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Client Alert

Latham & Watkins
Tax Group

April 2013 — Key Changes to UK Employment Related Tax

Finance Bill 2013 — What Does It Mean for Employers?

On 20 March 2013, the UK Chancellor of the Exchequer delivered the Budget for the 2013-2014 fiscal year (Budget 2013), which was closely followed by the official publication of the Finance Bill 2013 on 28 March 2013. The Finance Bill 2013 includes key legislative changes to UK employment and benefit tax rules, some of which will become effective on 6 April 2013. This Client Alert summarises the key changes and proposals which employers with UK employees should be aware of to ensure that they remain compliant against this changing landscape.

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Budget 2013

The main theme of Budget 2013 was that it was to help "rebalance and rebuild" the British economy, and the Chancellor described it as a budget for an "aspiration nation". Some of the key announcements for employers in the Budget speech include the following:

- Introduction of an employment allowance with a view to making it cheaper for employers to hire new staff as of April 2014. Businesses and charities will have an allowance of £2,000 to be offset against their Class 1 secondary National Insurance contributions.
- The government will consult on measures to:
  a) Remove the presumption of self-employment for limited liability partnership (LLP) partners in order to tackle the disguising of employment relationships through LLP's
  b) Counter the manipulation of profit/loss allocations (by both LLP's and other partnerships) to secure tax advantages
- As a result of the review announced in the Autumn Statement 2012, the government will strengthen obligations to ensure the correct income taxes and National Insurance Contributions are paid by offshore employment intermediaries. HM Revenue & Customs (HMRC) is to publish a consultation on these measures in May 2013 and legislation is to be included in the Finance Bill 2014.

Tax Rates and Allowances

Personal Taxes

Starting on 6 April 2013, the additional tax rate for taxable income above £150,000 will be reduced from 50 per cent to 45 per cent. The move to this lower additional tax rate has resulted in a number of employers having sought to defer employee's bonus entitlement until on or after 6 April 2013 so that employees can benefit from this reduced tax rate. Although HMRC have not introduced any anti-avoidance measures in respect of bonus deferral, it is extremely important that all paper work in relation to decisions around bonus entitlement and payment can withstand scrutiny by HMRC. Generally, in order for bonus deferral to be effective, both the payment of the bonus and the employee's entitlement to payment must crystalise on or after 6 April 2013.

Employers should also consider the effect of any bonus deferral arrangements on their ability to claim corporation tax deductions. If a bonus payment is effectively deferred for income tax purposes, it may also defer the time when a bonus payment may be deducted for corporation tax purposes.

For the 2013-2014 fiscal year, the basic personal allowance for income tax will be £9,440, increasing to £10,000 for the 2014-2015 fiscal year.

Dividend Deferral

The top tax band rate for dividends will fall from 42.5 per cent to 37.5 per cent starting 6 April 2013. This will give an effective tax rate of 30.55 per cent when the relevant tax credit is taken into account.

Corporation Tax

The main rate of corporation tax is currently 24 per cent. As previously announced, this will be reduced to 23 per cent starting on 1 April 2013 and 21 per cent starting on 1 April 2014. In keeping with the government's desire to increase the competitiveness of the UK tax system, it was also announced in the 2013 Budget and published in the Finance Bill 2013 that the main rate of corporation tax would be further reduced to 20 per cent starting on 1 April 2015. The small profits rate of corporation tax applies to companies with profits up to £300,000 and will remain at 20 per cent.

General Anti-Abuse Rule (GAAR)

The Finance Bill 2013 introduces a general anti abuse rule (GAAR) which empowers HMRC to counteract tax advantages arising from abusive tax avoidance arrangements. For the GAAR to apply to an arrangement, both of the following conditions must be satisfied:

a) It must be reasonable to conclude that the obtaining of a tax advantage was the main purpose or one of the main purposes of the arrangement.

b) Having regard to all the circumstances, the entering into or carrying out of the arrangement cannot reasonably be regarded as a reasonable course of action in relation to the relevant tax provisions.

The GAAR will apply to tax arrangements entered into on or after the date the Finance Bill receives Royal Assent (expected in July 2013) and will apply to all taxes, including income tax and national insurance contributions (although separate legislation will be introduced to effect this), except stamp duty, stamp duty reserve tax and value added tax.

In December 2012, HMRC published draft guidance on GAAR along with the draft Finance Bill 2013 clauses. The GAAR Advisory Panel has not yet approved this draft guidance, but it is expected that final guidance will be published shortly.

Considerable uncertainties still remain as to which type of arrangements will be scrutinised by HMRC in accordance with the GAAR, and it is unclear whether common employment and remuneration structures may possibly be challenged once the GAAR comes into effect. Employers may wish to consider implementing tax planning arrangements before the GAAR commencement date to avoid such arrangements being caught by the GAAR.

Tax Residency Rules – New Statutory Residence Test

A new statutory residence test (SRT) will be introduced on 6 April 2013 to determine the UK tax residency of individuals. The existing rules are complex and uncertain as they are largely based on case law and while HMRC guidance assists in determining residency, it is often difficult to confirm UK residence with certainty. The SRT will apply for the purposes of income tax, capital gains tax and inheritance tax, with the concept of "ordinary residence" generally being abolished from the same date.

Under the SRT, an individual will be a resident in the UK if they meet the "automatic residence test" or the "sufficient ties test". The "automatic residence test" will be met if the individual meets any of the four "automatic UK tests" and none of the five "automatic overseas tests". The "automatic UK tests" generally take account of the number of days spent in the UK, the use of a UK home and UK employment. The "automatic overseas tests" generally take account of the number of days spent in the UK, along with previous periods of residency and employment.

In more complex cases, where an individual does not meet any of the "automatic UK tests" or the "automatic overseas tests", he will still be considered a UK resident if he has "sufficient ties" to the UK, such as accommodation, family and work. Whether an individual has enough ties to the UK will be assessed against whether or not they were resident in the UK for any of the three tax years before the tax year under consideration, and also the number of days the individual spends in the UK in the tax year under consideration.

Despite the fact that the overarching aim behind the introduction of a SRT was to create clear and uncomplicated rules, it is evident that the new rules are still complex and will require employers to monitor carefully internationally mobile employees to ensure that their UK tax residency is kept under review.

Share Schemes – Changes to Enterprise Management Incentive Option Rules

Enterprise Management Incentive (EMI) options are a tax efficient type of share option available to UK based employees of certain small and medium sized businesses. EMI's are a particularly tax efficient way of incentivising employees, because provided that a qualifying EMI option is granted, no income tax or National Insurance contributions are payable in respect of the option gain.

At the moment, broadly speaking, UK employees are only able to benefit from entrepreneurs' relief, (which benefits from a capital gains tax rate of 10 per cent, instead of the usual 18 per cent or 28 per cent rate), if the option holder holds (and has held for at least 12 months) at least 5 per cent of the company's ordinary share capital. The Finance Bill 2013 makes changes to the way that EMI shares are taxed, making them even more attractive as part of a remuneration package. The following changes will apply to shares acquired on or after 6 April 2012, and to shares disposed of on or after 6 April 2013:

- Shares acquired on exercise of EMI options will be able to qualify for entrepreneurs' relief, even if the individual does not meet the current 5 per cent of the stake in the company. Entrepreneurs' relief will also be available on shares

that replace EMI shares following a reorganisation of the company's share capital and on certain shares following an exchange for shares in another company.
- The 12 month qualifying period during which shares must be held before they will qualify for entrepreneurs' relief will be amended so that they will start to qualify for entrepreneurs' relief from the date of the grant of the EMI option, rather than the date the employee exercises the EMI option. This change will be particularly beneficial to option-holders whose EMI options are exercisable on a change of control, as they will not need to hold the shares for a further 12 months to benefit from the capital gains relief.

Other Changes on the Horizon

Other key changes included in the Finance Bill 2013:

- Employers operating their own Pay-As-You-Earn (PAYE) systems will need to ensure that their payment systems are updated to ensure compliance with HMRC's new "real time information" regime. Employers will be required to submit PAYE information to HMRC at the same time employees are paid, instead of waiting until after the end of the tax year. The Finance Bill 2013 introduces penalties for the late filing of PAYE returns under real time information.
- IR35 legislation, which is designed to tax "disguised employment", is to be amended to clarify and reinforce the existing provisions that office holders as well as employees fall within the scope of the IR35 provisions.
- The rules that govern corporation tax deductions for employee share acquisitions are clarified so that if statutory corporation tax relief is given under Part 12 of the Corporation Tax Act 2009, companies may not claim any other corporation tax deduction in relation to the provision of the employee shares or share options, or in relation to any connected matter, other than where specified. Also, no corporation tax deductions are available to a company in relation to employee share options, or any matter connected with such an option, unless shares are acquired pursuant to that option, other than in specific circumstances.
- The Finance Bill 2013 contains legislation aimed at simplifying tax advantaged employee share schemes, Company Share Option Plans ("CSOP"), EMI Plans, Save as You Earn Plans ("SAYE") and Share Incentive Plans ("SIP") so that the schemes are simpler and more attractive to users.
- Starting in April 2014, the annual amount in which individuals can claim tax relief in relation to pension contributions will be reduced from £50,000 to £40,000. The lifetime allowance will also be reduced to £1.25 million as of April 2014.

Finally, on the very day that the Chancellor confirmed in the Budget the implementation date of the new "employee ownership" arrangement, under which employees give up some of their statutory rights in exchange for shares in the employer company, the House of Lords voted to remove the policy from the government's Growth and Infrastructure Bill. The regime was heavily criticised during its passage through both houses of the Parliament, so it is not surprising that the House of Lords has blocked it. However, the concept of employee ownership is not completely dead in the water, as the proposal will go back to the House of Commons where the government will decide whether to try and introduce it again.

If you would like to discuss how any of the changes announced will affect your company's tax strategy then please get in touch with your usual Latham & Watkins contact, or one of the individuals noted below.

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