GAAR ADVISORY PANEL

Redacted and sub-panel approved version of the Opinion Notice issued on 7 April 2020

Subject Matter

Rewards for employees. Arrangements including contributions to a trust, a loan agreement under which the employee loans money to the manager of the trust and loans from the manager of the trust to the employee. Reward by way of loans.

Taxes

Income tax and corporation tax

Relevant Tax Provisions

Income Tax (Earnings and Pensions) Act 2003 especially Part 7A and Corporation Tax Act 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.

This opinion notice is given pursuant to paragraph 11 of Schedule 43 to the Finance Act 2013 ("FA 2013") by a sub-panel consisting of three members of the GAAR Advisory Panel (the "Panel") in the referral by HMRC dated 28 November 2019 relating to B ("the Individual").

The sub-panel received written material from HMRC under paragraph 7 Schedule 43 FA 2013 and representations from A Ltd ("the Company") and the Individual jointly under paragraphs 4 and 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." (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 the Individual.

2.2 In addition to the above, this case also involves:

(a) The Company.

(b) An offshore trust called the C Remuneration Trust ("the Trust"). The beneficiaries of the Trust are set out in paragraph 4.3.

(c) D, who manages the trust assets under a fiduciary services agreement ("the Manager").

2.3 When we refer to "Guidance" we mean the GAAR Guidance approved by the Panel with effect from 15 April 2013.

2.4 The Individual and the Company are together referred to as "the Taxpayers".

2.5 The arrangements in this case took place before national insurance contributions were covered by the GAAR.

2.6 Separate references were made to the Panel in relation to the Individual and the Company. We are today issuing opinion notices in relation to both of the references.

3. Background to the arrangements

3.1 The Individual has at all relevant times since incorporation been the Company's only director and shareholder. At all relevant times the Company has traded supplying the services of the Individual as a consultant to third parties.

3.2 In years where the Company did not contribute to the Trust economic profits of the Company's trade were extracted by way of dividend.

3.3 In the relevant period, the Individual extracted substantially all of the economic value generated by the Company through the arrangements described in section 4. The Individual also received a small salary and some dividends directly from the Company. Nothing turns on this salary and these dividends and they are not referred to in the remainder of this opinion.

3.4 The Trust was settled in 2012 by a company otherwise unconnected with the Company or the Individual. The Manager was appointed to manage the Trust's assets when the Trust was settled.

4. Outline of the Arrangements

4.1 The Manager was acting as nominee and custodian on behalf of the Trust.

4.2 On 3 March 2014, the Individual entered into a "trading loan agreement" with the Manager under which the Individual lent the Manager £1,200 a year. £100 was lent each month and repaid a month later so that only £100 was outstanding at any one time.

4.3 On 7 March 2014, the Company entered into a deed of adherence to the Trust. The Trust's beneficiaries were (i) individuals ("Providers") who provided finance to the Founder, the trustees or any manager of the Trust; and (ii) relatives of those Providers. "Founder" includes any person, individual or partnership who makes any contribution to the Trust.

4.4 On 7 March 2014, the Individual entered into a deep discount finance agreement with the Manager as lender under which amounts were lent to the Individual. The loans carried interest at LIBOR plus 2% and capital repayments and interest were not due for ten years and a day. The loans were unsecured and the Manager made no checks regarding the Individual's ability to repay the loans.

4.5 In the accounting period ended 31 October 2014, the Company made contributions to the Trust of £150,000.

4.6 Between 7 March and 26 October 2014 the Manager lent the Individual £124,500.

4.7 The Taxpayers' former advisers advised HMRC in correspondence that the difference between the contributions referred to in paragraph 4.5 and loans referred to in paragraph 4.6 "appears to relate to fees paid." The Taxpayers' later advisers stated to HMRC in a meeting that they did not know whether this was correct.

5. Are the deep discount loans to the Individual repayable?

5.1 HMRC do not accept that the loans will be repaid. The Taxpayers have informed us that the Individual is considering repayment of the loans. We have very little information about the terms of the Trust and what would happen to the funds if the loans were repaid. We do not consider that we need to decide whether the loans will be repaid and will assume for the purposes of the opinion that they will be repaid.

6. Substantive result of the arrangements

6.1 In the period between 7 March and 31 October 2014, the Company contributed £150,000 to the Trust and the Manager lent the Individual £124,500. The Company claims a tax deduction for its contributions to the Trust, and the Individual claims that the loans are tax free.

7. The tax advantage

7.1 Owner managed companies often choose to pay dividends or salary to their owner managers. If they pay a dividend, the company obtains no deduction for its payment and the owner manager is taxed on the dividend. If they pay salary, the company generally obtains a deduction for the payment and the owner manager is taxed on the salary. Here, the Company and the Individual have tried to structure the arrangements so that when the Company transfers economic value deriving from the Individual's activities as a director to the Individual the Company obtains a deduction for what it pays but the Individual is not taxed on what they receive.

8. Tax results argued for by the Taxpayers

8.1 The Taxpayers have claimed that the Company is entitled to a tax deduction from its trading profits in respect of its contributions to the Trust.

8.2 The Taxpayers claim that the loans to the Individual are not emoluments of employment chargeable under section 62 ITEPA 2003, are not within Part 7A ITEPA 2003 ("Part 7A"), are not taxed as dividends under Part 4 ITTOIA 2005 and do not fall to be taxed as loans to participators under Part 10 CTA 2010.

8.3 Where a payment is made by a company to an employee via an employee benefit scheme sections 1290 to 1292 CTA 2010 normally defer the company's tax deduction until the employee is taxed on a payment from the scheme. Even where a payment is made by way of loan, the employee may be taxed under Part 7A on what the employee receives from the scheme if the loan is connected with the employee's employment. The Taxpayers argue that these provisions do not apply to the arrangements they entered into.

8.4 The Taxpayers argue that the Company made contributions to the Trust to improve "dealings with customers, suppliers and other parties either incentivised through benefits being provided to them or through the knowledge of the existence of a commercial incentives fund". The Taxpayers note that "It was understood, albeit incorrectly, that the beneficiaries [of the Trust] included suppliers to and customers of the Company".

8.5 The Taxpayers argue that Part 7A does not apply because the loans to the Individual are not connected with their employment. (For the purposes of Part 7A, officers such as directors are treated in the same way as employees). They argue that "the alternative position is not one of employment taxation" but shareholder taxation. They also argue that the loans to the Individual are independent investments by the Trust or are made because they have provided finance to the Trust under the trading loan agreement. The Trust Deed precludes employees from benefitting from the Trust and the Trustee from entering into a relevant arrangement under Part 7A.

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

9.1 The scheme of taxation affecting the extraction of cash from owner managed companies is a patchwork including:-

(a) Income tax on earnings under section 62 ITEPA 2003;
(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;
(d) Income tax on dividends and other distributions under Part 4 ITTOIA 2005;
(e) 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".

9.2 The so called IR 35 legislation can also be in point where the owner managed company is a personal service company providing the services of an individual to a client. HMRC have not argued that it is applicable in this case and we say no more about it.

9.3 Sections 1290-1292 CTA 2009 restrict a company's deductions for contributions to an employee benefit scheme until, broadly, benefits chargeable to tax in the hands of the recipient are paid out of the contributions. Where these sections do not apply, deductions are generally available for revenue payments wholly and exclusively for the purposes of a trade.

9.4 When Part 7A was introduced, a written ministerial statement was issued dated 9 December 2010. This stated:

"Following the Written Ministerial Statement on 6 December 2010 and as announced at the June Budget, the Government is introducing legislation to tackle arrangements involving trusts or other vehicles used to reward employees which seek to avoid or defer the payment of income tax or National Insurance Contributions (NICs)…

The legislation inserts a new Part 7A into ITEPA 2003. The legislation 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, for example by transferring or otherwise making available an asset for the employee's use and benefit as if the employee owned the asset. The amount concerned will count as a payment of employment income and the employer will be required to account for PAYE."

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

10.1 As the Taxpayers note, owner managers have a variety of options available but usually extract value from their companies in the most tax efficient way. The fact that tax consequences are considered does not automatically make the means adopted contrived. However, tax planning may cross the line and become contrived or abnormal.

10.2 In our view, the arrangements as a whole are contrived and abnormal and appear to us to serve no purpose other than to avoid tax. Had it not been desired to obtain a tax deduction for the Company without any tax on the funds received by the Individual much simpler means of extracting value could have been adopted. The Company could, for example, have continued to pay dividends. Alternatively, if the Company wanted to adopt a solution which gave it a tax deduction, it could have paid a salary or bonus.

10.3 There are, in particular, a number of features of the arrangements which strike us as particularly contrived or abnormal.

10.4 First, the Company has tried to link its contributions to the Trust to the incentivisation of customers and suppliers, when the Trust's beneficiaries are in fact limited to providers of finance and their relatives. Even if customers and suppliers had been beneficiaries of the Trust, it is difficult to see why such large sums should be devoted to incentivising parties who have presumably entered into commercial arrangements with the Company. The Company's failure to understand (and presumably to check) who the beneficiaries of the trust were indicates to us the artificiality of its arrangements. Linking contributions to incentivisation of customers and suppliers seems to us to be a contrived attempt to justify a tax deduction when the more obvious route of claiming a deduction for payments to employees via an employee benefit scheme would have brought into play the restrictions in sections 1290-1292 CTA 2009.

10.5 Secondly, the trading loan agreement under which the Individual lends £100 a month to the Trust, repaid at the end of the month, and which makes the Individual a beneficiary of the Trust, appears to us to be contrived to enable the Taxpayers to argue that the loans are made to the Individual for a reason other than their employment.

10.6 Thirdly, the restrictions in the Trust Deed on the Trustee entering into Part 7A arrangements or benefitting employees appear to us to be designed to distance the arrangements from employment. For the reasons given in the next section, we do not think they reflect the substance of the arrangements.

10.7 Fourthly, the lack of credit checks on the Individual's ability to repay the loans to them and lack of security for the loans is abnormal if loans are being made on a commercial basis. This feature suggests to us that the loans are not independent investments of the Trust.

10.8 Fifthly, the deep discount nature of the loans to the Individual under which capital and interest are not payable for ten years appears to us to be abnormal for loans to an individual.

10.9 The Taxpayers argue that the arrangements do not involve the degree of contrivance or abnormality required to cross the threshold of abuse. As will be apparent, we disagree.

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 Taxpayers state that "The arrangements are, looked at in essence, the contribution of funds to the Trust by the company and the borrowing of money from the Trust by the shareholder". As already noted, we are assuming for the purposes of our opinion that the loans to the Individual will be repaid. We will proceed on the basis that the Taxpayers' description of the essence of the arrangements is correct, subject to the discussion in paragraphs 11.2 to 11.10 about whether the loans are connected with employment.

11.2 The Taxpayers argue that the context of the arrangements is not one of employment taxation. They note, correctly in our view, that the character of the payment made by a company to a director is not determined by the mere fact that the person is an officer and therefore treated as an employee for tax purposes. One must establish whether the payment is made to the director qua officer. Equally, we would add that the character of the payment made to a shareholder is not determined by the mere fact that the person is a shareholder.

11.3 As a sub-panel of the Panel noted in paragraphs 9.2 and 9.3 of the opinion it issued on 11 October 2018 [1]

"9.2 The overall policy objective of section 62 and Part 7A is clear; employment earnings and rewards (including arrangements that are in substance loans from an employee trust) 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, on receipt, to rewards from employment (including rewards by way of loan from employee trusts)."

11.4 We have already quoted the written ministerial statement dated 9 December 2010 concerning Part 7A:

[1] Published in redacted form on 7 November 2018 at https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/754322/GAAR_Advisory_Panel_opinion_of_11_October_2018_-_contractor_rewards_using_loans__Mr_N_.pdf

"The legislation 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."

11.5 It seems to us that the critical question when we are assessing consistency with policy and principles is whether the loans to the Individual were made to them in connection with their office as a director of the Company. We consider they were, and that the policy behind Part 7A is therefore in point.

11.6 The Taxpayers note that the Company has no history of paying substantial salaries to the Individual. In years where contributions were not made to the Trust, economic profits of the business have been extracted by way of dividend. We do not consider this means the loans to the Individual are not connected with their office as director.

11.7 Had the Taxpayers not entered into these or similar arrangements the Company might have continued to pay dividends or it might have paid a salary or bonus. We have to look at what was actually done. Dividends are paid out of profits – in this case, contributions were made to the Trust which are alleged to be deductible before profits are arrived at. Dividends are normally paid once or twice a year. In this case, in the year ended 31 October 2014 ten separate contributions and loans to the Individual were made. We have been provided with a schedule of payments. Each contribution to the Trust was followed almost immediately by a loan of 83% of the contribution to the Individual. The cashflow is more typical of a salary than a dividend, although we note the Individual received loans and not the absolute payments they would have received had a salary been paid. We nevertheless think the pattern of payments suggests a connection to their office as director.

11.8 The Company trades supplying the services of the Individual as a consultant to third parties. They are the Company's only director and shareholder. We do not know whether they have an employment contract with the Company, but as a director they are treated for Part 7A purposes as if they were an employee and as the Company's only director and shareholder they are the heart and mind of the Company. There has been no suggestion that the Company has any other employees so that it is the activity of the Individual as a director and, if they do have an employment contract with the Company, an employee of the Company that has generated its income. The arrangements are a means of transferring to the Individual, otherwise than by way of dividend, economic value deriving from their activities for the Company. Apart from the arrangements they only receive a small salary from the Company relative to the value generated by their activities. This suggests to us a connection (for Part 7A purposes) between the loans to them and their employment.

11.9 While we do not place particular reliance on the description in the Company's published accounts, we note that note 6 to the Company's annual accounts filed at Companies House provides:-

"**Employment trust contribution**

During the year the Company made an irrevocable contribution of £150,000 to the [Trust]."

We note also that the Trust's name includes the word "Remuneration". While we do not place particular reliance on these factors, we think they are consistent with our conclusion. In the description in the accounts and in the Trust's name we see the connection with employment being confirmed.

11.10 We consider that the consistency of what was done with the principles and policy of the relevant legislation needs to be assessed against the principles and policy behind Part 7A because the loans were connected with the Individual's office as director. We do not think the claimed results are consistent with those principles and policy.

11.11 The restriction in sections 1290-1292 CTA 2009 is in point where, as a result of any act, property is held for the benefit of persons who include employees or directors of a company. The purpose of the restriction is to defer a tax deduction for a contribution to an employee benefit scheme until a taxable benefit is paid out of it. We consider that the claimed tax results of a tax deduction for contributions to the Trust but no tax on loans from it to a person who is a director of the Company are not consistent with the policy and principles underlying these sections. The accounts description is consistent with this conclusion.

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

12.1 The arrangements do not seek to exploit any specific loophole in Part 7A or sections 1290-1292 CTA 2009. Rather, they seek to break the link with employment. While we expect the arrangements to fall within Part 7A and sections 1290-1292, if they escape these provisions technically, there do seem to be shortcomings in them which would then engage the GAAR.

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 As noted in paragraph 5.1, we are assuming for the purposes of this opinion that the loans to the Individual will be repaid. Looking at the arrangements as a whole, it would be surprising if the economic value which the Company contributed to the Trust and the Trust lent to the Individual were not one way or another to remain with the Individual or their family whether or not the loans are repaid. We cannot see why the Taxpayers would be prepared to enter into these arrangements on any other basis.

13.2 Whatever the position if the loans are repaid, we consider that the arrangements seek to achieve a result contrary to the principles and policy underlying Part 7A. Part 7A taxes loans in connection with employment. Even if it is correct to regard the loans as not giving rise to income "for economic purposes", we do not attach significant weight to the factor in section 207(4) in the context of a provision such as Part 7A which expressly taxes loans as if they were income of the recipient.

13.3 Similarly, we attach little weight to this factor in the context of sections 1290 - 1292. These sections seek to restrict deductions even in cases where there is an economic cost to the employing company.

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 has informed us that the arrangements do not accord with any established practice that HMRC had, at the time the arrangements were entered into, indicated acceptance of.

14.2 The Taxpayers argued that the use of loan-based tax arrangements was extremely widespread up to at least 2016 and that insofar as arrangements were outside the scope of Part 7A both established practice and judicial decisions were in support of the effectiveness of loan-based tax arrangements even as late as the end of 2014. We, however, consider that the arrangements in question are within the scope of Part 7A. The Taxpayers drew our attention to a large scale settlement offer promoted and accepted by HMRC around 2014 whereby they said that HMRC accepted the effectiveness of loans from EFRBs and EBTs "on the basis that there would be a corporation tax deferral until such time as the loans became actual emoluments (by distribution from the trust, or write off)". This is clearly not an acceptance of arrangements such as these which seek to achieve both an immediate corporation tax deduction and no tax on the loans. The Taxpayers did not provide any evidence of HMRC accepting the effectiveness of arrangements involving employment connected loans after the introduction of Part 7A.

15. Discussion

15.1 The Taxpayers say that "The arrangements are, looked at in essence, the contribution of funds to the Trust by the company and the borrowing of money from the Trust by the shareholder." They argue that the arrangements are shareholder based rather than employee based. As explained in section 11, we consider the loans are in fact connected with the Individual's office as director.

15.2 The Taxpayers have sought to achieve both an immediate corporation tax deduction for the Company and no taxation on the loans to the Individual. In doing so, they have faced a number of obstacles. They have needed to escape from Part 7A. The arrangements adopt contrived features to do this, notably the small trading loan agreement under which £100 a month is lent by the Individual to the Trust to make them a beneficiary of the Trust. Having distanced the loans from employment, the Taxpayers have needed to find a basis, other than the remuneration of employees, on which the contributions to the Trust could be deductible. This has resulted in another contrived feature, the attempt to argue that the contributions incentivise suppliers and customers of the Company when they are not in fact beneficiaries of the Trust.

15.3 One of the purposes of the GAAR is to counter contrived attempts to circumvent anti-avoidance legislation. As the Guidance notes,

"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."

"D2.7.1 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.

D2.7.2 One example of this would be the transactions giving rise to the recent change of law in relation to debt buy-back through partnerships. Other examples include the corporation tax shares as debt example below, devising ways of UK domiciliaries buying interests in excluded property trusts for inheritance tax purposes, *devising contrived ways of circumventing the disguised remuneration rules* [emphasis added] or enabling employees to obtain pension rights above the statutory limits."

15.4 In our view, the Taxpayers have devised a contrived way of circumventing the disguised remuneration rules and rules in sections 1290-1292 CTA 2009.

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

(a) The substantive results of the steps are not consistent with the policies and principles on which Part 7A and sections 1290-1292 are based;
(b) The arrangements adopted are both contrived and abnormal; and
(c) If the arrangements succeed, there is a shortcoming in the relevant legislation.

We cannot believe that Parliament intended loans to a person from a trust made out of funds deriving from economic value earned by that person's activities as a director to escape Part 7A.

15.6 There has been a naked attempt to break the connection between the loans to the Individual and their activities as a director of the Company which have generated the economic value channelled through the arrangements to them in order to prevent Part 7A and the restrictions on deductions for employee benefit contributions from applying. There has been a clear failure to heed "keep off the grass" legislation in Part 7A.

15.7 A high proportion of the cases referred to the Panel have involved arrangements for the tax free extraction of cash/value by an owner/director from their owner managed company. In each case the relevant sub-Panel has come to the conclusion that the arrangements were contrived and not consistent with the principles of the legislation. We do not regard the arrangements in this case as exceptional and it should come as no surprise that we reach a similar conclusion to that reached in the earlier cases.

16. Conclusion

16.1 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.