

PAYE and Tradeable Assets: The Interaction of s.144A and
s.203F ICTA 1988

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A great deal of uncertainty surrounds the issue of whether or not certain benefits given by an employer to his employee amount to “tradeable assets” within s.203F ICTA. If the benefits in question - such as insurance enhancement or redeemable shares - are tradeable assets, then the employer is under a duty to deduct an amount in respect of income tax chargeable under Sch E from the notional payment before making the notional payment of the tradeable assets to the employee (s203J(1) ICTA 1988). The employer must operate PAYE in respect of such transfers of tradeable assets.

Alternatively, s.203J(3) ICTA provides that where, by reason of insufficiency of payments actually made, the employer cannot deduct the amount of the income tax as required by virtue of subsection 203J(1) ICTA 1988, he has an obligation to account to the Board for an amount of income tax equal to the income tax that

the employer is required, but is unable, to deduct.

Any amount which the employer deducts or for which he accounts is treated as an amount paid by the recipient employee in respect of that employee's liability to income tax.

Where no such PAYE deduction is made and the employee receives the tradeable asset free of tax, s.144A ICTA 1988 treats the employee as having received a benefit equal to the value of the tradeable assets plus the amount of tax that ought to have been deducted. This is the position unless the employee "makes good" the amount of the undeducted income tax within 30 days after receiving the tradeable asset.

On the wording of s.144A ICTA 1988 three requirements must be met before an employee will be treated as receiving the undeducted tax as taxable Sch E income.

The first is that an employer must make a payment to an employee which, by virtue of ss.203B - 203I ICTA 1988, is treated as the employee's income.

As has already been indicated, a high degree of uncertainty surrounds the issue of whether the provision of certain types of assets by an employer to an employee falls within the ambit of s.203F ICTA 1988 ('tradeable assets').

A 'tradeable asset' is one which can be sold or realised on a recognised investment exchange, or the London Bullion Market, or on any market for the time being specified in PAYE regulations; and includes any asset for which, at the time when the asset is provided, trading arrangements exist. "Trading arrangements" are defined in s.203K ICTA 1988.

Due to the width of the definition of "trading arrangements", the Revenue claims that a wide variety of assets given by an employer to an employee are "tradeable assets" and that, consequently, PAYE is deductible.

The second condition set out in s.144A is that the employer is required, by virtue of s.203J to either deduct the amount of PAYE from the actual payment made or (if there is no cash payment but only a transfer of an asset) to account to the Revenue for the amount

of PAYE due.

This requirement will invariably be satisfied where an asset, falling within ss.203B - 203I ICTA 1988, is provided by an employer to an employee.

The third requirement is that the employee does not, before the end of a period of 30 days from the date on which the employer is treated as making that payment, make good the due amount to the employer.

Section 203A ICTA 1988 provides, inter alia, that a payment is treated as made at the time that it is actually made.

In effect, therefore, an employee who receives a gift or bonus from his employer from, or in respect of, which PAYE has not been deducted, must “make good” an amount in respect of that income tax to the employer within 30 days of receiving the gift/bonus.

On the face of it the third condition appears to make sense. It is, however, the requirement to “make good” within the prescribed time limit of 30 days that causes practical problems.

Where there is a definite s.203F ICTA 1988 (tradeable assets) liability, the position is straightforward. The employer must deduct or account for the amount of income tax due on providing that asset. In the event that the employer fails to do so, the recipient employee must reimburse the employer for the undeducted tax within 30 days of receiving the asset. If he does not do so, the employee will be treated as having received the asset plus the undeducted tax thereon as a Sch E benefit. Sch E tax will, accordingly, be due on that gross amount.

Where, however, it is uncertain whether there is a s.203F liability at the time that an employer makes a gift to an employee, obvious problems arise.

The employer generally has three choices: first, to deduct the PAYE on the basis that income tax might be due on the payment; or second, not to deduct any income tax; or third, in order to cover himself he may ask the employees for an indemnity or request them to put the amount of income tax that may be due in escrow.

In practice, employers have generally favoured the third option

- that of taking an indemnity or putting money in escrow.

The question arises whether either a deed of indemnity or putting money in escrow actually “makes good” the amount of income tax that may be due.

The term “makes good” is not statutorily defined. Nor has it been defined in cases. It is generally taken to mean reimbursement or repayment. The Shorter Oxford English Dictionary defines “reimburse” as “1. To repay or make up to a person (a sum expended). 2. To repay, recompense (a person).” “Repay” is defined in the same dictionary as “1. To refund, pay back (a sum of money, etc.)”. In effect it means an action which puts to an end the indebtedness between one person and another.

An indemnity, being a contract under which one party agrees to keep another party harmless against loss (Yeoman Credit Limited v. Latter [1961] 2 All ER 294 @ 296), falls within the meaning of “reimbursement” and hence constitutes “making good”.

Under general principles, an intended deed delivered as an

escrow is a simple writing which does not become the deed of the party expressed to be bound by it until some condition has been performed. The occasion on which a Sch E tax liability arises on a transfer of assets between employer and employee can be a condition. A deed which promises to reimburse that Sch E tax liability once the condition is fulfilled can be said to “make good” the required amount within the meaning of s.144A ICTA 1988.

The real difficulty with s.144A ICTA 1988 lies in the requirement that the making good ought to take place within 30 days of receipt of the asset.

Whether or not an indemnity or escrow serves to make good the tax within the prescribed time limit depends on all the circumstances.

Generally speaking, a person entitled to an indemnity may obtain relief as soon as his liability to the third person - in this case, the Revenue - has arisen and before he has made payment (Re Richardson ex p Governors of St Thomas' Hospital [1911] 2 KB 705, CA).

An indemnity makes good a liability as soon as it arises. That much is clear.

The effect of s144A ICTA 1988 in the following situation is less clear. An employer transfers an asset to an employee in 1994. It is not clear at that time whether a PAYE deduction should be made. The employee gives an indemnity in that year. A Court, in 1996, finds that the asset is liable to a PAYE deduction. The liability will be treated as arising at the time that the asset was provided to the employee i.e. in 1994.

The employee ought, therefore, to have made good the amount of undeducted PAYE to his employer within 30 days of receiving the asset .

On a narrow reading of s.144A an indemnity granted within 30 days after the gift was made should satisfy this requirement. But an indemnity granted 40 days after the gift will not.

On a wider reading, it is arguable that s144A ICTA 1988 merely requires that the amount of any PAYE that should have been

deducted or accounted for is made good within thirty days after the asset was provided. As long as an indemnity does this, the exact time when the indemnity is granted should be immaterial.

Turning to the example given above, as long as there is an indemnity in place at some point before the court decides that PAYE should have been deducted or accounted for in respect of the transferred asset, the time limit in s144A ICTA 1988 should be satisfied because the PAYE liability will be made good as soon as it arises.

In relation to an escrow, the rule is that when a specified condition is satisfied, for instance, the liability to deduct PAYE arises, the delivery of the deed relates back to the time of its delivery as an escrow. Consequently, when the PAYE liability arises, the money put in escrow is treated as paid (in our case, to the employer) at the time when the money was put in escrow.

If, therefore, the money was put in escrow within 30 days after the asset was transferred to the employee, the employee will be treated as “making good” the PAYE liability within the 30 day time

limit.

Money put in escrow more than 30 days after the asset was provided will probably fall outside the time limit.

Further, on a narrow reading of s144A ICTA 1988, an indemnity granted later than 30 days after the asset was provided to the employee, will probably also fall outside the 30 day time limit.

As a result, an employee who has put money into escrow or set aside money to honour the indemnity with the result that he does not have use of those sums, will nevertheless be treated, by virtue of s.144A ICTA 1988, as having had the benefit of those sums. He will be taxed accordingly.

The employee is effectively hit twice as a result of the 30 day time limit.

When one looks at other provisions dealing with benefits in kind, such as ss.156 and 158 ICTA 1988, it is interesting to note that none of them has such short a time limit for “making good”.

Yet even with a one year time limit for “making good”, s158(6) ICTA can result in double taxation. The wording of s.158(6) suggests that the requirement to make good and the making good should both occur during “the relevant year”.

The CIOT brought s158(6) ICTA’s potential for double taxation to the notice of the Revenue:

“... [If] late reimbursement had to be disregarded a full scale charge of, say, £600 might have been impressed despite the fact that the fuel had been paid for by the employee ... Making good within the terms of s.156(1) ... need not happen immediately to be effective and indeed may occur as a result of a Revenue investigation, but the different wording of s.156(1) and s.158(6) causes concern that the time limits may differ in what are essentially similar situations ...”

This almost exactly mirrors the situation where an escrow or an indemnity is granted later than 30 days after the receipt of the asset: An employee who has paid over the money or has set it aside is still taxed as if he had use of it or could benefit from it.

Replying to the CIOT letter the Revenue stated:

“I do not currently see any policy reason to have a stricter test for car fuel than for making good other benefits. So I would have thought that where an unintentional error is not detected until after the end of the tax year, and a requirement promptly to make good

would have applied had the error not been made, we should not deny a fresh opportunity promptly to make good.” (June 1995 Taxation Practitioner)

In stark contrast to their reasonable view above, the Revenue are at present unwilling to accept that indemnities granted, or money put in escrow, later than 30 days after the asset is provided suffice to “make good” the PAYE liability for s.144A ICTA 1988 purposes.

It is difficult to see why benefits falling within s.203F ICTA 1988 should be subjected to stricter time limits than those applying to either car fuel or other benefits. The principal point is that the undeducted PAYE must be paid to the employer within a reasonable time after the liability arises. Undue emphasis ought not to be placed on whether or not the indemnity was granted, or money was put in escrow, within 30 days after the asset was provided.

It is even more difficult to see why the Revenue is willing on the one hand to seek parity of treatment at a policy level in relation to ss.156 and 158 ICTA 1988 and yet, on the other hand, is unwilling to deal consistently with s.144A ICTA 1988 situations.

The policy arguments undoubtedly favour the wider view of s.144A ICTA 1988 - that provided any undeducted PAYE is made good, it should not matter when the money was actually put in escrow or when the indemnity was actually granted.

If the Revenue were to adopt this view, the advantages would be twofold: first, the chances of an employee being effectively taxed twice would be minimised; and second, s203F ICTA 1988 and other benefits in kind would be taxed in a consistent manner.