

GAAR ADVISORY PANEL

Redacted and sub-panel approved version of the Opinion Notice issued on 26 January 2018

Subject Matter

Employee obligation to Employer Financed Retirement Benefit scheme arising through use of multiple tripartite arrangements. Reward by way of what the sub panel considered to be (in substance) loan to employee.

Taxes

Income tax and corporation tax

Relevant Tax Provisions

ITEPA 2003 especially Part 7A and 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 31 October 2017 relating to the taxpayer ABC Ltd.

The sub-panel received written material from HMRC under paragraph 7 Schedule 43 FA 2013 and additional representations from ABC Ltd 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. Terms used in this opinion and parties to the arrangements

- 2.1. This case relates to taxpayer ABC Ltd. Mr D and Mr E are the only two shareholders in, and the only two directors of, ABC Ltd.
- 2.2. In addition to Mr D and Mr E this case also involves an employer financed retirement benefit scheme established for ABC Ltd (“the EFRB”).
- 2.3. By “Trustee” we mean the legal entity that is trustee of the EFRB.
- 2.4. By “Accommodation Party” we mean the British Virgin Islands registered company that is party to certain of the tripartite deeds referred to in the outline of the arrangements (see section 3 below).
- 2.5. Precise figures, including the quantum of fees and expenses, are not important in this opinion so we use a simple “about £100,000” to cover amounts referable to the individual sums allocated to Mr D and to Mr E, and “about £200,000” to the aggregate amount.
- 2.6. 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.
- 2.7. The arrangements in this case took place before NICs were covered by the GAAR.

3. Outline of the arrangements

- 3.1. ABC Ltd acknowledges the arrangements are put in place to “motivate and incentivise employees”.
- 3.2. On 8 November 2013 ABC Ltd enters into two deeds of covenant with Trustee under each of which ABC Ltd covenants to pay about £100,000 to Trustee to be held on trust for ABC Ltd.
- 3.3. On 11 November 2013 the EFRB is established.
- 3.4. On 12 November 2013 an initial sub-fund and a subsequent sub-fund are created within the EFRB. The beneficiaries of the subsequent sub-fund are Mr D and Mr E and their respective relatives and dependents.
- 3.5. On 26 November 2013 the benefit of the two 8 November covenants, together with £2,000 from ABC Ltd, is contributed to the EFRB’s initial sub-fund and subsequent sub-fund in the ratio of 1:99.
- 3.6. On 27 November 2013 ABC Ltd determines the quantum of employee awards and allocates about £100,000 to each of Mr D and Mr E.
- 3.7. On 28 November 2013 a first tripartite deed is entered into under which:
 - a) ABC Ltd undertakes to pay Accommodation Party about £100,000;
 - b) Accommodation Party undertakes to pay Mr D about £100,000; and
 - c) Mr D undertakes to pay ABC Ltd about £100,000.
- 3.8. On 2 December 2013 a second tripartite deed is entered into under which:
 - a) Accommodation Party is released from its obligation to pay Mr D about £100,000;
 - b) ABC Ltd is released from its obligation to pay Accommodation Party about £100,000; and
 - c) ABC Ltd is obliged to pay Mr D about £100,000.
- 3.9. On 3 December 2013 a third tripartite deed is entered into under which:

- a) ABC Ltd is released from its obligation to pay Trustee about £100,000 under the 8 November deed of covenant;
- b) Mr D's obligation to pay about £100,000 to ABC Ltd under the first tripartite deed is satisfied by Mr D procuring ABC Ltd's release from its obligation to pay Trustee under the 8 November deed of covenant; and
- c) Mr D is obligated to pay Trustee (in its capacity as trustee of the EFRB) about £100,000.

- 3.10. As at 3 December 2013 ABC Ltd owes Mr D about £100,000, this amount is credited to Mr D's loan account with ABC Ltd.
- 3.11. In the case of each of the steps in 3.7 to 3.10 above relating to Mr D, there are mirror arrangements in relation to Mr E.
- 3.12. On 6 December 2013 under an instrument of transposition the assets of the sub-funds are organised so the initial sub-fund holds £2,000 cash and the subsequent sub-fund the obligations owed by Mr D and Mr E.
- 3.13. As at 6 December 2013 Mr D and Mr E each owe the EFRB about £100,000. The debts are due in 2033 (with a right for the debtor to pay early) and carry no interest (but with the EFRB trustee having the right to impose an obligation to pay interest at the higher of a commercial rate or the official rate).
- 3.14. HMRC considers the debts owed to the EFRB by Mr D and Mr E are unlikely to be paid. ABC Ltd disputes this view and the implication the obligations may not be genuine. We reach our conclusion without having to take a view on, and without being influenced by, how likely Mr D and Mr E are to repay these debts.

4. ***Summary of substantive result of the arrangements***

4.1. As a result of the arrangements:

- a) about £100,000 is available to each of Mr D and Mr E for their use;
- b) ABC Ltd's resources are reduced by about £200,000; and
- c) there are on-going contractual arrangements between the EFRB trustee and Mr D and the EFRB trustee and Mr E under which Mr D and Mr E each owe about £100,000 to the EFRB.

5. ***The tax advantage***

- 5.1. HMRC's position is ABC Ltd seeks to avoid a charge to income tax (and the associated PAYE charge) on the funds made available to Mr D and Mr E.
- 5.2. In particular it is HMRC's position that ABC Ltd seeks to avoid a section 62 remuneration charge (and the associated PAYE charge), and a Part 7A disguised remuneration charge (and the associated PAYE charge).
- 5.3. It is also HMRC's position that the scheme of the legislation for deductions for remuneration and employee rewards and benefits only allows a deduction to the extent, and at the time, a corresponding benefit is charged to income tax.

6. ***Tax results argued for by the taxpayer***

- 6.1. ABC Ltd argues 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 for falling within Part 7A are not satisfied, and ABC Ltd is accordingly outside of the charge).
- 6.2. ABC Ltd argues it is entitled to a corporation tax deduction for the amount it contributed to the EFRB (and recorded as an expense in its accounts) and in the period in which it incurred the expense. In particular ABC Ltd argues as a portion of the contribution made to the EFRB (here to the 1% initial sub-fund) is taxed in the hands of

employees, the entire contribution satisfies the restrictive employee benefits deductibility rules.

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

- 7.1. The overall scheme of taxation for sums derived from employment is a patchwork including:
- a) income tax on “money’s worth” earnings under section 62;
 - b) income tax on the sum of money (or value of the asset) made available under the disguised remuneration rules in Part 7A;
 - c) a charge to tax on beneficial loans made by the employer; and
 - d) in the case of a loan or advance by a close company to a participator, a tax charge on the company on the amount of the loan or advance “as if it were an amount of corporation tax”.
- 7.2. In this opinion we are concerned, against this legislative patchwork background, with Part 7A in particular.
- 7.3. The 9th December 2010 Ministerial Statement sets out the thinking behind Part 7A. *“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”.* (emphasis added)
- 7.4. Part 7A was introduced as a wide-ranging anti-avoidance measure to tackle arrangements used for the purposes of disguising remuneration to avoid, reduce or defer income tax. 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 trust (including by an EFRB) is chargeable even though, being a loan, there is a requirement for the principal of the debt to be repaid.
- 7.5. Where, for example, trustees of an EFRB, or other employee trust, make a loan to an employee on wholly commercial terms, the employee is charged to income tax as if they had been given the money out-and-out. If and when the loan is repaid, even if on the next day, no relief is given for the income tax paid.
- 7.6. As Part 7A operates in this way and imposes a charge to tax on “non-existent” income, Part 7A is viewed by some taxpayers and their advisers as arbitrary, unjust and capricious.
- 7.7. The Guidance sheds light on how this perceived unfairness should be resolved.

Paragraph D2.7.1 states:

“The GAAR is intended to bring to an end, so far as possible, the game of legislative catch-up and to make sure that ‘keep off the grass’ warnings are heeded. If, therefore, a TAAR has been introduced with a clear purpose of preventing a particular type of behaviour but a taxpayer enters into arrangements that are intended to exploit a loophole or shortcoming in the TAAR and obtain a benefit that is clearly unintended, the GAAR will apply.”

And Paragraph D2.7.2 continues:

“... examples [of D2.7.1 situations] include ... devising contrived ways of circumventing the disguised remuneration rules or enabling employees to obtain pension rights above the statutory limits.”

Paragraph B11.1 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."

Paragraph B12.2 states:

"... safeguards (and particularly the 'double reasonableness' test) would prevent the GAAR operating in relation to arrangements entered into for the purpose of avoiding an inappropriate tax charge that would otherwise have been triggered by a more straightforward transaction. Tax charges of this sort (sometimes referred to as 'bear traps') can be encountered from time to time. For example where a taxpayer has to take what appear to be contrived steps in order to ensure that they are not taxed on more than the economic gain, such an arrangement would not generally be regarded as abusive."

- 7.8. Where Guidance indicates in B12.2 that contrived steps taken to ensure the taxpayer is not taxed on more than the economic gain would not "generally" be regarded as abusive, it is recognising there can be exceptions to the "general" case. An exception arises where Parliament clearly intends to discourage "a particular type of behaviour" (see D2.7.1) by imposing a tax charge on an amount in excess of the economic gain.
 - 7.9. There is no economic difference between the arrangements in this case and a loan made to the employees by an employer funded EFRB; in substance there is a loan made to the employees by an EFRB. This is not a case of the legislative framework providing a taxpayer with a taxable/non-taxable choice.
 - 7.10. Where an employer makes a direct loan there is no corporation tax deduction and an employee benefits charge arises to the extent interest is charged at a rate lower than the official rate. In addition, where the relationship between employer and employee is one of close company and participator, the loan to participator charge may also be relevant.
 - 7.11. Part 7A when introduced in 2011 was headed "Employment income provided through third parties". The principle underlying Part 7A is that a taxpayer should not be able to avoid a charge to tax on employment income by entering into arrangements with a third party that make provision for what is in substance an employment related reward (including a reward by way of loan). Paragraphs D2.7.1 and D2.7.2 of the Guidance make it quite clear the GAAR is designed to put a stop to the game of legislative catch-up where, for example, taxpayers have sought to devise contrived ways of avoiding the disguised remuneration rules.
 - 7.12. The policy and intent behind the legislation charging tax on employee benefits and the charge under Part 7A is clear; a final tax charge is imposed on what is received, rather than on the apparent economic benefit which may well be lower.
 - 7.13. A tax charge intended by Parliament cannot in the context of the GAAR be said to be "inappropriate" and therefore cannot create a "bear trap" that it is reasonable to avoid by adopting contrived steps.
 - 7.14. The overall scheme for corporation tax deductions on rewards to employees (including rewards by way of loan) 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*)).
- 8. Does what was done involve contrived or abnormal steps (section 207(2)(b) FA 2013)?**
- 8.1. It is not abnormal for an employer to establish an EFRB. The scheme of legislation for employee benefits recognizes employers have a choice as to whether to reward employees (including a reward by way of loan) direct or via an employee trust.

- 8.2. It is, however, abnormal and contrived for an employer to arrange long term funding of an employee trust and the provision of money to employees through the mechanism of the deeds of covenant, assignment of the benefit of these covenants and the three sets of tripartite deeds adopted in this case.
- 8.3. In this case we can see no reason, other than for tax purposes, for the steps involving the EFRB to include the creation of a complex web of undertakings to pay, assignments of benefits of undertakings, and releases of obligations to pay so as to provide funding to the EFRB and money to the employees. Had the EFRB been funded in the normal way by cash from ABC Ltd, and the EFRB trustee lent funds to Mr D and to Mr E, none of ABC Ltd, Mr D, Mr E or the EFRB would have been in a substantially different economic or commercial position. And there would have been no need to involve Accommodation Party in the arrangements.
- 8.4. We are of the view that, taken together, the steps involving the EFRB are abnormal and contrived.

9. *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)?*

- 9.1. The resulting commercial position is one in which:
 - a) ABC Ltd's assets are reduced by about £200,000;
 - b) about £100,000 is made available by ABC Ltd to each of Mr D and Mr E in connection with their employment;
 - c) Mr D and Mr E each owe about £100,000 to the EFRB in which Mr D and Mr E and their respective relatives and dependents are beneficiaries, and Mr D is the protector.
- 9.2. The overall policy objective of section 62 and Part 7A is clear; employment rewards (including loans from employee trusts) are to be taxed on the sum of money available to the employee.
- 9.3. Part 7A was introduced in FA 2011 as an anti-avoidance measure to stop employers and employees sidestepping the policy decision that income tax should apply to rewards from employment (including rewards by way of loan from employee trusts), and apply at the time the employee has access to the reward.
- 9.4. Given the resulting commercial position, in our view the most likely comparable commercial transaction, if the aim of avoiding Part 7A was not an issue, is a funding by ABC Ltd of the EFRB followed by a loan from the EFRB trustee to Mr D and to Mr E (the terms of repayment mirroring the debt payment terms in the existing agreement).
- 9.5. The most likely comparable transaction gives rise to a charge to income tax under Part 7A.
- 9.6. The intended outcome for ABC Ltd of the steps taken is accordingly not consistent with the policy objectives of, or the principles behind, section 62 and Part 7A.
- 9.7. The overall scheme for corporation tax deductions on rewards and benefits to employees is to align the timing of the employer's deduction with the point at which the employee suffers tax.
- 9.8. The deductibility of ABC Ltd's contribution to the EFRB of about £200,000 should not, as a matter of principle, be affected by the inclusion in the arrangements of the very small (about £2,000 or 1%) contribution to the initial sub-fund.
- 9.9. The intended outcome for ABC Ltd of not only an upfront deduction for taxable sums paid out of its £2,000 cash contribution but also for the contribution of the debt of about £200,000 without an income tax charge in respect of that element, is not consistent with the policy objectives of, or the principles behind, Chapter 1 of Part 20 CTA 2009.
- 9.10. However, in the most likely comparable transaction the time of the corporation tax deduction is linked to the time when Mr D and Mr E suffer tax on their rewards so, consistent with Chapter 1 of Part 20 CTA 2009, an upfront deduction would be available to ABC Ltd since there would be a charge under Part 7A on the loan from the EFRB.

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

- 10.1. The arrangements provide Mr D and Mr E with what in substance is a loan from the EFRB. A conventional loan from the EFRB would have been taxable under Part 7A.
- 10.2. On its face, for the Part 7A loan charge to apply a direct provision of funds by a third party to the employees is required. Here ABC Ltd is seeking to achieve the economic equivalence of a payment of money by a third party (EFRB) but engineer the flow of money so it comes from a non third party (the employer, ABC Ltd).
- 10.3. This looks like an attempt to exploit a perceived shortcoming in Part 7A.
- 10.4. 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.*"
- 10.5. 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).*"
- 10.6. 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 D2.7.2 sets out particular examples including "*devising contrived ways of circumventing the disguised remuneration rules*".
- 10.7. We think it inconceivable Parliament wished, particularly in anti-avoidance legislation like Part 7A where the policy intent is clear, to treat the result of a series of contrived steps as tax free when the result of economically equivalent simple steps was, and was intended to be, taxed.
- 10.8. In our view the income tax position is clear. The steps in this case are designed to exploit a perceived shortcoming in Part 7A.
- 10.9. The position on corporation tax deductibility is in our view equally clear, paying taxable sums out of the small initial sub-fund should not affect the deductibility of contributions to the subsequent sub-fund and if it does, there is a shortcoming in the legislation.

11. 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)?

- 11.1. Section 207 (6) provides that "*The examples given in subsections (4) and (5) are not exhaustive.*" (emphasis added)
- 11.2. 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.

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

- 12.1. HMRC and ABC Ltd agree there is no relevant established practice to consider in this case.

13. Discussion

- 13.1. It is agreed Mr D and Mr E received about £100,000 each from their employer, ABC Ltd, under an arrangement to motivate and incentivise employees. Mr D and Mr E had use of those monies, albeit subject to contractual obligations to the EFRB akin to those of a loan repayment.
- 13.2. ABC Ltd hopes for the following tax position:
- a) no immediate charge to income tax (the employee benefits charging provisions in Part 7A do not apply);
 - b) an immediate corporation tax deduction for the full amount contributed to the EFRB (the corporation tax deduction provisions for taxed remuneration apply to the entire contribution because an amount, albeit a small amount, referable to the contribution is taxed).
- 13.3. In our view the most likely comparable commercial transaction, if the aim of avoiding Part 7A was not an issue, is a funding by ABC Ltd of the EFRB followed by a loan from the EFRB trustee to Mr D and to Mr E (the terms of the debt payment in each case mirroring those in the existing agreements).
- 13.4. ABC Ltd in this case seeks to avoid tax on a commercial outcome targeted by Part 7A. ABC Ltd and its advisers identified a potential shortcoming in wide-ranging “keep off the grass” anti-avoidance legislation. That shortcoming is seen to exist because the relevant statutory provisions in Part 7A dealt expressly with the straightforward position of an employee trust advancing monies to an employee. Part 7A did not expressly deal with complex economically equivalent arrangements. ABC Ltd following advice adopted a series of carefully orchestrated and contrived steps to exploit this perceived weakness in the legislation.
- 13.5. It is inconceivable Parliament intended the contrived arrangements in this case to fall outside of the Part 7A charge.
- 13.6. The deductibility of ABC Ltd’s contribution to the EFRB of about £200,000 should not be affected by the inclusion in the arrangements of the very small (about £2,000 or 1%) contribution to the initial sub-fund.
- 13.7. 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 (including rewards by way of loan).
- 13.8. 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 income tax, PAYE and corporation tax provisions:
- a) the substantive results of the steps taken are not consistent with the principles on which Part 7A and Chapter 1 of Part 20 CTA 2009 are based;
 - b) the means of achieving the intended result (that the EFRB did not pay a sum of money to Mr D and Mr E) relies on contrived and abnormal steps, in particular the creation of undertakings to pay, assignments of benefits of undertakings and releases of obligations to pay where a straightforward funding and loan would have been more natural (and cheaper); and
 - c) the steps are intended to exploit shortcomings in Part 7A, and in particular the prescriptive way in which the legislation appears, on a narrow construction, to deal with payments of money by third parties.
- 13.9. In this case a taxpayer and its advisers identified a potential shortcoming in wide-ranging “keep off the grass” anti-avoidance legislation. By adopting a series of carefully orchestrated and contrived steps the taxpayer and its advisers sought to frustrate the intent of Parliament and gain an unfair and unintended tax “win”.

14. 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.