



Global Reward Update

United Kingdom – Implications of withholding errors on equity income

Background

While many companies have clear processes in place to operate withholding when a tax charge arises relating to their share plans, occasionally errors may be made and PAYE withholding is not applied when it should be.

In these circumstances an additional charge to tax known as a “section 222 charge”, may arise for UK employees. This charge can significantly increase the cost implications of such failures.

HMRC have recently released further guidance concerning this charge, and the circumstances in which it may apply.

The s.222 Charge

The aim of s.222 ITEPA 2003 is to ensure that an employee receiving equity (or other “notional”) income is no better or worse off than one simply receiving a cash payment, where PAYE and social security apply. The original intention of the legislation was to prevent abusive schemes designed to avoid income tax. However it can be applied to situations in which an employee does not make good their income tax and social security on an equity-related taxable event.

In summary, a s.222 Charge may apply where a withholding obligation arises which is not “made good” by the employee within 90 days of the end of the tax year in which the relevant taxable event takes place (whether or not the employer actually pays the tax due via PAYE). The amount not “made good” by the employee to the employer is treated as additional earnings liable to PAYE and NIC, and reportable through the annual summary of benefits, P11D.

In settlement situations, companies often choose to bear this tax and NIC cost rather than pass it on to employees, which can significantly increase the costs to the employer.

HMRC's new guidance

The updated guidance provides commentary on key cases, namely the Chilcott case (Court of Appeal) and the Benedict Manning case (First Tier Tribunal). The conclusion from these cases is that whilst the application of s.222 should not concern the "fairness" of the charge, the application is not an automatic process. HMRC should consider all the relevant facts in a reasonable manner and conclude on whether or not the requirements of s.222 are or are not met.

Whilst the wording of s.222 is clear and unambiguous, the Courts urge HMRC to consider the unique facts of each case and whether applying a s.222 Charge would fall within the intention of the legislation.

Use of indemnities

Many share plans include a requirement for the employee to fund income tax and social security payable on their awards; an indemnity clause.

The Benedict Manning case (found in favour of the taxpayer) highlighted the importance of the inclusion of an indemnity agreement which created a contractual liability on the part of the employee to reimburse the employer the PAYE and NIC due. The Court determined that this (along with the true intention to apply it) was sufficient to determine that s.222 should not apply.

The inclusion of such an indemnity within the terms of equity awards is therefore key, however the guidance emphasises that the inclusion of the indemnity is by itself, not enough to fall out of the charge. The intention that it would be applied in the relevant circumstances should be demonstrated. Again this highlights that the facts of each unique case should be considered on their own merit.

Action

The inclusion of an appropriate indemnity agreement within equity award documents is key to potentially minimising the charge should it ever become relevant. It must also be demonstrated that the intentions of the relevant parties was always to apply the indemnity. In many cases this will be clear from other equity transactions for example because the employer has a clear "sell to cover" process in place. If an employee actively accepts their award, this also supports the intention that the employee agrees to pay the PAYE and NIC.

Companies should ensure that new and existing equity arrangements include appropriate wording and that the relevant individuals are made aware of their obligations under PAYE where equity (or other "notional") payments are received.

Companies in the process of discussions with HMRC on past payroll failures should consider the following:

- whether an appropriate indemnity exists in any form (this may extend beyond award documents);
- how and why the PAYE failure arose; and
- whether any other mitigating factors arise.

Deloitte has significant experience of supporting such discussions with HMRC and could support you in this process.

As mentioned above, although the s.222 tax liability is strictly an employee liability, it is not uncommon to see employers covering the tax cost on an employee or ex-employee's behalf where this has arisen through a company process failure. This means that any mitigation of the charge may reduce the cost to the employer.

People to contact

For assistance with these issues, or any other issue related to the operation of your global equity plans, please contact your usual Deloitte adviser or email us at globalshareplans@deloitte.co.uk, and an adviser will contact you.

This Global Rewards Update information is also included in our bi-weekly GES newsletter, Global InSight, which you will receive directly if you are on the central distribution list.

If you are not on the central distribution list and received this communication by some other means, you can follow these few simple steps to be added to the central distribution list:

- Go to the [Deloitte Subscriptions Page](#) on Deloitte.com.
- Fill out your contact information.
- Make sure that, under Email Newsletters, "Global InSight" (which is under the Tax heading) is selected and click "Save Profile."
- Be sure to visit us at our website: www.deloitte.com/tax.

© 2017 Deloitte LLP. All rights reserved.

This communication is from Deloitte LLP, a limited liability partnership registered in England and Wales with registered number OC303675. Its registered office is 2, New Street Square, London EC4A 3BZ, United Kingdom. Deloitte LLP is the United Kingdom member firm of Deloitte Touche Tohmatsu Limited ("DTTL"), a UK private company limited by guarantee, whose member firms are legally separate and independent entities. Please see www.deloitte.co.uk/about for a detailed description of the legal structure of DTTL and its member firms.

This communication is for the exclusive use of the intended recipient(s). If you are not the intended recipient(s), please (1) notify it.security.uk@deloitte.co.uk by forwarding this email and delete all copies from your system and (2) note that disclosure, distribution, copying or use of this communication is strictly prohibited. Email communications cannot be guaranteed to be secure or free from error or viruses.

Other than as stated below, this document is confidential and prepared solely for your information. Therefore you should not, refer to or use our name or this communication for any other purpose, disclose them or refer to them in any prospectus or other document, or make them available or communicate them to any other party. If this communication contains details of an arrangement that could result in a tax or National Insurance saving, no such conditions of confidentiality apply to the details of that arrangement (for example, for the purpose of discussion with tax authorities). In any event, no other party is entitled to rely on our communication for any purpose whatsoever and to the extent permitted by law, Deloitte LLP does not accept any liability for use of or reliance on the contents of this email by any person save by the intended recipient(s) to the extent agreed in a Deloitte LLP engagement contract.

Opinions, conclusions and other information in this email which have not been delivered by way of the business of Deloitte LLP are neither given nor endorsed by it.