

## **GAAR ADVISORY PANEL**

**Redacted and sub-panel approved version of Opinion Notice originally issued on 9 November 2017**

### **Subject Matter**

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

### **Taxes**

Income Tax and NICs, Corporation Tax,

### **Relevant Tax Provisions**

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

### **Opinion**

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

### **Opinion Notice**

This opinion notice is given pursuant to paragraph 11 of Schedule 43 to the Finance Act 2013 by a sub-panel consisting of three members of the GAAR Advisory Panel in the referral by HMRC dated 28 July 2017 relating to taxpayer Mr Y.

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

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

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

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

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

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

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

(c) it is not possible, on the information available, to reach a view on that matter, and the reasons for that opinion.” (para 11(3) Sch 43 FA 2013)

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

## **2. GAAR Advisory Opinion of 18 July 2017 (Earlier Similar Case)**

2.1 The arrangements entered into by the taxpayers in this case are substantially similar to the arrangements entered into by the taxpayers in the “employee rewards using gold bullion” case on which a sub-panel of the GAAR Advisory Panel opined on 18<sup>th</sup> July 2017 (the “Earlier Similar Case”). The opinions relating to the Earlier Similar Case are published on GAAR Advisory Panel opinions page on the GOV.uk website.

2.2 We come to the same conclusion in this case as the sub-panel did in the Earlier Similar Case, and do so for similar reasons.

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

3.1 This case relates to two taxpayers: the Company and Mr Y. Mr Y is the sole director and shareholder in the Company.

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

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

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

3.5 Precise figures, including the quantum of fees and expenses, are not important in this opinion so we use a simple “about £5 million” to cover all amounts referable to Mr Y’s reward.

3.6 In this opinion when we refer to “Guidance” we mean the GAAR Guidance approved by the Advisory Panel with effect from 30 January 2015, and statutory references without a statute are to ITEPA 2003.

3.7 The arrangements in the Earlier Similar Case took place in September 2014 so the relevant GAAR Guidance was the Guidance approved by the Advisory Panel with effect from 15 April 2013.

#### **4. Outline of the arrangements**

4.1 The Company was made aware of “mechanisms” enabling a company to incentivize employees. The Company decided to implement one of these mechanisms recognizing “your performance across the year as well as how it has contributed to the Company’s financial position” to reward Mr Y.

4.2 In outline the reward was structured in the following way, with the various steps taking place in September 2015:

- a) the EBT was established by the Company, the Company agreed to provide the EBT with a contribution of about £5 million within the next ten years;
- b) the Company agreed to fund a purchase of gold worth about £5 million for Mr Y;
- c) the gold was purchased from a third party for about £5 million;
- d) Mr Y immediately sold that gold back to the third party for about £5 million;
- e) the Company’s liability to pay the third party was substantially settled by Mr Y in return for a director’s loan account credit of about £5 million in favour of Mr Y; and
- f) in connection with the purchase of the gold a long-term obligation was created under which Mr Y, in place of the Company, was required in the future to pay to the trustees of the EBT about £5 million (adjusted by RPI).

#### **5. The arrangements - contentious facts**

5.1 HMRC maintains that Mr Y’s obligation to fund the EBT in return for receiving his reward is not a bargain on arm’s length terms. Mr Y disagrees.

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

5.3 HMRC maintains that there is no evidence to suggest Mr Y’s obligation to make payment to the EBT will be met. Mr Y maintains that the obligation is genuine.

5.4 We reach our conclusion without having to take a view on, and without being influenced by, whether Mr Y intended to meet his contractual funding obligation.

#### **6. Summary of substantive result of the arrangements**

6.1 A reward, given by reason of Mr Y's employment, resulted in about £5 million being available to Mr Y for his use.

6.2 As a result of making the reward available, the Company's resources were reduced by about £5 million.

6.3 There are on-going contractual arrangements between Mr Y and the trustees of the EBT under which Mr Y owes about £5 million (adjusted by RPI) to the EBT.

## **7. The tax advantage**

7.1 HMRC's position is that Mr Y seeks to avoid a charge to income tax (and the associated PAYE and NICs charge) on the funds made available to him.

7.2 In particular it is HMRC's position that Mr Y seeks to avoid a section 62 remuneration charge (and the associated PAYE and NICs charge), and that Mr Y seeks to avoid a Part 7A disguised remuneration charge (and the associated PAYE and NICs charge).

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

## **8. Tax results argued for by the taxpayer**

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

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

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

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

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

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

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

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

9.5 Part 7A contains detailed rules and in limited circumstances there is intended to be relief from the charge. Section 554Z8 (Cases where consideration given for relevant step) is designed to deal with certain situations in which there is both consideration and the transfer or acquisition of an asset, or the granting of a lease.

9.6 Where the relevant conditions in subsection 554Z8(5) are met, subsection 554Z8(6) provides that the amount which would otherwise be brought into account under Part 7A is reduced, and can be reduced to zero. The intention appears to be to recognize that where an asset is involved, the amount ostensibly made available to the employee may be different to the equivalent had a loan of money been made and money only been involved.

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

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

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

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

10.3 In this case we can see no reason for the steps to involve gold, other than for tax purposes. The steps provide the necessary entry point for Mr Y to argue that the “asset” provisions in Part 7A and the reduction of charge to zero provisions in subsection 554Z8(6) apply, and for the Company to argue that the relieving “consideration for goods” provisions in subsection 1290(4) CTA 2009 apply.

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

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

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

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

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

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

10.10 In this case we can see no reason, other than for tax purposes, for the steps involving the EBT to include the assumption by Mr Y of the Company’s trust funding obligation. Had the EBT been funded in the normal way by the Company and the trustees lent funds to Mr Y, none of the Company, Mr Y or the EBT would have been in a substantially different economic or commercial position.

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

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

11.1 The resulting commercial position is one in which:

- a) the Company’s assets are reduced by about £5 million;
- b) about £5 million is made available by the Company to Mr Y as an incentive in connection with his employment; and
- c) Mr Y owes about £5 million (adjusted by RPI) to the EBT in which he is a potential beneficiary.

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

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

11.4 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 the Company of the EBT followed by a loan from the trustees of the EBT to Mr Y (the terms of repayment mirroring those in the existing agreement).

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

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

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

11.8 In the most likely comparable transaction the time of the corporation tax deduction is linked to the time when Mr Y suffers tax on the reward.

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

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

12.1 To reduce the potential charge to tax under Part 7A to zero, Mr Y relies on subsection 554Z8(6).

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

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

12.4 What is now section 554Z8 when originally drafted covered the circumstance described in subsection 554Z8(5) but did not cover the

circumstance described in subsection 544Z8(1). Subsection 544Z8(1) was added at a later date in response to taxpayer representations.

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

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

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

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

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

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

12.11 Paragraph D2.7 of the Guidance provides guidance on this section 207(2)(c) FA 2013 circumstance. Paragraph D2.7.1 states: “The GAAR is intended to make sure that “keep off the grass” warnings are heeded.” Paragraph D2.7.2 sets out particular examples including “devising contrived ways of circumventing the disguised remuneration rules”.

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

### **13. Does the planning result in:**

- (i) an amount of income, profits or gains for tax purposes which is significantly less than the amount for economic purposes, or
- (ii) deductions or losses for tax purposes which are significantly greater than the amount for economic purposes, or



- (iii) a claim for the repayment or crediting of tax which has not been and is unlikely to be paid and, if so, is it reasonable to assume that such a result was not the intended result when the relevant tax provisions were enacted (section 207(4) FA 2013)?

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

13.2 The specific examples in section 207(4) FA 2013 carry little weight (one way or the other) in cases where, like Part 7A, the charge is explicitly on a position different to the economic position and where, like section 1290 CTA 2009, a deduction is expressly denied or deferred.

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

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

#### **15. Discussion**

15.1 It was agreed Mr Y should be incentivized by receiving a reward of about £5 million from his employer, the Company. Mr Y received that reward, albeit subject to contractual obligations to the EBT akin to those of a loan repayment.

15.2 So Mr Y could enjoy his reward without an immediate charge to tax and his wholly owned company could enjoy an upfront corporation tax deduction, a potential route or “mechanism” through the benefits tax legislation was identified. By including in the steps the purchase of gold and unusual funding of the EBT, it was hoped that exceptional tax benefits would flow to Mr Y and to the Company. The hoped for exceptional tax benefits are that the usual corporation tax deduction provisions for unpaid remuneration do not apply, and that the charging provisions in Part 7A are engaged but, relying on the absence of an explicit “no connection with a tax avoidance arrangement” condition, the prescriptive rules in subsection 554Z8(5) reduce the employee tax charge to zero.

15.3 In our view the most likely comparable commercial transaction, if the aim of avoiding Part 7A was not an issue, is a funding by the Company of the EBT followed by a loan from the trustees of the EBT to Mr Y (the terms of repayment mirroring those in the existing agreement).

15.4 The newly introduced example D25A (RSP Limited – Disguised remuneration) in the Guidance is relevant as it illustrates how HMRC and the GAAR Advisory Panel see the GAAR legislation applying to complex and contrived arrangements intended to establish a tax free path through Part 7A. The commentary in paragraphs D25A.5.1 to D25A.5.5 indicates that each of

the circumstances set out in section 207(2), (4) and (5) FA 2013 point to the arrangements in the example being abusive. Paragraph D25A.5 says:

“It was the intention of Part 7A of ITEPA to regularise the taxation treatment of arrangements which involved the provision of reward, recognition, earnings/employment income or loans through third parties (including trusts or other vehicles used to reward employees), and sought to avoid or defer the payment of income tax and or Class 1 NICs.

These arrangements are clearly designed, successfully or otherwise, to avoid Part 7A by the use of a number of contrived or abnormal steps. They would therefore be considered abusive for the purposes of the GAAR. “

15.5 In our view the taxpayers in this case, like the taxpayers in the D25A example, have sought to avoid the effect of commercial outcomes targeted by Part 7A by including contrived and abnormal steps designed to eliminate a key trigger point for a charge under Part 7A, namely the advancing of a loan by an EBT. The taxpayers in this case, as in the Earlier Similar Case, have in addition sought, by including contrived and abnormal steps, to create a favourable entry point to Part 7A. That entry point (the transfer of an asset by a third person) creates a tax charge, but the taxpayers have sought to exploit a shortcoming in the provisions dealing with commercial transactions with third parties to reduce the taxable value to nil.

15.6 The arrangements in this case are substantially similar to those in the Earlier Similar Case (see paragraph 2 above) and we reach the same conclusion for similar reasons in this case.

15.7 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.

15.8 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 corporation tax, income tax, PAYE and NICs provisions:

- a) the substantive results of the steps taken are not consistent with the principles on which section 62 and Part 7A (including section 554Z8), and Chapter 1 of Part 20 CTA 2009 are based;
- b) the means of achieving the intended result relies on contrived and abnormal steps, in particular the introduction of gold where the use of cash would have been more natural and cheaper, and the assumption by Mr Y of the Company's obligation to fund the EBT; and
- c) the steps are intended to exploit shortcomings in Part 7A, and in particular the lack of an explicit “no connection with a tax avoidance arrangement” condition in section 554Z8(5).

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

## **16. Conclusion**

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

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