GAAR ADVISORY PANEL

Redacted and sub-panel approved version of the Opinion Notice issued on 12 October 2018

Note
Separate references to the Panel were made in relation to taxpayers Mr B and A Ltd. Opinions in similar terms in respect of these references were issued on 12 October 2018.

Subject Matter: Rewards for employees having influence over company decisions. Supply of employees' services via a third party. Reward via loans. Transfer of creditor rights to Employer Financed Retirement Benefit Scheme.

Taxes: Income Tax and National Insurance contributions.

Relevant Tax Provisions: Income Tax (Earnings and Pensions) Act 2003 especially Parts 1,2, 3 and Part 7A, Income Tax (Pay As You Earn) Regulations 2003 especially Part 9, Social Security Contributions and Benefits Act 1992 especially section 3 and section 6, Social Security (Contributions) Regulations 2001 especially Regulations 22 and 22B.

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 (the "Panel") in the referral by HMRC dated 6 July 2018 relating to taxpayer Mr B.

The sub-panel received written material from HMRC under paragraph 7 Schedule 43 FA 2013 but no substantive representations from Mr B.

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." (paragraph 11(3) Schedule 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." (paragraph 11(4) Schedule 43 FA 2013)

2. *Terms used in this opinion and parties to the arrangements*

2.1. This case relates to Mr B.

2.2. In addition to Mr B this case also involves:

a) A Ltd, a company owned as 50/50 shareholders by Mr B and his wife, Mrs B;
b) an agency employer, a company acting as trustee of a trust employing Mr B ("XYZ"); and
c) an employer financed retirement benefit scheme with beneficiary Mr B ("the EFRBS").

2.3. By "Employed Solution" we mean the plan (involving in particular Mr B, A Ltd, XYZ and the EFRBS) promoted to and adopted by Mr B in 2014 and aimed at "*minimising [Mr B's] commercial and tax risks while allowing [him] to maximise his commercial return*" (quote from HMRC's notice issued under paragraph 3 Schedule 43 FA 2013).

2.4. By "National Minimum Wage" we mean the salary rate referred to as such in the recitals to Mr B's employment contract with XYZ.

2.5. In this opinion when we refer to "GAAR Guidance" we mean the GAAR Guidance approved by the Panel with effect from 15 April 2013.

2.6. In this opinion when we refer to "Panel Guidance" we mean the GAAR Advisory Panel published guidance entitled "Procedures for dealing with referred cases".

2.7. Statutory references without a statute are to ITEPA 2003.

3. *The Employed Solution*

3.1Prior to the adoption of the Employed Solution:

a) Mr B was Operations Manager of A Ltd; and
b) Mr B was an executive director of A Ltd and Mrs B was the other director.

3.2 In preparation for the Employed Solution:

a) an additional A Ltd director is appointed on 23 July 2014 to allow Mr B to resign as an executive director;
b) Mr B terminates his executive directorship of A Ltd with effect on 17 August 2014; and
c) Mr B is appointed a non-executive director of A Ltd on 18 August 2014.

3.3 Key Employed Solution building blocks:

a) employment contract between XYZ and Mr B;
b) services contract between XYZ and A Ltd;
c) establishment of the EFRBS;
d) payments by A Ltd to XYZ for the provision of Mr B's services;
e) payments by XYZ to Mr B of National Minimum Wage salary;
f) loans by XYZ to Mr B of the balance of Mr B's expected return; and
g) transfers of the creditor rights in those loans by XYZ to the EFRBS.

4. *Outline of the arrangements*

4.1. Mr B ceases to be employed by A Ltd on 18 August 2014 and is employed by XYZ from then to March 2017.

4.2. XYZ provides Mr B's services to A Ltd during that period.
4.3. Taking October 2014 as an example:

a) XYZ invoices A Ltd based on Mr B's timesheets;
b) A Ltd pays XYZ about £10,400 (net of VAT) for Mr B's services;
c) XYZ pays Mr B a gross salary equivalent of about £990 (National Minimum Wage);
d) XYZ makes interest free, repayable on demand, "discretionary" loans of in aggregate about £7,500 to Mr B in October and November 2014; and
e) in November 2014 XYZ transfers the creditor rights in those loans to the EFRBS.

4.4. The Employed Solution marketing suggests the plan provides a post tax return to the employee of 79% - 82% against a standard employment post tax return of 48% - 56%.

5. *Summary of substantive result of the arrangements*

5.1. As a result of the arrangements Mr B has the benefit of the sums (net of VAT) paid by A Ltd in respect of his services less:

a) fees and charges paid to XYZ;
b) tax on the National Minimum Wage amount paid by way of salary; and
c) tax on the benefit of the interest free loans.

5.2. The practical effect (and intended outcome) of the arrangements is that A Ltd continues to receive the benefit of Mr B's services and Mr B continues to have funds made available to him in return for those services. The funds made available to Mr B under the arrangements are greater than those that would have been made available under a standard employment arrangement.
5.3. A Ltd continues to claim a Corporation Tax deduction for the amount (net of VAT) it pays for Mr B's services.

6. *The tax advantage*

6.1. HMRC's position is Mr B seeks to avoid a charge to Income Tax (and the associated PAYE and National Insurance contributions charge) on payments made by A Ltd (or on funds made available to Mr B) under the Employed Solution.
6.2. HMRC considers that Mr B's liability to repay the loans "*will not be met and was never intended to be.*" (see section 14.9 below)
6.3. HMRC further states "*the arrangements have been deliberately structured in such a way that assuming XYZ were required to account for tax and National Insurance contributions in respect of relevant payments, it would not have adequate funds to meet the obligation*." (see section 14.9 below)

7. *Tax results argued for by the taxpayer*

7.1. Mr B has not made any substantive representations in this case, either under paragraph 4 Schedule 43 FA 2013 in response to HMRC's paragraph 3 notice or under paragraph 9 Schedule 43 FA 2013 in response to HMRC's paragraph 6 reference.
7.2. Certain arguments on behalf of Mr B are reflected in HMRC's notice issued under paragraph 3 Schedule 43 FA 2013.
7.3. Panel Guidance in section 4 headed "GAAR guidance to taxpayers/enablers on submission of cases" states the following: "*If the taxpayer's/enabler's representations do not indicate disagreement with any matter stated in HMRC's notice or comments, the sub-panel may assume that the matter is correct.*"

7.4. Not having received substantive representations from Mr B means we do not have the benefit of Mr B's comments on the following issues:

a) why, apart from tax, the adoption of the Employed Solution was beneficial to Mr B or to A Ltd;

b) why, apart from tax, the taxpayer was prepared to give up his employment with A Ltd in order to work for the National Minimum Wage and a loan.

In the absence of representations and obvious reasons we have assumed that there are no material reasons apart from tax.

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

8.1. 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".

8.2. In this opinion we are concerned, against this legislative patchwork background, with section 62 and Part 7A in particular.

8.3. 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 EFRBS) is chargeable even though, being a loan, there is a requirement for the principal of the debt to be repaid.

8.4. The policy objective of section 62 and Part 7A is that Income Tax is accounted for on earnings and rewards provided in relation to an employee's employment. There is a corresponding policy objective that Income Tax under PAYE be deducted or accounted for and that the relevant Class 1 National Insurance contributions charging provisions apply.

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

9.1. It is not abnormal for an individual to provide his services through an agency employer, whether a personal service company or an unrelated third party.

9.2. It is, however, abnormal for an employee providing existing exclusive services to his own company to move his employment arrangements to a third party agency employer. The move in this case has no commercial purpose other than a hoped for saving of tax.

9.3. It is contrived and abnormal for an agency employer to provide the bulk of an employee's recompense on a discretionary basis. We have no reason to believe the loans in this case were discretionary in any real sense and therefore we put the term discretionary in quotation marks.

9.4. It is abnormal for an agency employer, where tax is not the main motivator, to provide the bulk of an employee's recompense by way of loan from the agency employer.

9.5. The series of steps involving the move from executive to non-executive director, use of an agency employer (XYZ), "discretionary" loans by XYZ to Mr B and the assignment of the creditor position in those loans to the EFRBS are contrived and abnormal.

9.6. We can see no reason, other than to seek a tax advantage, for the steps to be structured in this artificial and complex way.

9.7. We are of the view that, taken together, the steps comprising the tax arrangements are contrived and abnormal.

10. ***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)?***

10.1. Looking at Mr B and A Ltd's commercial position little changes.

a) Before the Employed Solution was adopted A Ltd paid a sum for Mr B's services as Operations Manager and claimed a Corporation Tax deduction for that expense. Under the Employed Solution A Ltd pays a similar sum in respect of Mr B's services and claims a Corporation Tax deduction for that expense.

b) Before the Employed Solution was adopted Mr B received a sum in return for the services provided by him as A Ltd's Operations Manager. Under the Employed Solution Mr B has made available to him a larger sum in return for the Operations Manager services he provides to A Ltd through XYZ.

10.2. What changes under a successful Employed Solution is that Mr B receives a bigger share of the expense incurred by A Ltd for Mr B's services; that bigger share arises as Income Tax is charged only on salary equal to the National Minimum Wage (and on the under market rate interest benefit on the loans) and the principal amount of the "discretionary" loans is not treated as taxable income.

10.3. The overall policy objective of section 62 and Part 7A is clear; employment rewards (including arrangements that are, or in substance are, loans from employee trusts) are to be taxed on the sum of money made available to the employee.

10.4. 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).

10.5. Given the resulting commercial position, in our view the most likely comparable commercial transaction is Mr B continuing his employment with A Ltd and not adopting the Employed Solution, and in particular not entering into any agency arrangement with XYZ.

10.6. The intended outcome for Mr B of the steps taken is accordingly not consistent with the policy objectives of, or the principles behind, section 62 (and Part 7A) and the associated PAYE and National Insurance contributions charge.

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

11.1. The Employed Solution is designed to allow Mr B to retain 79% - 82% of the amount paid out by the ultimate recipient of his services, A Ltd. That is not possible without finding a way through the provisions charging earnings and rewards from employment to Income Tax.

11.2. It appears the Employed Solution promoters identified what they thought was a way through the provisions charging employee rewards to Income Tax. The identified way through was the way Part 7A dealt with loans.

11.3. On its face, for the Part 7A loan charge to apply a direct provision of funds by a third party to the employee is required.

11.4. The Employed Solution seeks to achieve the economic equivalence of a payment of money by an employee trust (the third party for the purposes of Part 7A) but by engineering the steps so the loan is initially made to Mr B by XYZ (not a third party for the purposes of Part 7A) who then assigns the loan to the EFRBS.

11.5. This looks like an attempt to exploit a perceived shortcoming in Part 7A by rearranging a natural sequence of steps so the loan is not made directly by the third party (the EFRBS).

11.6. Paragraph C5.8.1 of the GAAR 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.*"

11.7. Paragraph C5.9.1 of the GAAR 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).*"

11.8. Paragraph D2.7 of the GAAR 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".*

11.9. 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. We do not believe the Part 7A policy intent was that a loan in form from an employee trust should be taxable under Part 7A whilst a loan that is in substance (but not in form) made by an employee trust should be outside the charge to tax.

11.10. In our view the Income Tax position is clear. The Employed Solution steps are designed to exploit a perceived shortcoming in section 62 by implementing a sequence of arrangements which were themselves planned to exploit a perceived shortcoming in Part 7A.

12. *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)?

12.1. The amount which Mr B has treated as subject to Income Tax and National Insurance contributions is significantly less than either the cost to A Ltd of obtaining Mr B's services or the funds at Mr B's disposal through the combination of the National Minimum Wage payments to him by XYZ and the amounts of the loans made to him by XYZ and transferred to the EFRBS.

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

13.1. HMRC has stated that there is no relevant established practice to consider in this case.

14. Discussion

14.1. The scheme of legislation for employee rewards in section 62 (and supplemented by Part 7A) is to charge to Income Tax sums of money made available to the employee. Prior to the adoption of the arrangements Mr B was subject to Income Tax in the usual way on the sums he received from A Ltd for his services. By adopting the arrangements, and without changing the nature of the underlying services provided by Mr B to A Ltd, the Income Tax position is said to be completely different; the amount received by Mr B representing the principal on loans is said not to be income, and not to be taxable as income under the Part 7A anti-avoidance provisions.

14.2. The arrangements taken as whole, and individual components of the arrangements, are contrived and abnormal.

14.3. We cannot see any reason for Mr B to enter into the arrangements other than for tax purposes.

14.4. In our view the most likely comparable commercial transaction is Mr B continuing to be employed by A Ltd and none of the arrangements with XYZ being entered into.

14.5. The Employed Solution seeks to rely on a narrow interpretation of Part 7A as "*an opportunity for the Houdini taxpayer to escape from the manacles of tax*" (Templeman LJ in WT Ramsay Ltd v IRC [1979] STC 582 at 583)

14.6. Part 7A is wide–ranging, "keep off the grass" anti-avoidance legislation. If the third party loan provisions of Part 7A apply to the arrangements as intended by the Employed Solution promoters then there is clearly a shortcoming in the legislation. The relevant statutory provisions in Part 7A dealt at the time 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. It is inconceivable Parliament intended the contrived arrangements in this case should be treated differently to the straightforward economically equivalent arrangements set out in the legislation.

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

14.8. Each of the circumstances set out in section 207(2) FA 2013 and section 207(4)(a) 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 (and associated PAYE and National Insurance contributions) provisions:

a) the substantive results of the steps taken are not consistent with the principles on which section 62 (and Part 7A) are based;
b) the means of achieving the intended result relies on an overall contrived and abnormal plan and on individual contrived and abnormal steps;
c) the steps are intended to exploit a perceived shortcoming in the legislation charging employee rewards to Income Tax, and in particular a perceived shortcoming in the way Part 7A appears, on a narrow construction, to deal with payments of money by third parties; and
d) the arrangements result in the amount subject to Income Tax and National Insurance contributions being significantly less than either the cost to A Ltd of obtaining Mr B's services or the funds at Mr B's disposal through the combination of the National Minimum Wage payments and loans made to Mr B.

14.9. HMRC made arguments in relation to Mr B's intentions to repay loans (see section 6.2 above) and Mr B's intentions to enter into an arrangement that, if unsuccessful, would leave HMRC out of pocket (see section 6.3 above). In coming to our opinion we have not found it necessary to accept or reject either of these arguments.

14.10. In this case a tax scheme promoter identified a potential hole in the rules charging employee remuneration to Income Tax. By adopting a series of contrived steps the employer and employee taxpayers sought, in an abusive way, to reduce the normal incidence of tax on his continuing reward for services.

15. 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.