



**Finance (No.3) Bill 2011: Disguised Remuneration Legislation
– Frequently Asked Questions**

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Introduction

This document provides answers to frequently asked questions on the 'Disguised Remuneration' legislation included in Finance (No 3) Bill as Clause 26 and Schedule 2. These Frequently Asked Questions (FAQs) replace version 2 published on 31 March 2011.

Draft provisions were originally published on 9 December 2010 to allow comment on the proposed legislation for the disguised remuneration measure being introduced by the Government 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.

The first version of this FAQ document published on 21 February 2011 provided answers to common questions received by HM Revenue & Customs (HMRC), to clarify the policy intention in a number of areas where the application of the draft legislation as published on 9 December 2010 had raised concerns with external commentators, and to explain areas where the Government intended to make amendments. The FAQ document was updated on 31 March 2011 to reflect changes, and some new provisions, which addressed points arising during consultation and which were incorporated in the legislation, as presented to Parliament in Finance (No 3) Bill.

The legislation itself was amended at the Public Bill Committee stage of the Finance Bill process to extend some of the exclusions and clarify interactions with other legislation. These amendments were made following representations received after publication of the Bill. The primary aim of this legislation remains to protect the Exchequer. While the legislation has been refined in order to limit impacts on employers and individuals where it has been possible to identify arrangements that are not used for avoidance purposes, the relatively complex nature of many vehicles used in this sphere means that the legislation is also necessarily comprehensive.

These further-revised FAQs include revisions to some of the answers provided in Version 2, mainly to reflect the amendments made to the Finance (No 3) Bill legislation. References to previous FAQ numbers are indicated where appropriate.

These FAQs are not definitive guidance on the proposed legislation which remains subject to approval by Parliament. They will be subsumed into comprehensive guidance which will be published shortly after the legislation has been enacted.

Chapter 1 - FAQs

Scope of the legislation

1. Does new Part 7A of the Income Tax (Earnings and Pensions) Act 2003 ('ITEPA') only apply where the arrangements involve an employee benefit trust (EBT) or an employer financed retirement benefit scheme (EFRBS)? (FAQ1)

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.

2. Many third party transactions are carried out by companies in the same group as the employer and these are entered into wholly for commercial purposes. There doesn't appear to be any specific exclusion for group company transactions. Does the proposed legislation apply to such transactions? (FAQ2)

Most group company transactions will not give rise to any Part 7A charges. For the purposes of Part 7A any company in the same group as the employer at the time a relevant step is taken is treated as if they were the employer; therefore a group company will not normally be a relevant third person for the purposes of Part 7A. Section 554A(7) defines 'relevant third person' and in the majority of cases an employer is only a relevant third person when acting as trustee of an arrangement. (But there are the limited circumstances set out in Chapter 3 of Part 7A, which is concerned with EFRBS, where an employer can be a relevant third person in their own right.)

A group company will only be a relevant third person if it is acting as trustee of the arrangement (unless covered by the limited cases in Chapter 3 of Part 7A where an employer can be a relevant third person - see FAQs 37 to 40) or if there is some underlying tax avoidance purpose to a particular relevant step.

For Part 7A purposes a group of companies is defined in accordance with the rules for corporation tax on chargeable gains in sections 170(2) to (11) with one

modification; a 51 per cent test applies instead of a 75 per cent test. This is set out in section 554Z.

3. Does the proposed legislation apply to transactions under employee car ownership schemes? (FAQ3)

Some employee car ownership schemes are wholly run by the employer or other companies in the same group and where this is the case, the arrangements fall outside the new legislation as explained in the response to FAQ2. However, where this is not the case, there is a specific exclusion at section 554O for relevant steps (including the making of loans, which are made by a licensed lender and not by a trust) taken for the sole purpose of the purchase of a car or its sale-back under an Employee Car Ownership Scheme (ECOS).

The exclusion is subject to certain conditions, including that the car loan must be repaid by the later of 5 April 2012 or the repayment date specified in the arrangement (which must be no longer than four years from the date the loan was made). The exclusion will also be subject to a tax avoidance purpose test.

4. Does the legislation apply to 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? (FAQ4)

No, there is an exclusion for HPS at section 554E(1)(e), which will in practice operate until 30 October 2012.

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? (FAQ5)

No. A normal dividend payment that simply happens to follow a shares transaction will not be caught by the new rules.

6. 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? (FAQ6)

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

7. 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)? (FAQ7)

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. Section 554D(7) lists factors which may be taken into account in determining whether the employee is able to benefit from an asset in much the same way as the outright owner. These 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 paid 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).

8. What is the meaning of 'substantial proportion' in new section 554G(1)(c) and (d) which excludes certain transactions under employee benefit packages where they are available to a 'substantial proportion' of the employer's employees or comparable employees? (FAQ8)

HMRC intends to apply a similar approach as is used to applying the 'substantial proportion' test in section 176 of ITEPA. Following that approach, HMRC would accept that the test in new section 554G(1)(c) is satisfied where the benefits package is available to at least 50 per cent of the employer's employees. HMRC would accept

that the test in section 554G(1)(d) is satisfied where the benefits package is available to at least 50 per cent of the employer's employees who have a comparable status within the employer.

9. New section 554G(1)(h) 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? (FAQ9)

HMRC would accept that on its own, sacrificing salary in favour of provision of tax-exempt or tax-advantaged benefits does not constitute a tax avoidance purpose. Whether there is a tax avoidance purpose is a question of fact and there may be particular salary sacrifice arrangements that do have a tax avoidance purpose.

10. Section 554Z8 only allows credit for consideration given by way of a payment of a sum or the transfer of an asset if the consideration is given before, or at or about the time, of the relevant step. How much flexibility does 'at or about' allow? (FAQ10)

This will depend on the particular circumstances. However, HMRC would accept that 'at or about' means a few days either side of the date of the relevant step, possibly up to a week but may be longer depending on the particular circumstances.

11. If funds or assets are earmarked for a particular employee and subsequently earmarked for another purpose so that the employee will never have entitlement to the earmarked funds or assets, will the original earmarking charge under the proposed legislation be rescinded? (FAQ11)

Section 554Z14 provides for relief in a case where an earmarking charge has arisen under Part 7A and an event (the 'relevant event') subsequently arises whereby the earmarked funds/assets will no longer give rise to a further relevant step. Relief will only be available on an application to HMRC by the employee (or the employee's personal representatives if the employee has died) which must be made within four years from the time when the relevant event occurs.

12. If income arising on contributions to a trust is earmarked for particular employees or their families, will the earmarked income be subject to an employment income charge under Part 7A? (FAQ12)

No. Any income arising on funds or assets already earmarked for a particular employee (for example held within a sub-trust for a particular employee) will be excluded from an earmarking charge by virtue of section 554Q.

However, the full value of relevant steps under section 554C or 554D will still be chargeable where they are funded by income or gains on the original contribution.

13. The exclusion at section 554Q doesn't appear to apply to funds or assets which were earmarked prior to 6 April 2011. Is this intended? (FAQ13)

Paragraph 56 of Schedule 2 makes transitional provision for the purposes of section 554Q. It treats the requirements of that section as having been met in relation to the earmarking prior to 6 April 2011 of the funds or assets (giving rise to income on or after 6 April 2011) as if the section had applied when the earmarking took place.

Loans

14. 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? (FAQ14)

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. There are limited exclusions for the following loans:

- Loans made between 9 December 2010 and 5 April 2011 (inclusive) which are repaid before 6 April 2012 - see FAQ15.
- Loans made on ordinary commercial terms (section 554F).
- Loans made as part of an employee benefits package (section 554G).
- Loans made under an ECOS arrangement (section 554O) - see FAQ3.
- Certain short-term loans used to exercise employee share options (section 554N) - see FAQ28.

Where none of these exclusions apply the making of the loan will be a relevant step to which Chapter 2 of Part 7A applies.

Loans made by a company in the same group as the employer at the time the loan is made will not be within the scope of Part 7A provided they are not made in connection with a tax-avoidance arrangement. Similarly where the employer is a Limited Liability Partnership (LLP), loans made by a company wholly owned by that LLP will be outside the scope of Part 7A.

15. 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? (FAQ15)

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.

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, except in the case of certain short-term loans used to exercise employee share options and loans made under an ECOS arrangement to which the exclusions at section 554N and 554O respectively apply (see FAQ14).

Deferred remuneration

Note: FAQs 17 to 21 apply to deferred remuneration arrangements generally. FAQ16 relates specifically to deferred cash awards and there are specific FAQs about deferred remuneration arrangements involving share awards in the section on 'Employee share schemes' at FAQs 22 and 32.

16. Where arrangements for deferred cash bonuses are entered into to meet the requirements of the FSA Remuneration Code, or otherwise as good business practice or for reasons associated with corporate governance, will the new legislation apply? (FAQ16)

The legislation provides exclusions at sections 554H, and 554J to 554M for deferred remuneration whether deferred under the FSA code, or for other business reasons, subject to certain conditions being met.

The exclusion for deferred awards of cash is at section 554H. Broadly, the effect of this exclusion is that a deferred remuneration arrangement which has certain characteristics will not give rise to a Part 7A charge on earmarking at the time that the remuneration is deferred.

In order to qualify for the section 554H exclusion the following conditions must all be met:

a. On a date (the award date') the employee is awarded remuneration ('the deferred remuneration') in respect of his or her employment with the employer. (The person awarding the deferred remuneration does not necessarily have to be the employer.)

b. The main purpose of the award is not the provision of 'relevant benefits'.

('Relevant benefits' has the same meaning as in Part 6 Chapter 2 ITEPA 2003 (relating to Employer Financed Retirement Benefit Schemes), except that, here, 'relevant benefits' can include benefits charged to tax under Part 9 ITEPA 2003 (pension income).)

c. The deferred remuneration is awarded on terms whose main purpose is to defer the provision to the employee of the deferred remuneration to a specified date ('the vesting date') which is after the award date.

d. These terms also provide that the award is revoked if specified conditions are not met on or before the vesting date.

e. The vesting date is not more than five years after the award date.

f. As at the award date, there is a reasonable chance that the award of the deferred remuneration will be revoked because not all the specified conditions will be met on or before the vesting date.

g. If any person provided the deferred remuneration to the employee on the award date, that action would rank as a payment of PAYE employment income of his or her employment with the employer.

h. When the earmarking occurs, the sum of money or asset which is the subject of a section 554B relevant step represents some or all of the deferred remuneration and does not represent anything else.

i. There is no connection (direct or indirect) between the relevant step and a tax avoidance arrangement.

17. What is meant by 'specified conditions' and what amounts to a 'reasonable chance' that an award will be revoked because specified conditions are not met? Will the deferred remuneration arrangement be capable of meeting the tests for the exclusion if the only condition for providing the award on the vesting date is that the employee is not a bad leaver? (FAQ17)

Even if the only circumstances that would result in the specified conditions failing to be met are that the employee departs from the employment as a 'bad leaver' the test can still be met provided that it is realistic to suppose that the terms of the bad leaver clause could be satisfied. But this will only apply if there is no possibility of the employee receiving the reward if the conditions for forfeiture are triggered. Whether or not the reasonable chance test is met must be decided on a case by case basis. But the specified conditions must be genuine and not amount to guaranteed remuneration, just at a future date.

Where 'bad leaver' clauses include a provision for the remuneration committee or Board to exercise its discretion to override the rules in exceptional circumstances, the terms of awards can still be capable of meeting the condition at section 554H(1)(e) (and the equivalent conditions in sections 554J and 554L); ie if there is a reasonable chance that the award is revoked because the conditions for obtaining it have not been met. In other words, awards on such terms will be capable of coming within the earmarking exclusions at 554H, 554J and 554L for deferred awards. But, again, this

must be determined on a case by case basis and the conditions, when looked at against any residual discretion of the remuneration committee, must be genuine.

18. What if the reward is revoked under the deferred remuneration terms, i.e. because performance conditions haven't been met or are unlikely to be met, or otherwise withdrawn? (FAQ18)

If, following revocation of the award under the deferred remuneration terms, no further relevant step will be taken in relation to the previously earmarked sum of money or asset (or any sum or asset deriving from it), there will be no Part 7A charge.

19. Can an award only qualify for the deferred remuneration exclusion at section 554H if it is lost completely if the specified conditions are not met? (FAQ19)

No, an award can also qualify for this treatment if it could be lost only in part if the specified conditions are not met completely (provided that it also meets the other terms of section 554H).

20. Will there be an earmarking charge if the conditions have been met and the award of the deferred remuneration, or part of it, still stands but it is not received on or before the vesting date? If so, when does the charge apply? (FAQ20)

Yes, a section 554B relevant step will be treated as having been taken at the end of the vesting date if the deferred remuneration continues to be earmarked for the employee after that date.

21. If the deferred remuneration is received by the employee before the vesting date and/or before the specified conditions have been met does this mean there will be a retrospective earmarking charge back to the date when the deferred remuneration was originally earmarked? (FAQ21)

No, as long as the early receipt of the deferred remuneration does not cast any doubt on the genuine nature of the original deferral, then provided the deferred

remuneration is PAYE employment income of the employee at the time it is received there will be no earmarking charge under Part 7A.

Employee share schemes

22. Where shares are allocated to named employees to meet future liabilities under an employee share or share option plan or a long term incentive plan (LTIP), will a charge arise under the disguised remuneration measure? (FAQ22)

The policy objective of the legislation 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 the concern that these share plans could give rise to charges under the disguised remuneration measure, the legislation now provides 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 ten years from the date of grant. Where this condition is fulfilled, if vesting does not take place within ten 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.

See also FAQs 16 to 21 above on the meaning of 'specified conditions' and 'reasonable chance' and the circumstances in which a Part 7A charge may still arise in relation to deferred share awards.

23. Where there is no fixed time limit for a share award to vest, because the vesting is linked to exit events, can this give rise to a charge under Part 7A if shares are earmarked? (FAQ23)

The characteristics of arrangements which do not give rise to a charge at that point must be as listed in the answer to question (28) above, but with the difference that the vesting will only take place where certain exit events take place, rather than within a 10 year time limit. These exit events are a sale or flotation of the company in which the shares are held, and also a sale of the company's assets to a non-connected person, winding-up of the relevant company, or a change of control of the company.

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? (FAQ24)

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.

In general, there will be no earmarking where there is a pool of shares and a pool of employees and:

- the trustee has not granted the awards to the employees
- the trustee does not know the number of shares to be awarded to an employee

So, for example, no earmarking will have occurred if the trustee:

- only knows that 'x' shares have been granted to 'y' employees of a particular company; or
- only knows that 'x' shares in total have been granted to a named group of employees but does not know how many of those shares have been awarded to particular individuals.

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? (FAQ25)

No, section 554Z8 provides for credit to be given, subject to certain conditions, for the market value of the asset sold by the employee.

26. Where shares are earmarked to satisfy the exercise of employee share options, in circumstances where a Part 7A charge arises, will this give rise to a charge on the entire value of the shares which have been earmarked? (FAQ26)

Section 554Z7 provides that subject to certain conditions a reduction can be made to the value of a relevant step for the amount which the employee has to pay to exercise the option.

27. Where a charge to tax on earnings arises when shares are transferred to an employee, will there also be a charge under Part 7A? (FAQ27)

Where a relevant step gives rise to 'relevant earnings' (which include earnings under section 62 of ITEPA - see section 554Z6) 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.

28. Where a short term loan is provided by a third party, such as a stockbroker, to exercise options, will this give rise to a charge under Part 7A? (FAQ28)

Section 554N provides that short term loans for the purpose of exercising the option will not give rise to a charge, provided that the exercise of the option gives rise to employment income which is charged to Income Tax, or is exempt income, and that no tax avoidance is involved.

29. Where a loan is provided to an employee by a relevant third person to allow him or her to buy shares, or where an employee is allowed to pay for shares in instalments, or otherwise defer payment, will this give rise to a charge under Part 7A? (FAQ29)

Yes, if the loan is made from an EBT or other entity which is not in a group relationship, this will give rise to a charge under Part 7A.

Representations have been made on this subject, but excluding loans made by particular types of intermediary would inevitably result in the structuring of loan arrangements through excluded third parties.

30. Where an employee has paid full market value for shares or securities, can a later charge arise under part 7A?

Section 554N(7) provides an exclusion in certain circumstances. If the employees have either paid market value, or been taxed on the market value of the shares or securities when they are awarded, then part 7A will not apply on any later relevant step subject to other conditions set out in section 554N.

31. If an option is granted to an employee, does that amount to an earmarking of a share, as well as the grant of an option? If so, is an earmarking charge in such circumstances excluded by section 554N(2)?

No, the grant of an option does not in itself automatically mean that a share has been earmarked. The earmarking of a share is a separate relevant step and the exclusion in 554N(2) applies only to the acquisition of the option and not to the earmarking of the shares.

32. Are all types of employment-related securities covered by the exclusions in Sections 554J, K, L and M?

No, only some of the categories included in the definition of employment-related securities in section 420 of ITEPA qualify for the exclusions in sections 554J, K, L and M. For the purposes of those exclusions generally, relevant shares are defined in section 554I, and include only:

- shares in the employer or a group company
- instruments issued by the employer or a group company which fall within section 420(1)(b) (broadly, loan stock and similar instruments)
- units in a collective investment scheme within section 420(1)(f) which is managed by the employer or a group company

However, for sections 554K and 554M, the securities covered are limited further to shares in a trading company or a company which controls a trading company, or

instruments within section 420(1)(b) issued by a trading company or a company which controls a trading company.

Tax-Advantaged Share Schemes

33. Where shares are put in a trust for the purposes of one of the tax-advantaged share schemes (Company Share Option Plan, Enterprise Management Incentives, Save As You Earn, or Share Incentive Plan), can this lead to a charge under Part 7A?

No, provided that the number of shares is not excessive, these schemes are specifically excluded from a charge by section 554E.

34. To benefit from the exclusion in section 554E, must a separate trust be used for the tax-advantaged scheme?

No, it is possible to use one trust for more than one different tax-advantaged scheme, or for tax-advantaged and non tax-advantaged schemes, and still benefit from the exclusion.

Pensions

35. 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? (FAQ30)

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)(h) will not provide an exemption for genuine EFRBS. The provision will apply 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 will 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.

36. Does section 554P provide a general exemption from Part 7A for the provision of death or retirement benefits under section 307 ITEPA 2003? (FAQ31)

No. Section 554P will provide an exclusion from charges arising under Part 7A for benefits subject to the 'employment income exemptions' under Part 4 ITEPA. Although section 307 is in Part 4, it is an 'earnings-only exemption' as defined in section 227(2) ITEPA 2003, not an 'employment income exemption' as defined in section 227(3) ITEPA 2003.

37. What is the effect of Chapter 3 of Part 7A?

Chapter 3 treats certain steps taken by an employer as if they were relevant steps taken by a relevant third person within section 554B. Chapter 2 of Part 7A accordingly imposes tax charges on the value of those relevant steps.

Chapter 3 does not apply unless an employer has given a 'relevant undertaking' - see below - under a 'relevant arrangement' (as defined in section 554A).

An undertaking is a relevant undertaking if it is an undertaking to pay contributions to a relevant third person towards the provision of retirement benefits but excluding contributions to be paid:

- a. to a registered pension scheme
- b. to a relevant non-UK scheme:
 - in respect of which the employer receives transitional corresponding relief, migrant member relief or double taxation relief or

- which is an 'overseas pension scheme' as defined in section 150(7) FA 2004 and in respect of which the employee is exempted from liability to tax under the benefits code by virtue of section 307 ITEPA 2003

A relevant step is taken under section 554B when a sum of money or asset is earmarked or starts being held by an employer with a view to the relevant undertaking being performed.

Alternatively, a relevant step is also taken under section 554B if an employer provides security for performance of the relevant undertaking.

The relevant undertaking will have been performed when the contributions described in section 554Z16(2) have been paid.

38. Does Chapter 3 of Part 7A apply when the employer undertakes to pay retirement benefits directly and only directly to an employee?

In order for Chapter 3 to apply there first has to be a relevant undertaking (see FAQ37 above). An undertaking to pay retirement benefits directly to an employee or former employee is not a relevant undertaking because it is not an undertaking to pay contributions to a relevant third person.

Chapter 3 is not therefore intended to apply when an employer provides security for an undertaking to pay a pension or other retirement benefits directly to an employee for the full period over which the benefits are to be paid, without the benefits at any stage being provided through an insurer, trust or other third person.

The performance of this type of undertaking does not involve a third party providing benefits to an employee and is accordingly outside the scope of Part 7A.

The Government has however 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.)

39. Section 554Z17 is very difficult to follow. What does it do?

Section 554Z17(2) to (5) identify the provisions in the rest of Part 7A that may safely be ignored when determining what tax charges arise under Part 7A as a result of relevant steps treated as taken by virtue of Chapter 3. It is intended to simplify how Chapter 3 works in practice.

40. If the employer has given a relevant undertaking to pay pension contributions to a relevant third person, does the recording of unpaid contributions as a liability on its balance sheet constitute a section 554Z18 step?

It is probable that the recording of a liability on the balance sheet for accounting reasons would not on its own count as the earmarking of assets held by the employer within section 554Z18. However, this will depend on the facts of the case.

41. How does Chapter 3 apply to secured arrangements that existed before 6 April 2011?

Chapter 3 does not apply unless there is a relevant undertaking.

If the relevant undertaking was made and secured before 6 April 2011 and is not changed on or after that date in a way that increases the pension contributions to be paid pursuant to the undertaking, Chapter 3 does not apply for as long as security for the relevant undertaking in place at 6 April 2011 continues to be provided.

In cases where the value of the continuing security becomes insufficient and more sums and assets have to be made subject to the security to cover fully the contributions to be paid, this is not regarded as the provision of new security.

However, if the terms of the relevant undertaking, for which the continuing security is provided, are changed so that the amount of pension contributions to be paid is increased, Chapter 3 will apply as if there has been a new provision of security in respect of that increase.

42. Will charges arise under Part 7A in relation to unregistered defined benefit schemes? (FAQ34)

There is no statutory exclusion from the charges arising under Part 7A for defined benefit schemes. However, so long as the assets and liabilities of a relevant third person providing defined benefits are both genuinely separate and pooled, then it is probable there would be no earmarking.

43. Will charges arise under Part 7A in relation to relevant non-UK schemes? (FAQ35)

The Government intends to introduce secondary legislation which will be made later this year under the regulation-making powers in section 554Y. The draft regulations will be published on the HMRC website for consultation shortly. They will provide an exclusion from charges arising under Part 7A for relevant steps in respect of sums or assets derived from:

- the UK tax-relieved fund of a relevant non-UK scheme or
- the relevant transfer fund created by a transfer from a registered pension scheme to a qualifying recognised overseas pension scheme

44. Will charges arise under Part 7A in relation to pension contributions paid by an employee? (FAQ36)

Section 554T will provide an exclusion from charges arising under Part 7A for relevant steps in respect of sums or assets derived from an employee's pension contributions.

45. Will a charge arise under Part 7A where there is a transfer from one unregistered pension scheme to another? (FAQ37)

Charges may arise when there is a transfer from one unregistered pension scheme to another either on the payment to, or an earmarking of sums and assets by, the transferee scheme.

Section 554X will prevent most transfers of sums and assets from giving rise to charges under Part 7A to the extent they derive from employer contributions paid before 6 April 2006 to schemes that HMRC accepted as corresponding to an approved pension scheme. The exclusion is restricted to transfers made to other schemes accepted as corresponding to approved schemes or to bona fide non-UK

pension schemes. (Transfers of sums or assets derived from personal contributions will be excluded from giving rise to charges under Part 7A by section 554T.)

Section 554U will prevent any charges from arising under Part 7A to the extent that the relevant step is in respect of sums and assets derived from taxed contributions to an EFRBS paid before 6 April 2006, including relevant steps in connection with transfers.

46. Do the Part 7A charges arise in respect of schemes accepted by HMRC as corresponding to approved schemes with effect before 2006-07? (FAQ38)

Sections 554Q and 554R will prevent any charges from arising under Part 7A to the extent that income arises from earmarked assets and acquisitions are made out of earmarked assets. Under paragraph 56 and 57 of the Schedule sections 554Q and 554R apply as if the earmarking of sums or assets before 6 April 2011 took place on or after that date.

Section 554X will prevent most transfers of sums and assets between non-UK pension schemes from giving rise to charges under Part 7A - see FAQ45 above.

Section 554S will provide that pensions paid by schemes accepted as corresponding to approved schemes are chargeable to tax under Part 9 ITEPA 2003 in priority to Part 7A. As a result, the remittance basis and the 10 per cent abatement for foreign pensions given under Part 9 will continue to apply where appropriate.

Section 554W will prevent any charges from arising under Part 7A in respect of lump sum relevant benefits to the extent that rights to receive the lump sum accrued before 6 April 2011. This provision will also apply to schemes accepted by HMRC as corresponding to an approved scheme. Such lump sums consequently remain chargeable to tax as PAYE employment income under section 394 ITEPA 2003.

Section 554V will prevent charges from arising under Part 7A on the purchase of an annuity to the extent that rights to receive the annuity accrued before 6 April 2011.

HMRC announced on 31 March 2011 that Extra Statutory Concession A10 (lump sums paid by overseas EFRBS and section 615 trusts) is being partially withdrawn

from 6 April 2011. HMRC will continue to apply ESC A10 to payments of lump sum relevant benefits, rights to receive which accrue to employees before 6 April 2011, whenever the lump sum is paid. The concession reduces the amount counting as employment income under section 394 ITEPA 2003 when some or all of the lump sum relates to foreign service.

47. Will lump sums and retirement benefit arrangements that would previously have been exempt be taxed? (FAQ39)

Section 554U will prevent any charges from arising under Part 7A to the extent that the relevant step is in respect of sums and assets derived from taxed contributions to an EFRBS paid before 6 April 2006.

Section 554V will prevent charges from arising under Part 7A on the purchase of an annuity to the extent that rights to receive the annuity accrued before 6 April 2011.

Section 554W will prevent any charges from arising under Part 7A in respect of lump sum relevant benefits to the extent that rights to receive the lump sum accrued before 6 April 2011. Such lump sums remain chargeable to tax as PAYE employment income under section 394 ITEPA 2003.

HMRC announced on 31 March 2011 that Extra Statutory Concession A10 (lump sums paid by overseas EFRBS and section 615 trusts) is being partially withdrawn from 6 April 2011. HMRC will continue to apply ESC A10 to payments of lump sum relevant benefits, rights to receive which accrue to employees before 6 April 2011, whenever the lump sum is paid. The concession reduces the amount counting as employment income under section 394 ITEPA 2003 when some or all of the lump sum relates to foreign service. HMRC will also continue to apply ESC A10 where the lump sum is not paid by a relevant third person and so is not chargeable to tax under Part 7A, but is chargeable to tax under section 394 ITEPA 2003 instead. (The full text of the HMRC announcement is available on the HMRC website as an update for the 23 March 2011 Budget.)

48. When the rights accrued as at 5 April 2011 comprise sums and assets acquired from contributions paid by the employer, may increases in the value of

those funds after that date due to investment income and gains to be taken into account for the purposes of section 554V, 554W and ESC A10 when apportioning the value of those rights on a just and reasonable basis? (FAQ40)

What constitutes a just and reasonable basis will vary according to the individual circumstances but as a general rule investment returns from funds held on 5 April 2011 may be taken into account when apportioning the value of rights accrued before 6 April 2011.

49. What are pre-6 April 2011 lump sum rights in section 554W?

The intention is to prevent people from obtaining an exclusion from charges arising under Part 7A by converting rights to non-relevant benefits held before 6 April 2011 into rights to relevant benefits on or after that date. The term 'rights' includes both 'actual rights' and 'prospective rights'.

Where the member has the actual or prospective right to receive relevant benefits at 5 April 2011 and may receive them in the form of a lump sum:

- either unconditionally or
- under a member's election or
- at the option or at the discretion of the trustee

the intention is that the future lump sum relevant benefits received under the scheme will be excluded from giving rise to employment income under Part 7A to the extent the rights to receive them accrued before 6 April 2011. This is however on condition that the election, option or discretion either could have been exercised at 5 April 2011 or could have been exercised at that time had the member met the sufficient conditions (eg around age).

50. What are pre-6 April 2011 annuity rights in section 554V?

The intention is to prevent people from obtaining an exclusion from charges arising under Part 7A by converting rights to other types of benefits held before 6 April 2011 into rights to receive an annuity on or after that date. The term 'rights' includes both 'actual rights' and 'prospective rights'.

Where the member has the actual or prospective right to receive an annuity at 5 April 2011:

- either unconditionally or
- under a member's election or
- at the option or at the discretion of the trustee

the intention is that the value of relevant steps taken in the process of purchasing, transferring or paying the annuity will be excluded from giving rise to employment income under Part 7A to the extent the rights to receive the annuity accrued before 6 April 2011. This is however on condition that the election, option or discretion either could have been exercised at 5 April 2011 or could have been exercised at that time had the member met the sufficient conditions (eg around age).

51. 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? (FAQ41)

Section 554S provides that pension payments will be subject to tax under Part 9 as pension income in priority over Part 7A. As a result, the remittance basis and the 10 per cent 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 relevant steps constituting earmarking on or after 6 April 2011, with credit given against the Part 9 charge for earlier Part 7A charges.

52. 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? (FAQ42)

The 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.

53. 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? (FAQ43)

Paragraph 14 of Schedule 2 to FB 2011 makes consequential amendments to section 394 ITEPA 2003 to prevent the double taxation of benefits received under EFRBS. 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, before any reduction under section 554Z4 (Residence issues).

Residence and domicile

54. 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? (FAQ44)

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.

55. 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? (FAQ45)

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 554Z9.

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

56. 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? (FAQ46)

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.

57. Do the anti-forestalling provisions apply to loans made before 9 December 2010 which are still outstanding on 6 April 2011? (FAQ47)

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.

58. 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? (FAQ48)

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.

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.

59. 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? (FAQ49)

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.

60. 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? (FAQ50)

Section 554R(8) prevents a relevant step under section 554C(1) to (c) from being chargeable where it is taken for the purposes of reinvesting trust funds, provided the conditions in section 554R are met.

End 5 July 2011