA 2003 s 554Z2A).

Who is a relevant third person?

In general terms a 'relevant third person' is usually someone other than the employer or a member of its group, such as the trustee of an EBT or other third party. It also includes the employee or a person linked to the employee, a person chosen by the employee or linked person and any other person who takes a relevant step on behalf of the employee or linked person or at their request (ITEPA 2003 ss 554A(7) and 554D(5)–(6)).

The employer (or other member of the same group of companies) is treated as a third person if they are acting as trustee, they take a relevant step in connection with a tax avoidance arrangement, and also in relation to certain steps regarding the financing of employer financed retirement benefit schemes (EFRBS) (ITEPA 2003 s 554A(7) and ss 554Z(16)–(20) (see 'Implications for pensions' below).

A 'group' for these purposes only covers certain kinds of bodies corporate (but not partnerships or limited liability partnerships (LLPs)) and consists of a principal company and any subsidiaries in which it owns (directly or indirectly) more than 50% of the ordinary share capital and from which it is beneficially entitled to receive more than 50% of the profits and assets (on a winding up) that are distributable to equity holders (ITEPA 2003 ss 554Z(5)–(6) and TCGA 1992 s 170).

Groups which include LLPs and joint venture companies need to be handled with care, as they may not qualify as group companies for these purposes. A company which is wholly owned by an employing LLP cannot be a 'relevant third person', unless it is acting as a trustee (ITEPA 2003 ss 554A(7)–(9) and TCGA 1992 s 170). This may be of assistance in private equity backed groups, but it will not be of any help where the employing LLP does not wholly own the other relevant company or where the employer itself is not the LLP.

It should also be noted that the definition of tax avoidance arrangement for the purposes of Part 7A is very wide. It is any arrangement where any party has a tax avoidance purpose, irrespective of whether or not the person taking the step is aware of the tax avoidance purpose (ITEPA 2003 ss 554Z(13)–(16)).

> The breadth of scope of the rules, and their potential to catch legitimate remuneration arrangements with no anti-avoidance motive, require them to be handled with care, to ensure unexpected PAYE and NICs liabilities are avoided

What is a relevant step?

The following are examples of relevant steps which will become chargeable if taken by a relevant third person:

- the earmarking of money or assets (however informally) for an employee with a view to a later relevant step being taken. It does not matter if details of the later relevant step have not been worked out or the employee has no right to the later relevant step being taken (ITEPA 2003 s 554B(1)(a));
- the payment of a sum of money to an employee, including any payment by way of loan (ITEPA 2003 s 554C(1)(a));
- the transfer of an asset to a relevant person (ITEPA 2003 s 554C(1)(b));
- taking a step enabling a person to acquire shares, an interest in shares or share options (ITEPA 2003 s 554C(1)(c));
- making a sum of money or an asset available to an employee as if the asset had been transferred outright, or making it available as a security (this includes making an asset available for two or more years following employment to benefit a former employee or associated person) (ITEPA 2003 ss 554C(1)(d) and 554D and EIM45080);
- acquiring the right to receive a payment or an asset where there is a connection between the acquisition of the right and the payment or transfer (ITEPA 2003 s 554C(aa));
- releasing or writing off a loan or right (including any form of credit) (ITEPA 2003 s 554C(ab); and
- granting a lease of premises for a period which is likely to exceed 21 years (ITEPA 2003 s 554C(1)(e)).

For HMRC's guidance, see the *Employment Income Manual* at EIM45055.

Of all the relevant steps, perhaps of the most concern to employers is earmarking, as it has the potential to give rise to upfront tax charges, whether or not any actual benefit is received by the employee. It is particularly unhelpful that there is no definition of earmarking in the legislation and the qualification 'however informally' has given rise to concerns about 'inadvertent' earmarking (see 'Implications for share schemes' below).

The charge to tax

The taxable amount

Once a disguised remuneration gateway has been passed through, the Part 7A charge is triggered, subject to the availability of any reliefs and exclusions (see below). Where the relevant step involves a loan or cash payment, the amount of money is the taxable value. In the case of a loan, no relief is given, even if the loan is subsequently repaid (EIM45065). In other cases, the value of the relevant step is the market value of the asset or the actual cost of the relevant step if higher (ITEPA 2003 ss 554Z2–554Z3 and TCGA 1992 Part 8). The value of the cash or assets that are the subject of the 'relevant step' is treated as employment income and is subject to income tax and NICs which the employer is responsible for withholding under PAYE. This is the case even where the assets are not 'readily convertible assets' for the purposes of the PAYE regulations.

The employer is responsible for operating PAYE in respect of its best estimate of the value of the relevant step, unless the third party operating the arrangement has already done so. The timescales for withholding are short. The tax is payable within 17 days of the end of the tax month in which the relevant step occurs if the employer accounts for tax electronically and within 14 days in other cases (ITEPA 2003 ss 687A and 695A and the Income Tax (PAYE) Regulations, SI 2003/2682, regs 62 and 69).

Detailed provisions apply to the calculation where the employee was non-resident in the UK, taxed on the remittance basis or subject to split year treatment for any period of the arrangement (ITEPA 2003 ss 554Z6 and 554Z9–554Z11A).

In many cases, the employer will be unable to recover the tax and NICs from the employee by deduction. Unless the employee makes good to the employer the amount of tax paid on his behalf within 90 days of the end of the relevant tax year, there is a further income tax and NICs charge on the employee, with the tax paid on his behalf being treated as earnings (ITEPA 2003 s 222, Social Security Contributions and Benefits Act 1992 s 4(6) and Social Security (Contributions) Regulations, SI 2001/1004, reg 22(4)).

If the employer is unable to account for the tax, HMRC can make a determination under Income Tax (PAYE) Regulations, SI 2003/2682, reg 80 and use its power under reg 81 to direct the liability to the employee. HMRC has confirmed this power will apply to all Part 7A charges, including the loan charge (see below), but will not apply to class 1 NICs charges, which remain the responsibility of the employer (see HMRC's guidance *Tackling disguised remuneration: transfer of liability*).

Exclusions

One of the issues with the drafting of Part 7A is its wide-reaching nature. For this reason, a broad set of exclusions

was introduced to cover certain steps taken pursuant to legitimate arrangements. The following is a summary of the key exclusions:

- tax-advantaged share schemes: share incentive plans, save as you earn (SAYE) schemes, company tax-advantaged plans, the provisions of lump sum benefits on death or retirement under ITEPA 2003 s 393B, registered pension schemes, certain non-UK established pension schemes and arrangements to make payments under FA 2004 s 160(1) (such as pensions sharing orders) (ITEPA 2003 s 554E);
- payment of sums of money by way of loans made on ordinary commercial terms where no tax avoidance motive exits (ITEPA 2003 s 554F);
- employee benefit packages (ITEPA 2003 s 554G);
- deferred remuneration arrangements (ITEPA 2003 s 554H);
- employee share schemes (ITEPA 2003 ss 554I–M);
- car ownership schemes (ITEPA 2003 s 554O);
- acquisition of employment related securities and securities options and charges arising in relation to them under Part 7 (ITEPA 2003 s 554N);
- where certain employment income exemptions apply (ITEPA 2003 s 554P);
- payments of inheritance tax and corporation tax to HMRC which arise in respect of Part 7A arrangements (from 6 April 2017) (ITEPA 2003 s 554XA);
- certain loans, including cashless exercise for employee share schemes (ITEPA 2003 ss 554N (13)-(16)), transfers of employment related loans to the employer (up to £10,00) (ITEPA 2003 s 554OA) and repayment of the principal amount of a loan (ITEPA 2003 s 554RA);
- exclusion for income arising on sums or assets which have already been earmarked, provided the return is at a normal commercial rate (ITEPA 2003 s 554Q) and where a sum or asset has been earmarked and a new asset is acquired using that sum of money or asset (ITEPA 2003 s 554R); and
- various pension related matters (ITEPA 2003 ss 554S, 554T, 554U, 554V, 554W and 554X) (see 'Implications of pensions' below).

It should be noted that the exclusions are, in some cases, limited and certain conditions must be satisfied before they can be relied upon. Therefore, care is required when relying on the exemptions to exclude a Part 7A liability. HMRC has power to make regulations to make further exclusions from the application of Part 7A (ITEPA 2003 s 554Y).

Double taxation

There are detailed provisions in Part 7A to prevent instances of double taxation (ITEPA 2003 ss 554Z5 and 554Z11B–554ZE and FA 2011 Sch 2 para 59). These operate to reduce the value of the relevant step where there is an overlap with an earlier event which has given rise to an income tax liability that has been paid (or is not yet due). Where liabilities arise in respect of the same sum of money or asset, liabilities settled in connection with a later relevant step will be treated as payments on account of earlier liabilities; and payments made in respect of earlier steps will be treated as payments on account of the later liability. The value of the relevant step is reduced by the amount of overlap, but not below nil.

Similarly, there are provisions to prevent double charges to NIC. Where a tax liability under Part 7A is reduced, the amount chargeable to NICs is reduced by the same amount (Social Security (Contributions) Regulations (SSCR), SI 2001/1004, reg 22B). However, they do not provide full alignment with the income tax position. For example, no NICs relief is available where a further relevant step is not taken and income tax relief is available under ITEPA 2003 s 554Z14 (see below).

Relief from Part 7A charges

The reliefs from Part 7A charges are set out below.

Where a relevant step gives rise to a 'relevant earnings charge', the value of the relevant step is reduced by the amount taxed as relevant earnings. Relevant earnings include any amount taxed as general earnings under ITEPA 2003 s 62, amounts treated as earnings under ITEPA 2003 Part 3 Chapter 12 or any deemed employment payment under ITEPA 2003 s 50 (IR35 taxation charges) (ITEPA 2003 s 554Z6). So, for example, if a bonus was paid by a trustee of an EBT from trust assets, relief from Part 7A would apply as the bonus would be chargeable under ITEPA 2003 s 62.

Where an employee or linked person provides consideration in the form of a payment of money for the relevant step, the value of the relevant step is reduced by the amount of consideration paid, provided no tax avoidance motive exists (ITEPA 2003 s 554Z8) (see 'Implications for share schemes' below).

Similarly, where an employee or linked person provides consideration in the form of an asset transferred to the relevant person taking the step, the value of the relevant step is reduced by the value of the asset transferred (ITEPA 2003 s 554Z8). For example, where an employee sells shares to an employee trust, Part 7A relief would apply.

Where a subsequent income tax liability arises following an earlier relevant step, the later income tax liability is reduced (ITEPA 2003 s 554Z13).

ITEPA 2003 s 554Z14 provides relief where a Part 7A charge has arisen on a prior earmarking and a 'relevant event' then occurs (which is not a relevant step) which means no further relevant step will arise. An application for the relief must be made within four years of the event. HMRC will give such relief as it considers 'just and reasonable' to any Part 7A and ITEPA 2003 s 222 charges which have arisen. This appears to provide relief in situations where accidental earmarking may have occurred (EIM45875).

Part 7A provides relief in respect of the exercise price due under a securities option or phantom option where Part 7A charges arise (ITEPA 2003 s 554Z7). This may be of assistance if the general share scheme exclusions cannot be relied on (see 'Implications for share schemes' below).

The loan charge

One of the key drivers for Part 7A was to curb arrangements whereby loans in lieu of bonuses were provided to employees from assets held in EBT sub-structures. However, one of the problems with Part 7A, as originally implemented, was that it did not specifically deal with loans which were made prior to 9 December 2010 and remained outstanding. Unless a further relevant step was taken, no Part 7A liability arose in respect of the loan. Despite HMRC's contention that these types of arrangement should be taxed to income tax and NICs, and in the absence of a major decision in the courts up until *RFC 2012 Plc (in liquidation)* [2017] UKSC 45 (the *Rangers* case), not all employers sought to settle outstanding liabilities under the settlement opportunity (see below). To tackle this, F(No. 2)A 2017

Sch 11 ('Sch 11') created a one-off tax charge on disguised remuneration loans which remained unpaid at the end of 5 April 2019 (the 'loan charge').

The legislation deemed there to have been a 'relevant step' in relation to certain loans and quasi-loans made on or after 6 April 1999 that had not been repaid, written off or released by 5 April 2019.

The value of the relevant step was the amount of the loan or quasi-loan outstanding immediately before either:

- the end of the 'approved repayment date', if the benefit was an 'approved fixed term loan' on 5 April 2019; or
- the end of 5 April 2019 in any other case.

The definition of 'loan' was broad and included any form of credit or payment to be made by way of loan, however described.

If an employee or the employer acquired part or all of the loan receivable before the end of 5 April 2019, that amount was treated as still outstanding (whether or not consideration was given). This prevented any argument that the loan was outside of the scope of the charge because the lender was not a relevant third person.

Similarly, anti-avoidance provisions were included to prevent a situation where an employee repaid a loan or quasi-loan and received some form of tax-free benefit in lieu of it (Sch 11 paras 4 and 12).

There were lengthy provisions concerning loans and quasi-loans denominated in currencies other than sterling and in depreciating currencies, and how they should be treated for the purposes of the loan charge (Sch 11 paras 6–10 and 14–18).

The charge was postponed in the case of an 'approved fixed term loan'. Where certain conditions were met, a borrower could apply to HMRC to postpone the loan charge that would otherwise arise to the approved repayment date (the date on which the loan must be repaid under its original terms) (Sch 11 para 1(2)(a)).

The conditions comprised the following:

- the loan must have been made before 9 December 2010;
- the loan must have a fixed term of ten years or less; and
- the loan must not have been replaced by another loan, and it cannot have been varied to meet the exemption conditions, or to extend the repayment date (Sch 11 para 19).

In addition, either one of the following conditions must also have been met:

- loan repayments must have been made at intervals of not less than 53 weeks throughout the term of the loan; and
- the loan must have been made on commercial terms, and the borrower must have complied with those terms (Sch 11 paras 22–22).

It was open to a borrower to make an application to HMRC for approval for fixed term status during 2018 on form DR100. Late applications to HMRC for approved fixed term status were allowed, provided that HMRC considered it 'reasonable' in all the circumstances for a late application to be made (Sch 11 para 20).

Accelerated payments

The legislation also provided for the loan charge to be postponed if an accelerated payment notice or a partner payment notice had been issued under FA 2014, and the borrower made a payment under that notice on or before 5 April 2019 (or, in the case of an approved fixed-term loan, the approved repayment date). The amount of the outstanding loan must have been equal to or less than the accelerated payment (Sch 11 para 23).

In such circumstances, HMRC could determine that the loan charge did not apply until 30 days after repayment of the accelerated payment by HMRC to the borrower. This provision could be relevant where there is an ongoing dispute about an earlier event in relation to the loan. If HMRC is successful, part or all of the loan charge will not apply, as HMRC will have recovered tax on some or all of the loan amount already (the accelerated payment). If HMRC is unsuccessful, any postponed loan charge would then fall due within 30 days of the repayment by HMRC of the accelerated payment.

The loan charge did not apply to the following loans, provided no tax avoidance motive existed:

- those made on ordinary commercial terms;
- outstanding employment-related loans up to £10,000;
- certain loans made under employee benefit packages;
- cashless exercise loans to facilitate the exercise of share options;
- certain car ownership schemes; and
- loans to acquire unlisted shares in an employing or group company (Sch 11 paras 25-35).

Non-UK employers

The host employer provisions apply where the legal employer is outside the UK and the employee is providing services to the UK entity (the host employer). Whist they apply to Part 7A charges in general, the rules were amended by Finance Act 2018 so as not to apply to the loan charge, requiring the employee to pay it through self-assessment. The NICs position mirrors the income tax position so the employer is relieved from having to account for Class 1 NICs (ITEPA 2003 ss 689(1A) and 689(4A), FA 2018 Sch 1 para 12 and Social Security (Contributions) (Amendment No. 2) Regulations, SI 2018/257, reg 22B(3A)).

Loan charge review

On 11 September 2019, the chancellor commissioned an independent review of the loan charge, following concerns widely expressed by individuals, campaigners and MPs. This was largely due to the retrospective nature of the charge (covering loans dating back to 1999) and its potential to give rise to potentially significant amounts of tax. The review was published on 20 December 2019 and made a number of recommendations. It noted that HMRC's position that tax was always due on loans before December 2010 was strongly disputed; and for pre-December 2010 loans, its approach was not supported by the courts until the decision in the *Rangers* case (see what arrangements have been affected by Part 7A below). The government recognised the concerns raised in the review about the impact of the loan charge on individuals and its fairness.

As a result of the review, the government confirmed the following recommendations:

- The loan charge would be amended so that it only applies to loans taken out on or after 9 December 2010 (the date the disguised remuneration rules were announced), rather than 1999.
- The loan charge will not apply to users of loan schemes between 9 December 2010 and 5 April 2016 (when the loan charge was announced) who fully disclosed their schemes and where HMRC failed to raise an enquiry. (Taxpayers who failed to make a disclosure will remain subject to the charge.)
- Loans entered into after 5 April 2016 will still be subject to the charge (even if HMRC has not opened an enquiry).

- Draft legislation will be introduced to support repayment of loan charges settled voluntarily but that now fall within the exclusions.
- The maximum amount a taxpayer can be asked to pay in one year should be capped at half of their disposable income and a 'reasonable proportion' of their liquid assets.
- Taxpayers should not have to sell their main residence or use their pension to pay the loan charge.
- Users of affected schemes will be able to defer filing their tax returns and paying their loan charge liability until September 2020.
- Taxpayers will be permitted to split the balance of any affected outstanding loans over three tax years to make repayment plans more affordable and to avoid a taxable amount falling within one tax with the associated impact on marginal income tax rates.
- HMRC should extend previously announced time to pay arrangements for settled liabilities to taxpayers subject to the loan charge, on the same terms, so that taxpayers earning up to £30,000 have up to seven years to pay, and taxpayers earning up to £50,000 have up to five years.
- The report recognised that tax avoidance schemes, including loan schemes, continue to be promoted and that there was an increase in first time users of such schemes in 2017/18. A number of recommendations were made to tackle avoidance in this area (see 'Implications for EBT based remuneration planning' below).

On 21 January 2020, draft legislation and guidance was published to implement some of the recommendations. The following were included:

- The loan charge will only apply to loans made on or after 9 December 2010.
- The loan charge may be split equally over three tax years (2018/19, 2019/20 and 2020/21), provided an election is made by the taxpayer before 1 October 2020.
- Where taxpayers made reasonable disclosures of their loans or quasi loans in a tax return but HMRC took no action before 6 April 2019, the amount due under the loan charge is reduced by the amount that reasonably could be considered to be taxable.
- Late payment interest will not apply to income tax and capital gains tax liabilities due in respect of the 2018/19 tax year and outstanding between 1 February 2020 and 30 September 2020 where a taxpayer files and makes payment of the tax by 30 September 2020.

Self-assessment

If the taxpayer is required to report and pay the loan charge, the deadline would usually have been 31 January 2020. However, following the loan charge review, HMRC has agreed that taxpayers can file their returns by 31 January 2020 giving a best estimate of the outstanding loan balance or can defer the return until 30 September 2020.

ITEPA 2003 s 222

The loan charge is within the scope of ITEPA 2003 s 222. Therefore, if the employee does not make good the loan charge accounted for under PAYE within 90 days of the end of the 2018/19 tax year, a s 222 liability will arise.

Corporation tax relief

In general terms, contributions to EBTs do not qualify for corporation tax relief until 'qualifying benefits' are paid in a form that gives rise to employment income and NICs (subject to a number of exceptions) (CTA 2009 ss 1290 to 1296).

The definition of 'employee benefit scheme' in CTA 2009 s 1291 includes 'relevant arrangements' in ITEPA 2003 ss 554A and 554AA; and the definition of qualifying benefits in CTA 2009 s 1292(6A) includes 'relevant steps' under Part 7A. This means that a corporation tax deduction potentially becomes available when, and to the extent that, there is a disguised remuneration charge (CTA 2009 ss 1291(4) and 1292(6A)).

However, in order to create a further disincentive for disguised remuneration planning, F(No. 2)A 2017 amended CTA 2009 s 1290 to restrict deductions for contributions made on or after 6 April 2017 in two ways. First, deductions for an employee benefit contribution will be permanently disallowed if qualifying benefits are not provided out of the contribution within five years of the end of the period of account in which the contribution was made. Secondly, no deduction is available unless income tax and NICs liabilities in respect of the benefits provided out of the employee benefit contribution are accounted for within 12 months from the end of the period of account (F(No. 2)A2017 s 37, HMRC's *Business Income Manual* BIM44611 and CTA 2009 ss 1290(1A), (3B)–(3F)).

What arrangements have been affected by Part 7A?

Broadly, any arrangements which provide employment benefits through a third party, such as an EBT, have been significantly affected unless a statutory exemption applies.

Common historic uses of EBTs that fall within the scope of the legislation include:

- loans from the trustees of an EBT to an employee (even if subsequently repaid) (FA 2011 Sch 2 paras 53–54 and EIM45910); and
- the allocation of assets from an EBT to a sub-fund established for the benefit of an individual employee and/or his family (this constitutes earmarking within ITEPA 2003 s 554B).

In the *Rangers* case, a long-running piece of litigation regarding the provision of loans to employees through EBT sub-fund structures, the Supreme Court ruled that contributions made by a company to an EBT to provide employee loans were 'redirected earnings' of the employee for whose benefit they were contributed and therefore taxable. This was the first key victory for HMRC in the courts, that loans would be taxable as income. In turn, this led to a debate as to whether Part 7A would apply (or need to apply) given the funds in the EBT were the employee's own taxed funds anyway.

As a result, specific provisions were added to the disguised remuneration rules by FA 2018 to clarify the position. These provisions stated that Part 7A applies where the arrangement was originally funded by the employee's redirected earnings (whether or not those earnings were taxed). This treatment applies to relevant steps taken on or after 22 November 2017 for the main gateway and 6 April 2018 for the close company gateway (irrespective of when the redirection of earnings took place) (ITEPA 2003 ss 554(5A)–(5C) and 554AA(5)–(7) and FA 2018 Sch 1 paras 1–2), namely:

- the distribution of assets from a sub-fund, even if the sub-fund was established before 6 April 2011 (this constitutes a payment or transfer within ITEPA 2003 s 554C); and
- the operation of certain employee share plans (whether

or not tax-advantaged, although many of the steps associated with tax-advantaged schemes are specifically excluded) (see 'Exclusions' and 'Implications for share schemes').

Implications for pensions

EFRBS and unapproved pensions

One of the government's policy objectives in introducing Part 7A was to target contributions to pension arrangements outside the registered pension scheme regime to ensure they did not benefit from tax advantages beyond the annual allowance and lifetime allowances.

Whilst there are specific exclusions from the disguised remuneration rules for steps taken in relation to registered pension schemes, the introduction of Part 7A has significantly affected the use of EFRBS or unapproved pensions. Here, trustees will be treated as earmarking when assets are acquired and held for the provision of retirement benefits for an individual, with the associated Part 7A charges arising. There are provisions to prevent double taxation, with Part 7A charges applying first and any associated EFRBS charges applying to any excess (EIM15010).

However, a relevant step within ITEPA 2003 s 554C or 554D does not give rise to a Part 7A charge if the step is the provision of pension income under ITEPA 2003 Part 9. This means that pension income deriving from unregistered pension arrangements will continue to be charged under the existing income tax legislation and not under the disguised remuneration rules, ensuring that pensions income will not be subject to double taxation (ITEPA 2003 s 554S and EIM45610).

There is only one category of unapproved pension funding that remains outside the scope of Part 7A. This is where wholly unfunded pension promises are provided by employers, provided there is no form of security for the pension; or where the benefits are to be provided by the employer directly, provided there is no third-party involvement (EIM45155). ITEPA 2003 s 554U prevents a Part 7A charge arising to the extent that the relevant step is in respect of money or assets derived from taxed contributions into the EFRBS prior to 6 April 2006 (ITEPA 2003 ss 554E(1)(g)–(h)).

There are various exclusions for payments from, and transfers between, certain types of existing unapproved pension arrangements, to the extent that payments/transfers derive from rights accrued at specified dates (ITEPA 2003 ss 554X and 554W).

Registered pension schemes

While there are no blanket exclusions in relation to registered pension schemes which prevent them from being 'relevant arrangements' for the purposes of Part 7A, a number of specific exclusions cover their operation as follows:

- the provision of pension income chargeable to income tax or which is exempt from tax under ITEPA 2003 Part 9A is not a relevant step for the purposes of ITEPA 2003 ss 554C or 554D; and
- ITEPA 2003 s 554T prevents relevant steps from giving rise to Part 7A income if they are taken in respect of sums of money or assets derived from an individual's pension contributions, subject to various requirements.

However, a Part 7A charge will arise where an employer provides a 'relevant undertaking' that a contribution will be made to a registered pension scheme (even if it is not acting as trustee) (ITEPA 2003 ss 554Z16–554Z21).

Implications for share schemes

The exclusions for share schemes and deferred remuneration arrangements were not as broadly drafted as they might have been, but cover the majority of share plans operated by employers through employee trusts, provided they are used with care. Some scheme rules will need to be amended to benefit from the relevant exemptions (ITEPA 2003 ss 554E and 554I–554N).

Many companies 'warehouse' shares in an EBT to be used to support their share scheme arrangements. Care should be taken to avoid inadvertent 'earmarking' of shares where, for example, the trustee of an EBT agrees to satisfy awards granted by an employer. For an arrangement to pass through a gateway, there must be a specific employee to whom the arrangement relates. HMRC has confirmed that where a pool of shares is held by a trustee and the trustee has not granted the awards and does not know the number of shares awarded to an employee, no earmarking arises (EIM45110). However, given that it will often be necessary for a trustee to have full details of awards at the time they are asked to exercise their discretion to satisfy them, to ensure they are exercising proper fiduciary duties, it may remain important to ensure that statutory exclusions are available (see above).

Arrangements which involve the acquisition of shares from EBTs by relevant employees on deferred payment terms are caught by Part 7A (as a transfer of assets within ITEPA 2003 s 554C). Where tax-advantaged share schemes (such as EMI or CSOP) are not available, companies may choose to offer shares to employees on terms that allow the future growth in value to be taxed to capital rather than income (through, for example, the grant of unapproved options).

To achieve this, employees must acquire shares by paying their unrestricted market value for tax purposes (entering into an election under ITEPA 2003 s 431). If the share price is prohibitively high for employees to fund at the outset, schemes will typically be structured such that employees commit to paying the full market value for shares (allowing future growth to be taxed as a capital gain), but with the purchase price left outstanding until such point as a gain can be realised from the shares in the future. The outstanding unpaid purchase price is taxed under the notional loan rules (ITEPA 2003 s 446S).

This type of arrangement offered through an EBT usually gives rise to an upfront tax charge under Part 7A. There is an exemption for the acquisition of an asset where consideration is given by the employee, equal to or greater than its market value, but the consideration must be paid 'before, at, or at about the time of the acquisition in money or money's worth', which of course does not assist with this type of arrangement (ITEPA 2003 ss 554N(7)–(8)).

Implications for EBT-based remuneration planning

As indicated above, the disguised remuneration rules have prevented the use of tax efficient loans, unapproved pension provision and other forms of remuneration through EBTs, to the extent that they are not covered by statutory exemptions.

Despite the success of HMRC's settlement opportunities (see below), it is recognised that many

arrangements remain in place, and ever more artificial and contrived schemes are being implemented to exploit perceived loopholes in Part 7A. It is clear the government remains intent on preventing avoidance by taxpayers. HMRC's general anti-abuse rule (GAAR) guidance contains, at Part D, an example on disguised remuneration (D25A), highlighting HMRC's view that arrangements operated via EBTs are contrived or abnormal; it will seek to use the GAAR to counter them (Part D).

Additionally, a specific employment income hallmark targeting schemes designed to avoid the disguised remuneration rules was introduced into the disclosure of tax avoidance schemes (DOTAS) regime with effect from 4 November 2013 for income tax and NICs purposes.

The government has introduced a penalty regime for those who enable the use of tax avoidance arrangements which HMRC later defeats. The provisions, which follow the August 2016 consultation on strengthening tax avoidance sanctions and deterrents, were included in F(No. 2)A 2017. They include those who design, manage or market the arrangements and also certain individuals who participate in them.

HMRC regularly issues 'Spotlights', which highlight tax avoidance schemes that HMRC believes are being used to avoid paying tax due. Disguised remuneration and related matters have appeared regularly since Spotlight 5 (August 2010), which was one of the first communications from HMRC that warned of its attack on the use of EBTs to reward employees. Spotlight 41 (September 2017) followed HMRC's victory in the Supreme Court as part of the *Rangers* case litigation and its assertion that the principle of re-directed earnings applied to a wide range of disguised remuneration arrangements. HMRC also issued a number of spotlights highlighting disguised remuneration and schemes affected by the loan charge (Spotlights 36, 39, 49 and 50). Whilst the Spotlights do not carry any legal weight, they are an insight into which schemes HMRC is aware of and prepared to act against.

HMRC also maintains its stance on the scope for inheritance tax charges on contributions made to an EBT by close companies and transfers out of EBTs to sub-funds (*Revenue & Customs Brief 18/11*). This is supported in the information provided as part of the settlement opportunity as to where IHT may have arisen and what must be settled.

As noted above, the report on loan charges urged the government to explain how it proposes to deal with anti-avoidance arising from loan schemes in the future. It also highlighted the role of promoters and recommended the government to take further measure to tackle them, including explaining to taxpayers how to challenge promoters and advisers who may be misselling these schemes.

It further recommended that the government should publish a new strategy for a more effective system of oversight for tax advisers, including possibly formal regulation of tax advisers, within six months. This may come as unwelcome news for practitioners.

Disguised remuneration settlement opportunity

The original settlement opportunity which followed the implementation of Part 7A under the employee benefit trust settlement opportunity (EBTSO) closed in 2015. On 7 November 2017, HMRC published details of a new disguised remuneration settlement opportunity enabling companies, employees and self-employed contractors to settle income tax, NICs, capital gains tax, inheritance tax and corporation tax relating to disguised remuneration arrangements, in particular the loan charge. The arrangements were not as generous as EBTSO (HMRC employee benefit trust settlements after 31 July 2015).

When originally announced, HMRC issued a deadline of 31 May 2018 for taxpayers to register an interest in taking advantage of the settlement terms. On 1 June 2018, the 31 May 2018 deadline was removed, but updated guidance was published in February 2019 and provided a deadline of 5 April 2019.

In addition to settling liabilities for open tax years, the settlement opportunity offered the ability for the taxpayer to make a voluntary 'restitution' payment to ensure that no further disguised remuneration charges arise in future in relation to closed tax years.

HMRC made it easier for those earning less than £30,000 and £50,000 who settle under the November 2017 terms to arrange to pay their settlement in instalments. Those with gross earnings of less than £30,000 can pay over a period of seven years; and those earning less than £50,000 can pay over five years, without having to provide detailed financial information.

Implications for non-employees

In the 2016 Autumn Statement, the government confirmed that the disguised remuneration rules would be extended to apply to self-employed individuals. HMRC's main concern were arrangements which sought to divert monies to a third party which would otherwise be earnings of an individual's trade. The individual would then receive the benefit of those amounts in a tax free or reduced tax basis. F(No. 2)A 2017 introduced detailed provisions for a charge to income tax on certain benefits received by self-employed traders. The relevant provisions of the F(No. 2)A 2017 amended the ITTOIA 2005.

Final thoughts

The disguised remuneration legislation is a complex set of interlinking provisions which employers and advisers need to be aware of. The breadth of scope of the rules, and their potential to catch legitimate remuneration arrangements with no anti-avoidance motive, require them to be handled with care, to ensure unexpected PAYE and NICs liabilities are avoided.

Whilst the rules have been largely successful in countering *Rangers* style loan planning through trust arrangements, it seems inevitable that the legislation will continue to grow in complexity to counter the continued appetite for ever more contrived schemes promoted to avoid, defer or reduce the payment of tax.

However, despite the force of such a piece of legislation there are salient lessons to be learned by HMRC, in response to the widespread concerns as to how the loan charge was implemented, its fairness and the manner in which tax-payers have been treated. The further legislation is awaited with interest, along with details of the government's strategy for the regulation of tax advisers in this area. ■

For related reading visit www.taxjournal.com

- Amendments to the 2019 loan charge: work in progress (David Southern QC, 17.2.20)
- The *Rangers* case and the redirection of earnings principle (Karen Cooper & Mairi Granville-George, 18.11.15)