GAAR ADVISORY PANEL

Redacted and sub-panel approved version of Opinion Notice originally issued on 17 November 2017

Subject Matter

Distributions. Participator loans/participator benefits. Extraction of cash (or cash equivalent) from close company thorough the use of trusts and trust interests.

Taxes

Income Tax. Amount chargeable as if it were Corporation Tax.

Relevant Tax Provisions

Chapter 2 of Part 23 CTA 2010, especially sections 1000 and 1020, section 383 ITTOIA 2005, Chapters 3 and 3A of Part 10 CTA 2009.

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 6 July 2017 relating to the Company.

The sub-panel received written material from HMRC under paragraph 7 Schedule 43 FA 2013 (including representations on behalf of Mr A and the Company under paragraph 4 Schedule 43 FA 2013) and from HMRC under paragraph 10 of Schedule 43 FA 2013. The taxpayers made no representations under paragraph 9 of Schedule 43 FA 2013. The sub-panel requested, under paragraph 10 of Schedule 43 FA 2013, both the taxpayers and HMRC for a copy of the trust deed constituting the Trust. We were not provided with a copy by the taxpayers, and HMRC responded that they did not have a copy.

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 other parties to the arrangements

2.1 This case relates to two taxpayers: the Company and Mr A. Mr A is the sole director of and shareholder in the Company.

2.2 Separate references to the GAAR Advisory Panel were made in relation to the taxpayers. We are issuing today opinions relating to both of the references. A single set of composite planning arrangements should be analysed as a whole. As the planning arrangements inseparably involve both taxpayers, today's opinions are issued in substantially the same form.

2.3 The taxpayers' representations under paragraph 4 of Schedule 43 FA 2013 were composite representations made on behalf of both taxpayers.

2.4 We use "Trust" to mean the trusts established in 2013, prior to the taxpayers' involvement, and combined in July 2014 for use by Mr A.

2.5 We use the term "Promoter" to mean the XX group, a group providing tax services.

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

2.7 When we use "distributions" legislation we refer to the legislation in Chapter 3 of Part 4 ITTOIA 2005.

2.8 When we use "loan to participator" legislation (or charge under that legislation) we refer to Chapter 3 of Part 10 CTA 2010 (Charge to tax in case of loan to participator).

2.9 When we use “other participator benefits” legislation (or charge under that legislation) we mean Chapter 3A of Part 10 (Charge to Tax: Other Arrangements).

3. Outline of the arrangements

3.1 The arrangements were entered into in 2014. At the time Mr A owed the Company £460,000. Had that loan remained in place the Company would have incurred a charge to tax under the loan to participator rules in section 455 CTA 2010.

3.2 Mr A and the Company adopted a planning arrangement brought to them by the Promoter. The planning was designed to allow Mr A to extract cash (or cash equivalent) from the Company with no charge to income tax on Mr A, and no loan to participator charge or other participator benefits charge on the Company. The planning looked to the overall combined tax position of Mr A and the Company (his wholly owned company), in this opinion we will accordingly make reference not only to the Company’s tax position but to that of Mr A as well.

3.3 In outline the planning involved:

a) On 16th and 17th July 2013 two trusts were created by an offshore company settlor and funded with £325,000 each. Those funds were lent back to the settlor.

b) On 26th August 2013 a company established under the laws of Cyprus and associated with the Promoter took over as sole trustee of the trusts.

c) On 7th July 2014 the assets of one of the trusts (and corresponding loans to the settlor) were reduced by £150,000 and the assets of the two trusts (now £500,000) were combined under one deed.

d) On 16th July 2014 the settlor assigned to Mr A the settlor’s interest in the Trust for £500,500, the settlor repaid its £500,000 loan to the Trust and the Trust made a £500,000 loan to Mr A. These steps did not involve the incurring of any cost by Mr A, other than £500 in trust set up costs.

e) On 31st October 2014 the Company purchased the “primary interest” in the Trust from Mr A for £500,000. The purchase price was paid via a credit to Mr A’s loan account with the Company, thus eliminating Mr A’s £460,000 loan from the Company.

f) On 11th November 2014 a company, associated with the Promoter and in its capacity as trustee of a separate Mr A family trust, acquired the “secondary interest” in the trust for £100.

g) The “primary interest” entitled the holder to income on the Trust’s assets until 2135.

h) The “secondary interest” entitled the holder to the remaining capital after 2135.

i) The terms of Mr A’s loan from the Trust were that it would be interest free for so long as Mr A held the primary interest and thereafter interest would become payable at a rate of the lower of 5% and 4% above the Bank of England base rate from time to time.

j) The 25th September 2014 Board minutes of the Company recited that the trustee had the power to make an outright distribution of the underlying assets of the Trust to the holder of the secondary interest, in effect the trustee can end the holder of the primary interest’s right to income. Despite our requesting the Trust deed neither HMRC nor the taxpayers have provided us with a copy so we take the statement in the Board minutes as an accurate reflection of the position.

4. Summary of substantive result of the arrangements

4.1 The substantive result of the arrangements is that:

a) Mr A receives £500,000 from the Company, £460,000 of which is used to discharge the loan he owes to the Company;

b) until the loan from the Trust to Mr A is repaid on his death or the loan is otherwise unwound Mr A funds the annual income the Company receives from the Trust;

c) the Company reflects the right to receive annual income from the Trust as a £500,000 asset in its accounts; and

d) the trustees of the Trust have the power to make an outright distribution of the trust assets to the holder of the secondary interest (Mr A’s family trust).

5. The tax advantage

5.1 The arrangements seek to provide Mr A with £500,000 tax free with no charge arising on the Company either as a loan to participator charge or as another participator benefits charge. The £500,000 received on sale of his primary interest to the Company enables Mr A to repay his existing £460,000 loan from the Company and so prevent a loan to participator charge applying to that loan.

5.2 The arrangements in other words seek to get around the taxing provisions by steering a course away from the distributions legislation (which charges to income tax shareholder extractions of value from a company), away from the loan to participator legislation (which levies tax on a close company providing loans to participators), and away from the other participator benefits legislation (which levies tax on a close company providing, as part of tax avoidance arrangements, an otherwise untaxed or under taxed benefit).

5.3 The tax position of hypothetical normal transactions is as follows:

a) A dividend paid by the Company to Mr A gives rise to a charge to income tax on the amount of the dividend.

b) A loan by the Company to Mr A gives rise to a loan to participator charge in the Company by reference to the amount of the loan.

c) The sale of a valuable asset by Mr A to the Company at overvalue gives rise to a charge to income tax under the distributions legislation on the difference between the value received by Mr A and the market value of the asset received by the Company (in essence the charge is on the value extracted from the Company).

d) The sale of a valuable asset by Mr A to the Company has potential capital gains consequences for Mr A.

6. Tax results argued for by the taxpayers

6.1 Mr A and the Company argue that the £500,000 Mr A received from the Company is a market value purchase price for an asset (the primary interest in the Trust). Accordingly as no value is extracted from the Company no charge to income tax under the distributions legislation can arise. In addition, Mr A argues his capital gains base cost is at least £500,000 so that no capital gain arises on the sale of the primary interest to the Company.

6.2 Mr A and the Company also argue that the existing loan to Mr A is repaid and is not replaced by another loan from the Company, and that Mr A has received no other taxable benefit. Accordingly Mr A and the Company argue no charge can arise on the Company under the loan to participator rules in section 455 CTA 2010 or under the other participator benefit rules in section 464A CTA 2010.

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

7.1 The overall scheme of the distributions legislation is that distributions as defined in Chapter 2 of Part 23 CTA 2010 (Matters which are Distributions) when received by individual members of the distributing company are subject to income tax (section 383 ITTOIA 2005).

7.2 Subject to exceptions, none of which are argued to be relevant in this case, any dividend or other distribution out of the assets of a company in respect of the shares in the company is a distribution (section 1000(1) CTA 2010).

7.3 Subject to exceptions, none of which are argued to be relevant in this case, the amount of the benefit received by a member on the transfer of an asset by a member to the company is a distribution to the extent the amount received by the member is in excess of the market value of the asset received by the company (section 1020 CTA 2010).

7.4 The Company is a "close company" and Mr A is a "participator" in the Company. Where a benefit, which is not a distribution, is conferred by a close company on a participator, the loan to participator legislation and other participator benefits legislation apply to bring the benefit into charge to tax.

7.5 Where a close company makes a loan or advance to an individual who is a participator, tax becomes due from the company "as if it were an amount of corporation tax" (section 455 CTA 2010). Tax is charged on the amount of the loan or advance. Relief is given when and if the loan is repaid (section 458 CTA 2010).

7.6 Where a close company is party to tax avoidance arrangements under which a benefit is conferred on an individual who is a participator in the company, a charge is made on the company "as if it were an amount of corporation tax". The charge is on the amount of the value of the benefit (section 464A CTA 2010). No charge arises where the individual is charged to income tax on the benefit, for instance under the distributions legislation (section 464A (2)).

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

8.1 There is no commercial, non-tax, reason for Mr A and the Company to involve a trust in the desired goal of extracting cash from the Company.

8.2 The Trust and splitting of the Trust interests in this case appears to be designed to manufacture (at no cost other than trust set up costs) an asset that is not a loan and can be sold to a wholly-owned affiliate.

8.3 In addition to the overall use of the Trust and the Trust interests being contrived and abnormal, there are a number of specific features we regard as contrived and abnormal:

a) Mr A buying a trust interest where the only trust asset is intended to be an interest free loan to himself, the amount of the loan being substantially the same as the purchase price he pays for the trust interest;

b) entering into arrangements for over 120 years where the underlying asset is a loan to an adult individual and where little regard is paid (as far as we can see) to what happens if the loan is repaid on Mr A's death or otherwise before the expiry of that period; and

c) a contract for the purchase of an income stream (the primary interest in the Trust) that contains none of the purchaser protections you would typically see in a third party transaction.

8.4 Using a trust in this way to achieve a commercial goal is both contrived and abnormal.

8.5 We are therefore of the view that in their totality the steps involving the Trust and the trust interests are contrived and abnormal.

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 principles and policy objectives of the legislation referred to in paragraphs 7.1, 7.5 and 7.6 above are to charge tax on a cash (or cash equivalent) benefit received by a participator from a close company. Together the three heads of charge form a cohesive whole. The benefit can fall into one of three categories – a distribution, a loan and a benefit associated with a tax avoidance arrangement to which the company is a party.

9.2 We conclude in paragraph 8.5 above that, given the context of a commercial arrangement to extract cash from a company, in their totality the steps involving the Trust and the trust interests are contrived and abnormal. In our view the most likely comparable commercial transaction, if the option of acquiring and selling a trust interest was not available, is a £500,000 dividend paid by the Company to Mr A, £460,000 of which is used to discharge the loan he owes to the Company.

9.3 In our view, contrived and abnormal steps have been adopted to avoid the tax consequences of the most likely comparable commercial transaction. The taxpayers state “the arrangements … involved a structure which, in both form and substance, stands outside the intended scope of the statutory provisions under consideration”. We disagree.

9.4 The intended outcome of the insertion of the contrived and abnormal trust steps to achieve a tax free extraction of cash (or cash equivalent) for Mr A from the Company is not consistent with the policy objectives of, or the principles behind, the legislation referred to in paragraphs 7.1, 7.5 and 7.6 above taken as a whole.

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

10.1 We do not consider there to be a shortcoming in any of the three separate sets of rules charging tax on benefits conferred by close companies.

10.2 That does not mean we do not consider that Mr A and the Company are seeking to exploit the fact that benefits to participators are taxed under three separate codes rather than under a single code.

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 Mr A received £500,000 from the Company. If that amount or any part of it is for economic purposes income and it is not taxed as income then it is clear that the result is not the intended result of the distributions legislation.

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

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, Mr A and the Company agree there is no relevant established practice to consider in this case.

13. Discussion

13.1 Paragraph C5.6.5 of the Guidance states "If the companies 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".

13.2 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".

13.3 So Mr A could extract £500,000 from the Company with no charge to income tax on Mr A, and no loan to participator or other participator benefits charge on the Company, Mr A and the Company adopted a plan involving contrived steps entered into on a cost free (excluding scheme fees) basis between Mr A, Mr A's associates, the Promoter and the Promoter's associates. Those steps were designed to manufacture an asset that could be sold to the Company for a sufficient amount to repay the outstanding (and potentially taxable) £460,000 loan made by the Company to Mr A.

13.4 In our view the only purpose of the Trust is to bring into being an asset, without which there would be no doubt as to the application of the distributions legislation. We regard the totality of the steps involving the Trust as contrived and abnormal. The lack of customary protections for the Company as the

purchaser of an income stream – in particular the absence of security, and the power in the hands of the Promoter associate trustee at any time to make an outright distribution of the Trust funds to the holder of the secondary interest and so end the Company's entitlement to income – reinforces our view that the acquisition of a valuable and enduring asset by the Company was not a commercial aim of the arrangements.

13.5 As Mr A is the sole director and shareholder of the Company, corporation tax paid on the income received from the Trust by the Company can be seen simply as an additional scheme cost.

13.6 The taxpayers' commercial objective (as reflected in the Promoter's Letter of Advice to the Company of 3rd September 2014) was "to extract cash from a company" and to do so "without incurring a charge to tax". When we view the arrangements as a whole in the light of this objective we see no reason for steps involving the Trust beyond a tax reason.

13.7 In our view the most likely comparable commercial transaction, if the option of acquiring and selling a trust interest was not available, is a £500,000 dividend paid by the Company to Mr A, £460,000 of which is used to discharge the loan he owes to the Company.

13.8 In our view neither the entering into nor the carrying out of the complex, contrived and abnormal steps in this case amount to a reasonable course of action in relation to the provisions charging tax on distributions, on a loan to a participator and on other participator benefits.

13.9 The circumstances set out in paragraphs (a) and (b) of 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 tax provisions:

a) substantive results of the steps taken are not consistent with the principles on which the distributions, loan to participator and other participator benefits legislation are based; and

b) means of achieving the intended result relies on contrived and abnormal steps, in particular the steps involving the Trust and trust interests.

13.10 This is a clear case of associated taxpayers seeking, with the help of a promoter and the promoter's associates, to use an uncommercial and contrived scheme designed for the purpose of getting around a set of complimentary legislative rules. The GAAR legislation is, as explained in the Guidance, targeted at such activity and we have no difficulty in concluding that the contrived and abnormal steps undertaken in this case are not a reasonable course of action.

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

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