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Global Employer Services

GES NewsFlash

United Kingdom – Disguised remuneration and expatriate assignments: A further update

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Summary

The UK has introduced new tax rules to prevent employees avoiding the normal tax charge on outright payment of remuneration through long-term loans, unapproved pension arrangements, and other forms of remuneration deferral. Previous Global Employer Services (GES) NewsFlashes have outlined the potential impact that the UK's draft legislation on "disguised remuneration" could have on regular expatriate assignments. This update reflects the publication of revised draft legislation as part of the Finance Bill 2011.

Although the revised draft legislation includes some welcome changes, there are still a number of issues that employers need to be aware of particularly in relation to deferred compensation plans, share-based arrangements, and certain pension schemes.

In any case where a tax charge arises under the new legislation, the employer will be required to account for income tax and, where applicable, National Insurance Contributions (NICs) under the UK's Pay As You Earn (PAYE) withholding system. This will be the case even if there is no sum from which the tax and NICs can be withheld. In the case of tax-equalized employees, an immediate tax gross-up will be required.

The good news

In our NewsFlash of January 21, 2011, we explained that the disguised remuneration legislation applies where payments or benefits are provided by a "relevant third party" and that this could apply where a host entity pays or provides some or all of an international assignee's remuneration.

In our NewsFlash of March 2, 2011, we explained that the government had

confirmed that, subject to an anti-avoidance override, group companies would not be regarded as relevant third parties. In this context, companies are in a group only where they are 75% subsidiaries of either the principal company of the group or another 75% subsidiary. This is more restrictive than we would have liked and while it is a welcome change, the revision does not assist in cases where an expatriate is assigned to, for example, a Joint Venture or a public body. Employers who second employees to an entity outside the group should take professional advice at the earliest opportunity.

The above change may resolve the potential issue that existed in relation to tax loans, but only insofar as these are advanced by another company within the group, typically the host entity. Any tax-related loans, including those intended to defer tax gross-up, which are advanced by an entity outside the group could be problematic unless advanced by a recognized lender on genuine commercial terms.

However, the change did not resolve the issue for companies that outsource relocation services to a third-party provider, but a specific amendment has been made to make sure that all qualifying relocation benefits, whether or not they exceed the £8,000 exemption, are excluded from the new rules.

Deferred compensation arrangements

Deferred compensation arrangements remain problematic where a nongroup entity is involved. As outlined in our NewsFlash of March 2, 2011, deferred compensation arrangements will not be subject to UK tax provided various conditions are met, including each of the following:

- The vesting date must not be more than five years from the date of deferral and the reward must not be delivered before the vesting date
- Vesting must be subject to specified forfeiture conditions which, if not met, cause the reward to be revoked
- On vesting, the deferred reward must be subject to tax as employment income
- The deferral or avoidance of tax must not be the main or one of the main purposes of entering into the arrangement

HM Revenue & Customs (HMRC) has confirmed that bad leaver provisions will meet the “specified forfeiture conditions” test, but only where “there is no possibility of the employee receiving the reward if the conditions for forfeiture are triggered.”

Two key areas of concern are voluntary deferrals which may not be forfeitable under any circumstances and amounts deferred for periods in excess of five years. Many U.S. plans, in particular, allow deferrals for periods well in excess of five years. To the extent that voluntary or long-term deferrals are for a period of service in the UK,

the amount deferred will attract an immediate UK tax charge.

Share based arrangements

Generally speaking, the disguised remuneration legislation will not apply to the grant and exercise of stock options or the award and vest of other share based incentives. However, a tax charge under the "earmarking" provisions can arise where such options or awards are hedged with shares, i.e., where shares are held with a view to obligations under the scheme being met.

This is a complex area and employers are advised to take professional advice in order to ensure they understand the new rules. In general terms, an earmarking charge can be avoided provided conditions not dissimilar to those outlined above in relation to deferred compensation arrangements are met. For example, in relation to stock options, an earmarking charge will not arise even where the award is hedged provided:

- The option is not exercisable before the vesting date
- The vesting date is no later than five years from the award
- The option terms are such that the entire award is forfeitable if specified conditions are not met on or before the vesting date
- There must be a reasonable chance that the specified conditions will not be met

Where the conditions above are not met such that an earmarking charge applies to any funding of the award, the amount subject to tax is reduced by the amount the employees will need to pay to exercise their option.

Pension arrangements

Significant changes have been made to the initial draft legislation insofar as it relates to pension schemes that are neither UK-registered pension schemes nor a foreign equivalent.

The good news is that the legislation has been amended to make clear that:

- Retirement income taken as pension income will continue to be taxed as and where appropriate under the pensions legislation
- The provisions of any relevant double tax agreement insofar as it covers retirement income will take precedence over the new rules

The legislation has also been amended to carve out lump-sum retirement benefits insofar, as these accrued on or before April 5, 2011. Such lump sums will continue to be taxed under the existing legislation. Lump sums attributable to pensionable service while living and working outside the UK will remain exempt, under the UK's

Extra Statutory Concession A10 (ESC A10).

Lump sum retirement benefits accruing on or after April 6, 2011 will be taxed under the new rules without relief under ESC A10 other than in the case of wholly unfunded arrangements where the benefit is paid by the employer.

Deloitte's View

We are pleased that the government has listened to and responded positively to many of the concerns we raised with HMRC during the consultation period that started on December 9, 2010. However, we are disappointed that the definition of "group companies" is so restrictive and we remain concerned about the application of the legislation to expatriates working in the UK who continue to participate in home country benefit plans that are not set up to comply with UK legislation. U.S. deferred compensation plans are of particular concern and we strongly recommend that employers obtain professional advice in relation to any such arrangements within the immediate future.

Employers also need to consider carefully the issues relating to share-based incentives and non-UK pension schemes, as the rules are complex and can give rise to some surprising results.

When considering these changes, employers should remember that where a tax charge arises under the new rules, there will be a PAYE obligation and a possible NIC charge. Where this legislation applies, there will frequently be no payment from which tax can be deducted, but the employer must account for withholding all the same. Employers should ensure they have the processes in place to remain compliant with UK law, budgets are updated to reflect any increased costs, and their international assignment policies are reviewed and where necessary amended to cover the issues raised by these changes.

People to contact

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