



E-Update: November 2009

This month Robert Bradley takes a look at the recent tax case of P A Holdings Limited in which HMRC won the right to national insurance contributions on bonuses paid as dividends.

The Background

As dividends aren't subject to National Insurance, paying them instead of salary is a common way to cut your PAYE bill. But in a recent case H M Revenue & Customs (HMRC) won the right to National Insurance Contributions on bonuses paid in the form of dividends. Could they use this ruling to attack your company? The case involved a tax avoidance scheme devised by Ernst & Young and sold to an international firm of consultants, PA Holdings Ltd (PA).

Dividends

The scheme was devised so that PA could pay bonuses to its employees without being subject to PAYE. A jersey company was set up and PA's employees bought shares in it at nominal cost. PA made a payment of around £20 million into an offshore trust, which paid the money to the Jersey company, which then paid dividends to the employees. Dividends aren't subject to PAYE. The employees would, of course, have to pay personal tax on them but overall it saved the company a substantial amount in National Insurance. HMRC took exception to this treatment and took the case to tribunal.

HMRC Arguments

The case put forward by HMRC was that the dividends were a sham. The payments received by the employees were not dividends at all but a disguised bonus. Therefore tax and National Insurance should have been accounted for under the PAYE system.

Ruling

The tribunal agreed with HMRC that the payments were a bonus and PA would have to pay National Insurance on the £20 million bonus. Where does this decision leave us now?

Tax law changes

Tax law has changed since the scheme was devised, so that new bonus payments paid out as dividends will be treated as earnings from employment and only taxed on that basis. That leaves the question of National Insurance. A lot of owner-managed companies pay themselves a small salary and take most of their income as dividends. It's a standard tax planning strategy which until now seemed solid as a rock. Will the Taxman now challenge it because of the decision in this case?

Conclusion

There's no sign that HMRC will use this case to launch a universal attack on owner-managed companies. All we can do is await future developments. In the meantime to avoid National Insurance company profits should be paid out as dividends rather than salary/bonus.

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