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Employers beware: New UK anti-avoidance tax laws on 'disguised remuneration' - share schemes and employee benefit trusts

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New anti-avoidance legislation in the UK is in force and could result in unexpected and costly tax charges for employers and employees in relation to remuneration arrangements using employee benefit trusts (EBTs) and other intermediaries. Whilst there are a number of complex exemptions which should apply in most cases where EBTs are used in conjunction with share schemes, employers need to take much care and seek advice on the operation of their plans.

Introduction

For many years, HMRC has been seeking to attack tax planning arrangements which seek to defer or avoid employment income tax or National Insurance Contributions (**NICs**) using intermediaries, usually EBTs. On 9 December 2010, HMRC published complex draft anti-avoidance legislation attacking "disguised remuneration".

The legislation applies to arrangements which involve an **intermediary** and provide an **employee** with a **reward**, **recognition or loan**, whether in the form of cash, shares or other assets. The legislation contains a number of charging provisions which may apply a charge to tax earlier than expected (e.g., when funds are "earmarked") even if the employee never actually receives any reward.

The initial legislation was widely drawn and appeared to catch many standard commercial incentive arrangements where intermediaries such as EBTs are used. However, after much lobbying, the legislation has been comprehensively amended and now there are a number of exemptions and relieving provisions.

What types of arrangement are caught?

Employers need to be extremely careful as the disguised remuneration provisions potentially cover a wide spectrum of situations. For example:

- Using an EBT to hold deferred cash remuneration, even if this is to comply with obligations under the FSA Remuneration Code!
- Loans to employees, including certain cashless exercise facilities, and there is no relief even when the loan is repaid
- Certain unapproved pension arrangements
- Hedging the cost of share plans using shares held in an EBT
- Granting options and other awards under a share plan

This list is not exhaustive. The only "safe" form of remuneration is direct employer-to-employee salary payments since, in most cases, for the legislation to apply, **a third party must be involved**. So, for example, if a company issues shares to satisfy share options it has granted, there should be no charge. Furthermore, the same applies to a group company, e.g., a parent company issuing shares to an employee of a subsidiary.

Are share plans caught?

Potentially, but there are a number of exemptions and relieving provisions to consider. The main concern has been whether there will be a tax charge when a trustee determines that it holds funds or shares for the purposes of satisfying awards or options under a share plan (a new tax concept of "**earmarking**"). This is an extremely common arrangement used by companies in conjunction with their share plans either for hedging purposes or to reduce the dilution impact of their share plans. There are also company law reasons why EBTs have had to be used with certain forms of long-term incentive award.

As a result of amendments to the legislation, in most cases one of the exemptions should apply. Certainly, there are fairly wide exemption provisions for HMRC-approved share plans, such as company share option plans and enterprise management incentive share options. There are also exemptions for non-HMRC-approved share plans but more care is required. In either case, employers cannot assume that they will always fall within one of the exemptions as there are a number of potential pitfalls. For example, the exemption in relation to earmarking shares to satisfy unapproved share options applies only if the number of shares earmarked is not more than the maximum number reasonably required.

Deferred consideration share plans using EBTs (i.e., where the employee acquires shares up front but payment is deferred) are potentially caught in all cases and advice should be taken in each case.

Can we still operate deferred bonus and long-term cash plans?

Employers need to be very careful using EBTs with deferred cash bonus arrangements and other types of cash plans. The main target of the legislation is long-term cash tax-deferral arrangements particularly using sub-trusts. It is still possible to use EBTs for deferred cash plans but the arrangements need to be designed to fall within the restrictive exemptions in the legislation.

Cashless exercise

Usually employers offer cashless exercise facilities to employees to help them exercise their options without having to find the cash upfront to pay the exercise price or tax/NICs charges. Effectively, an employee is offered a loan to bridge the funding gap until he or she can sell shares to pay the exercise price and tax/NICs bill. These types of loans will generally be exempted provided the loan is refunded within 40 days.

What about our existing arrangements?

The legislation is not meant to be retrospective and, generally, arrangements made by EBTs prior to 9 December 2010 are not affected by the new legislation. Indeed, most non-loan arrangements are only caught from 6 April 2011. However, extensions or alterations to existing arrangements could be caught.

Our services

The legislation is complex and employers should review their employee incentive arrangements and obtain relevant tax advice. This is particularly important if remuneration is provided by an intermediary. We will review your existing arrangements to determine the application of the legislation and work with you to design tax-effective plans. We have particular experience in advising financial service companies on how to avoid this legislation whilst still complying with the FSA Remuneration Code.

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