



HMRC publish new guidance on ‘negative earnings’

The case of *HMRC v Julian Martin* introduced us to the concept of negative earnings in 2014. HMRC have now published their view on the context in which negative earnings can arise, and how they should be identified.

In summary, Mr Martin entered into an employment contract which committed him to his employer for a period of five years in return for a fixed bonus payment. PAYE and Class 1 National Insurance Contributions were deducted via the payroll. The gross payment was £250,000 and Mr Martin received £147,500.

Subsequently, Mr Martin notified his employer that he wished to terminate the employment, triggering a pro-rata claw-back provision. The amount that he paid back to his employer was calculated to be £162,500. Consequently, Mr Martin sought to recover the income tax previously collected under PAYE in respect of that amount.

Two routes were explored before the UT:

- Could the original charge be reversed or amended?
- Could the £162,500 be treated as negative taxable earnings?

The UT held that there was no way to reverse the original charge but that the amount could be classed as negative taxable earnings. While the concept was not necessarily new, it was the first time it has been properly considered by the courts. HMRC were subsequently asked if they would update their guidance to confirm their position on the matter.

HMRC’s guidance

HMRC’s newly issued guidance on this can be found in the Employment Income Manual entries at [EIM00800](#) – [EIM00845](#).

The new guidance provides a brief recap of *HMRC v Julian Martin* before placing the concept of negative earnings in the statutory landscape; the concept of negative earnings being somewhat counterintuitive.

While the legislation does specifically cater for negative earnings, the reference is fleeting and cryptic. Much of the UT judgment was focused on articulating what negative earnings are and the circumstances in which negative earnings could arise, and both are summarised in the new manual entries.

Broadly speaking, negative earnings are payments from the employee to the employer (or exceptionally, a third party) which “...arise directly out of the employment”.

The new guidance places heavy emphasis on this last condition, and is clear that there is a distinction to be drawn between a payment made due to an employment relationship (but unrelated to the actual employment itself) and a payment which arises directly out of the employment. The manual quotes the Tribunal Judge:



“It is clearly the case that not every payment which an employee makes to an employer is negative general earnings. This is not a matter of dispute. To give an obvious example, the repayment of money which a cashier had stolen from their employer’s till would not be such an item. The mere existence of an employment relationship is not enough.”

Without doubt, HMRC will scrutinise claims in this area closely.

Finally, the manual deals with the matter of timing. A payment can be negative taxable earnings only for the period in which it is actually paid unless they are made after an employment has terminated, in which case they are treated as being for the final year of employment.

NIC

No updates to the National Insurance Manual appear to have been published to date. That said, the updates to the EIM manual also refer to a non-tax case where both the income tax and NIC were refunded.

The implication could be drawn that NIC may also be reclaimed, especially considering the following comment from the First-tier Tribunal (FTT):

“We were not addressed in relation to any NIC implications that might arise in this case, but we were told that in practice HMRC had indicated that NIC adjustments would be made if our decision was in favour of the Appellant. We make no observation on whether that was technically correct or not.”

However, in the absence of an explicit statement to the contrary, the more prudent position for now is to assume NIC cannot be reclaimed.

How does it affect me?

The Judge was careful to emphasise that the existence of negative taxable earnings in the Julian Martin case turned “critically on the interpretation of the [employment] contract” i.e. the fact that the payment arose “directly out of the employment”. Unsurprisingly therefore, HMRC’s examples are all based on clawback provisions contained in employment contracts and it appears that they are of the view that this is the only practical scenario in which negative taxable earnings are likely to arise.

While such scenarios may not have been so common in the past, clawback is now increasingly common, especially for those working in finance, as regulators seek to increase the scope of clawback rules. Indeed, employers and employees should check whether a repayment is available for any clawbacks made since 6 April 2012 under the overpayment relief provisions.

KPMG View

We welcome the guidance, but even now HMRC’s position on many aspects of negative earnings remains unclear (especially around restricted shares, options etc); scenarios more complicated than cash are not addressed. With the ongoing trend towards clawback clauses more clarity in this area would be well received.



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