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A legal update from Dechert's International and Domestic Tax Group

HMRC Publishes FAQs on Proposed Anti-Avoidance Provisions Targeting Employee Benefit Trusts

HM Revenue & Customs published draft legislation in December 2010 to tackle perceived tax avoidance arrangements using employee benefit trusts and other vehicles to reward employees whilst seeking to avoid the payment of tax. As a part of an ongoing consultation into the legislation, questions and answers dealing with interested parties' comments were released on 21 February. The FAQs specifically address some unintended consequences of the original draft and provide some comfort that common non-tax driven remuneration structures should not be caught. However, they also confirm that the legislation is deliberately broad and will remain so when applied to planning with a tax avoidance purpose.

The draft legislation released in December had been expected since the coalition Government announced in the June budget that it would introduce legislation to counter arrangements for "*avoiding, deferring or reducing liabilities to income tax and national insurance contributions or avoiding restrictions on pensions tax relief*" using EBTs and similar vehicles, but the scope and effect of the legislation was broader than anticipated (and, it now appears, broader than intended).

In overview, the legislation is intended to ensure that loans made available by an EBT (or other third party) in connection with an employment (whether past, current or future) will give rise to a charge to income tax (by way of PAYE) and national insurance as if the loan was an outright payment. Similarly, if the EBT provides assets for use by employees a charge to income tax will arise on the market value of the assets. The legislation is very widely drawn and extends to the informal earmarking of a sum of money or an asset for an employee even if details of how the sum of money or asset will actually be provided are not known or if the proposed recipient has no legal rights in respect of such sum or asset.

The evolving nature of tax planning means that anti-avoidance provisions will often be general in their application to remain effective over time. The danger of this broad approach is that the provisions extend beyond their intended scope to commercially driven planning. In the present case, many respondents noted the potential application of the draft legislation to genuine deferred remuneration arrangements and conditional employee share plans (which may, in some cases, be required by the FSA's Remuneration Code). To address this concern, the legislation will be amended so that no charge will arise on the making of a deferred award provided that (i) the award is subject to conditions which, if not met, will prevent the employee receiving the full reward; (ii) the arrangements specify a vesting date within five years of the date of the grant; and (iii) the award will be taxable as employment income at the time of vesting. It will also be a requirement that the deferral or avoidance of tax must not be one of the main purposes of the arrangements.

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Further amendments and clarifications include:

- The FAQs explain that changes will be made to the application of the provisions to group companies to prevent a charge arising to commercial and otherwise innocent arrangements between employees and a non-employing group company. This could be relevant to remuneration structures involving parent companies and cashless exercise facilities used on the exercise of options.
- The accrual of any income and gains arising on assets already earmarked for a particular employee (for example in a sub-trust) will not itself give rise to a charge. It is not clear how the reinvestment of such income and gains into other assets will be treated.
- It is confirmed that no charge will arise where shares or funds are put into an EBT to meet the future requirements of an employee share plan but are not specifically earmarked for particular employees at that time.
- The legislation will not apply to loans paid and assets made available before the legislation applies, but a subsequent reallocation of the loan or asset could bring them within scope.
- There was a great deal of concern that any reinvestment by a trustee at the suggestion of an employee will be caught by the legislation, but HMRC has confirmed that amendments will be made to the legislation so that this will not be the case and a charge will only arise where value leaves the arrangement in favour of the employee.
- It was also confirmed that changes will be made to ensure that the remittance basis and the 10% abatement for foreign pension schemes will continue. In addition, it was confirmed that the new rules would not alter the character of pensions and retirement income under the UK's double tax treaties.

The changes summarised above are helpful in clarifying the intended scope of these 'disguised remuneration' provisions. However, the FAQs confirm the legislation will apply in its original breadth in other areas. In particular, the FAQs confirm that the rules are not restricted to arrangements involving EBTs and employee financed retirement benefit planning ("EFRBS") but extend to other structures which have the same or a similar effect. It is confirmed that the wide charging provisions in relation to loans are intended and that loans without genuine commercial rationale are at risk of being caught (though there may be an exemption for short term loans in certain transactions). No tax credit is available where a loan which has been subjected to a disguised remuneration charge outside the initial transitional period is repaid. It is also confirmed that it is intended that a tax charge could arise under the provisions after an employee has ceased to be employed even if the employee has since become non-UK resident.

The FAQs helpfully clarify the intention behind the draft disguised remuneration legislation. Further FAQs will be published as appropriate in due course. However, the proposed changes are described by HMRC as mere "*refinements*" to the legislation and the FAQs do not give any indication that there will be a relaxation of the intended scope of the provisions. Until revised draft legislation is published later this year, employers should take the uncertainty over these provisions into account and exercise caution in their remuneration and incentive planning.

Practice group contacts

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