

GAAR ADVISORY PANEL

Redacted and sub-panel approved version of Opinion Notice originally issued on 18 July 2017

Subject Matter

Rewards for employees. Reward via gold/assets. Obligation to Employee Benefit Trust taken on by employee.

Taxes

Income tax and NICs, corporation tax

Relevant Tax Provisions

ITEPA 2003 especially section 62 and Part 7A (including in particular section 554Z8), Social Security Contributions and Benefits Act 1992 especially section 3 and section 6, Social Security (Contributions) Regulations 2001 paragraph 1 of Part III of Schedule 3 CTA 2009 Part 20 Chapter 1 (especially section 1290).

Opinion

The entering into of the tax arrangements is not a reasonable course of action in relation to the relevant tax provisions; and the carrying out of the tax arrangements is not a reasonable course of action in relation to the relevant tax provisions.

Opinion Notice

This opinion notice is given pursuant to paragraph 11 of Schedule 43 to the Finance Act 2013 by a sub-panel consisting of three members of the GAAR Advisory Panel in the referral by HMRC dated 3 April 2017 relating to the Company.

The sub-panel received written material from HMRC under paragraph 7 Schedule 43 FA 2013 and from the Company's representative under paragraph 9 Schedule 43 FA 2013.

1. Reminder of what the sub-Panel's opinion notice is to cover

"An opinion notice is a notice which states that in the opinion of the members of the sub-panel, or one or more of those members—

- (a) the entering into and carrying out of the tax arrangements is a reasonable course of action in relation to the relevant tax provisions—

(i) having regard to all the circumstances (including the matters mentioned in subsections (2)(a) to (c) and (3) of section 207), and

(ii) taking account of subsections (4) to (6) of that section, or

(b) the entering into or carrying out of the tax arrangements is not a reasonable course of action in relation to the relevant tax provisions having regard to those circumstances and taking account of those subsections, or

(c) it is not possible, on the information available, to reach a view on that matter,

and the reasons for that opinion.” (para 11(3) Sch 43 FA 2013)

“For the purposes of the giving of an opinion under this paragraph, the arrangements are to be assumed to be tax arrangements.” (para 11(4) Sch 43 FA 2013)

2. GAAR Guidance provides authoritative guidance to taxpayers, to HMRC and to the sub-Panel on the GAAR legislation

2.1 Paragraph C5.6.7 of the Guidance states “[the GAAR] rejects the proposition that taxpayers have unlimited freedom to use their ingenuity to reduce their tax bills by any lawful means.”

2.2 Paragraph B7 of the Guidance (The GAAR and other statutory anti-avoidance provisions) states:

“B7.1 There are many statutory provisions relating to the taxes covered by the GAAR which set out specific anti-avoidance rules. Some of these are known as targeted anti-avoidance rules (“TAARs”), while others may take the form of less explicit anti-avoidance protection.

B7.2 In principle the GAAR operates independently of these other anti-avoidance rules, and it might well be used to counteract an abusive arrangement which was itself contrived to exploit a defect in the other anti-avoidance rules, whether a TAAR or otherwise.”

2.3 Paragraph B11 of the Guidance states “It is recognised that under the UK’s detailed tax rules taxpayers frequently have a choice as to the way in which transactions can be carried out, and that differing tax results arise depending on the choice that is made.

The GAAR does not challenge such choices unless they are considered abusive. As a result in broad terms the GAAR only comes into operation when the course of action taken by the taxpayer aims to achieve a favourable tax result that Parliament did not anticipate when it introduced the tax rules in question and, critically, where that course of action cannot reasonably be regarded as reasonable.”

2.4 Paragraph C5.6.5 contains a specific warning to taxpayers “If the [taxpayers] concerned enter into complex transactions designed for the specific purpose of getting around these legislative rules, then it is not possible to regard those transactions as a reasonable course of action in relation to the relevant tax provisions, as they were specifically designed to frustrate the effect of those provisions.”

3. Terms used in this opinion and other parties to the arrangements

3.1 This case relates to three taxpayers: the “Company, Mr X a director and indirect 51% shareholder in the Company and Mrs Y the other director and 49% shareholder in the Company. Mr X and Mrs Y are together referred to as the “Employees”.

3.2 This case in addition relates to an employee benefit trust established by the Company (the “EBT”).

3.3 Separate references to the GAAR Advisory Panel were made in relation to each of the three taxpayers. We are issuing today opinions relating to each of the three references.

3.4 The taxpayers’ representations under Schedule 43 FA 2013 were composite representations made on behalf of all three taxpayers.

3.5 Precise figures, including the quantum of fees and expenses, are not important in this opinion so we use a simple “about £150,000” to cover all amounts referable to the individual rewards made to Mr X and to Mrs Y, and “about £300,000” to the aggregate reward.

3.6 In this opinion when we refer to “Guidance” we mean the GAAR Guidance approved by the Advisory Panel with effect from 15 April 2013, and statutory references without a statute are to ITEPA 2003.

4. Outline of the arrangements

4.1 The Company wished to reward and incentivise its key employees Mr X and Mrs Y. Advice was sought on how to structure this reward so it would not constitute remuneration for tax purposes.

4.2 The reward was structured in the following way: a purchase of gold for the Employees was funded by the Company; that gold was immediately sold by the Employees; the Company’s liability to pay the third party gold supplier was settled by the Employees in return for a director’s loan account credit in favour of the Employees; in connection with the purchase of the gold a long term obligation was created under which the Employees were required in the future to pay to the trustees of the EBT an amount at least equal to the purchase price of the gold (plus indexation).

5. The arrangements - contentious facts

5.1 HMRC maintains that the Employees' obligation to fund the EBT in return for receiving his reward is not a bargain on arm's length terms. The Company and the Employees disagree.

5.2 We reach our conclusion without having to take a view on, and without being influenced by, whether or not the obligation to fund the EBT is a bargain on arm's length terms.

5.3 HMRC maintains that there is no evidence to suggest the Employees' obligation to fund the EBT will be met. The Company and the Employees maintain that the obligation is genuine.

5.4 We reach our conclusion without having to take a view on, and without being influenced by, whether the Employees intended to meet their contractual funding obligations.

6. Summary of substantive result of the arrangements

6.1 A reward, given by reason of Mr X's employment, resulted in about £150,000 being available to Mr X for his use. A reward, given by reason of Mrs Y's employment, resulted in about £150,000 being available to Mrs Y for her use.

6.2 As a result of making the rewards available, the Company's resources were reduced by about £300,000.

6.3 There are ongoing contractual arrangements between the Employees and the trustees of the EBT under which the Employees owe about £300,000 (plus indexation) to the EBT.

7. The tax advantage

7.1 HMRC's position is that the Company and the Employees seek to avoid a charge to income tax and the associated NICs charge on the funds made available to them.

7.2 In particular it is HMRC's position that the Company and the Employees seek to avoid a section 62 remuneration charge and the associated PAYE and NICs charge, and that the Company and the Employees seek to avoid a Part 7A disguised remuneration charge and the associated PAYE and NICs charge.

7.3 It is also HMRC's position that the Company seeks an upfront corporation tax deduction for the cost of the reward where the scheme of the legislation for deductions for remuneration and employee benefits denies an immediate deduction.

8. Tax results argued for by the taxpayer

8.1 The Company argues that no liability arises under either section 62 (as the arrangements do not constitute remuneration) or under Part 7A (as the steps taken mean the detailed requirements under section 544Z8 for the chargeable amount to be reduced to zero are satisfied).

8.2 The Company argues that irrespective of the treatment of the reward in the hands of the Employees, it is entitled to a corporation tax deduction for the amount it funded (and recorded as an expense in its accounts) and in the period in which it incurred the expense.

9. What are the principles of the relevant legislation and its policy objectives?

9.1 The overall scheme of taxation for sums derived from employment is income tax on “money’s worth” earnings under section 62, and income tax on the sum of money (or value of the asset) made available under the disguised remuneration rules in Part 7A.

9.2 The 9th December 2010 Ministerial Statement sets out the thinking behind Part 7A ITEPA. “The legislation [Part 7A introduced by FA 2011] ensures that where a third party makes provision for what is in substance a reward or recognition, or a loan, in connection with the employee’s current, former or future employment, an income tax charge arises.

Income tax is charged on the sum of money made available and on the higher of the cost or market value where an asset is used to deliver the reward or recognition ... The amount concerned will count as a payment of employment income and the employer will be required to account for PAYE”.

9.3 Part 7A was introduced to tackle arrangements used for the purposes of disguising remuneration to avoid, reduce or defer income tax or NICs. Part 7A does not require the chargeable benefit to be an unconditional benefit. For example, the principal amount of a loan made available by an employee benefit trust is chargeable even though, being a loan, there is a requirement for the loan principal to be repaid.

9.4 The policy and intent behind Part 7A is clear; a final tax charge is imposed, on what is received (unless the reduction for consideration provisions apply), rather than on the apparent economic benefit which may well be lower.

9.5 Part 7A contains detailed rules and in limited circumstances there is intended to be relief from the charge. Section 554Z8 (Cases where consideration given for relevant step) is designed to deal with certain

situations in which there is both consideration and the transfer or acquisition of an asset, or the granting of a lease.

9.6 Where the relevant conditions in subsection 554Z8(5) are met, subsection 554Z8(6) provides that the amount which would otherwise be brought into account under Part 7A is reduced, and can be reduced to zero.

The intention appears to be to recognize that where an asset is involved, the amount ostensibly made available to the employee may be different to the equivalent had a loan of money been made and money only been involved.

9.7 The overall scheme for corporation tax deductions on rewards to employees is to align the timing of the employer's deduction with the point at which the employee suffers tax (see Chapter 1 of Part 20 CTA 2009 (Restriction on Deductions – Unpaid remuneration and Employee benefit contributions)).

10. Does what was done involve contrived or abnormal steps (section 207(2)(b) FA 2013)?

10.1 It is abnormal for an employer to reward employees using gold.

10.2 It is abnormal where parties have a choice as to whether or not to introduce an asset into arrangements, for the asset to be sold immediately after the purchase.

10.3 In this case we can see no reason for the steps to involve gold, other than for tax purposes.

The steps provide the necessary entry point for the Company and the Employees to argue that the "asset" provisions in Part 7A and the reduction of charge to zero provisions in subsection 554Z8(6) apply, and for the Company to argue that the relieving "consideration for goods" provisions in subsection 1290(4) CTA 2009 apply.

10.4 Had cash been used, and gold not been involved, other than the saving of fees in relation to the purchase and sale of the gold, neither the Company nor the Employees would have been in a substantially different economic or commercial position.

10.5 Merely because legislation deals with particular positions, here the provision of an asset as a reward and the availability of a deduction for the consideration given for goods, does not mean that choosing a course of action to utilize that legislation is necessarily either a course of action that is not abnormal or a course of action that is not contrived.

10.6 We find helpful Example D24 of the Guidance. That example considers steps to buy and sell platinum sponge as part of an arrangement to reward employees and concludes, "there is little doubt that the arrangement involves contrived or abnormal steps."

10.7 In our view the steps in this case involving gold are abnormal and contrived.

10.8 It is not abnormal for an employer to establish an employee benefit trust. The scheme of legislation for employee benefits recognizes employers have a choice as to whether to reward employees direct or via an employee benefit trust.

10.9 It is, however, abnormal for the obligation to fund an employer established employee benefit trust to be fulfilled by its key employees.

10.10 In this case we can see no reason, other than for tax purposes, for the steps involving the EBT to include the assumption by the Employees of the Company's trust funding obligation.

Had the EBT been funded in the normal way by the Company and the trustees lent funds to the Employees, none of the Company, the Employees or the EBT would have been in a substantially different economic or commercial position.

10.11 We are of the view that, taken together, the steps involving the EBT are abnormal and contrived.

11. Is what was done consistent with the principles on which the relevant legislation is based and the policy objectives of that legislation (section 207(2)(a) FA 2013)?

11.1 The resulting commercial position is one in which: the Company's assets are reduced by about £300,000, about £300,000 is made available by the Company to the Employees as a reward in connection with their employment and the Employees owe about £300,000 (plus indexation) to the EBT in which they are potential beneficiaries and Mrs Y is a protector.

11.2 The overall policy objective of section 62 and Part 7A is clear; employment rewards (including loans from employee benefit trusts) are to be taxed on the sum of money available to the employee.

11.3 Part 7A was introduced in FA 2011 as an anti-avoidance measure to stop employers and employees sidestepping the policy decision that income tax and NICs should apply to rewards from employment, and apply at the time the employee has access to the reward.

11.4 In our view the most likely comparable commercial transaction, without the overlay of contrived or abnormal steps, is a funding by the Company of the EBT followed by a loan from the trustees of the EBT to the Employees (the terms of repayment mirroring those in the existing agreement).

11.5 The most likely comparable transaction gives rise to a charge to income tax under Part 7A and the associated PAYE and NICs charge with no reduction being available under section 544Z8.

11.6 The intended outcome for the Company and the Employees of the steps taken is accordingly not consistent with the policy objectives of, or the principles behind, section 62 and Part 7A.

11.7 The Company seeks a corporation tax deduction by reference to general principles and outside of the employee benefit restrictions in Chapter 1 of Part 20 CTA 2009.

11.8 In the most likely comparable transaction the time of the corporation tax deduction is linked to the time when the Employees suffer tax on the reward.

11.9 The intended outcome for the Company of the steps taken is accordingly not consistent with the policy objectives of, or the principles behind Chapter 1 of Part 20 CTA 2009.

12. Is there a shortcoming in the relevant legislation that was being exploited (section 207(2)(c) FA 2013)?

12.1 To reduce the potential charge to tax under Part 7A to zero, the Company and the Employees rely on subsection 554Z8(6).

12.2 Subsection 554Z8(5), unlike subsection 554Z8(1), does not contain an express “no connection with a tax avoidance arrangement” condition.

12.3 The Part 7A rules are detailed and prescriptive and were subject to much debate and significant change in the course of enactment.

12.4 What is now section 554Z8 when originally drafted covered the circumstance described in subsection 554Z8(5) but did not cover the circumstance described in subsection 544Z8(1). Subsection 544Z8(1) was added at a later date in response to taxpayer representations.

12.5 The representations we received do not include any published statement relating to the reason why the “no connection with tax avoidance arrangement” condition was included in subparagraph 554Z8(1)(d) or why no such condition was included in subsection 554Z8(5).

12.6 Given that both subsections 544Z8(1) and 544Z8(5) deal with consideration and assets (albeit passing in different directions), there is no obvious reason why situations covered by one should be treated materially differently from situations falling within the other.

12.7 We think it inconceivable that Parliament would have anticipated a reduction to zero of the Employees’ tax liability when introducing section 554Z8.

12.8 The mere fact that legislation is subsequently changed does not of itself mean the original legislation contained a shortcoming. Equally a shortcoming does not cease to be a shortcoming merely because HMRC is aware of taxpayer arguments on the point.

12.9 Paragraph C5.8.1 of the Guidance states “It is often the case that perceived loopholes in tax legislation are very narrow, and that to squeeze through them requires the adoption of some step or feature that would not otherwise have been taken.”

12.10 Paragraph C5.9.1 of the Guidance looks at how a shortcoming might arise “This may be because the tax rules have a defect that was not apparent to the drafter, or the drafter may not have contemplated that a particular type of transaction could be carried out (whether to come within the rules or to keep outside them).”

12.11 Paragraph D2.7 of the Guidance provides guidance on this section 207(2)(c) FA 2013 circumstance. Paragraph D2.7.1 states: “The GAAR is intended to ... make sure that “keep off the grass” warnings are heeded.” Paragraph 2.7.2 sets out particular examples including “devising contrived ways of circumventing the disguised remuneration rules”.

12.12 In our view the position is clear. The absence of a “no connection with tax avoidance arrangement” condition in subsection 554Z8(5) is a shortcoming in complex anti-avoidance legislation. The steps in this case are designed to exploit that shortcoming.

13. Does the planning result in:-

- (i) an amount of income, profits or gains for tax purposes which is significantly less than the amount for economic purposes, or
- (ii) deductions or losses for tax purposes which are significantly greater than the amount for economic purposes, or
- (iii) a claim for the repayment or crediting of tax which has not been and is unlikely to be paid

and, if so, is it reasonable to assume that such a result was not the intended result when the relevant tax provisions were enacted (section 207(4) FA 2013)?

13.1 Section 207 (6) provides that “The examples given in subsections (4) and (5) are not exhaustive”.

13.2 The specific examples in section 207(4) FA 2013 carry little weight (one way or the other) in cases where, like Part 7A, the charge is explicitly on

a position different to the economic position and where, like section 1290 CTA 2009, a deduction is expressly denied or deferred.

14. Was what was done consistent with established practice and had HMRC indicated its acceptance of that practice (section 207(5) FA 2013)?

14.1 HMRC and the Company agree there is no relevant established practice to consider in this case.

15. Discussion

15.1 It was agreed the Employees would receive a reward of about £300,000 from their employer, the Company. The Employees received that reward, albeit subject to contractual obligations to the EBT akin to those of a loan repayment.

15.2 So the Employees could enjoy their reward without an immediate charge to tax and the Company (their wholly owned company) could enjoy an upfront corporation tax deduction, a potential route through the benefits tax legislation was identified.

By including in the steps the purchase of gold and the abnormal steps in relation to the funding of the EBT, it was hoped that exceptional tax benefits would flow to the Employees and to the Company.

The hoped for exceptional tax benefits are that the usual corporation tax deduction provisions for unpaid remuneration do not apply, and that the charging provisions in Part 7A are engaged but, relying on the absence of an explicit “no connection with a tax avoidance arrangement” condition, the prescriptive rules in subsection 554Z8(5) reduce the employee tax charge to zero.

15.3 In our view the most likely comparable commercial transaction, without the overlay of contrived or abnormal steps, is a funding by the Company of the EBT followed by a loan from the trustees of the EBT to the Employees (the terms of repayment mirroring those in the existing agreement).

15.4 In our view neither the entering into nor the carrying out of the complex steps in this case amount to a reasonable course of action in relation to the provisions charging tax on and giving deductions for employee rewards.

15.5 Each of the circumstances set out in section 207(2) FA 2013 point unambiguously towards both the entering into and the carrying out of the steps as not amounting to a reasonable course of action in relation to the relevant corporation tax, income tax, PAYE and NICs provisions:

(a) the substantive results of the steps taken are not consistent with the principles on which section 62 and Part 7A (including section 554Z8), and

Chapter 1 of Part 20 CTA 2009 are based;

(b) the means of achieving the intended result relies on contrived and abnormal steps, in particular the introduction of gold where the use of cash would have been more natural and cheaper, and the assumption by the Employees of the Company's obligation to fund the EBT; and

(c) the steps are intended to exploit shortcomings in Part 7A, and in particular the lack of an explicit "no connection with a tax avoidance arrangement" condition in section 554Z8(5).

15.6 This is a clear case of associated taxpayers seeking to frustrate the intent of Parliament by identifying potential loopholes in complex interlinking anti-avoidance legislation, and arranging a series of intricate and precise steps to exploit those loopholes so as to gain an unexpected and unintended tax "win".

It should not come as a surprise that we conclude the steps taken are not a reasonable course of action.

16. Conclusion

Each of the sub-Panel members is of the view, having regard to all the circumstances (including the matters mentioned in subsections 207(2)(a), 207(2)(b), 207(2)(c) and 207(3) FA 2013) and taking account of subsections 207(4), 207(5) and 207(6) FA 2013, that:

- a) the entering into of the tax arrangements is not a reasonable course of action in relation to the relevant tax provisions; and
- b) the carrying out of the tax arrangements is not a reasonable course of action in relation to the relevant tax provisions.