GAAR ADVISORY PANEL

Redacted and sub-panel approved version of the Opinion Notice issued on 11 October 2018

Subject Matter: Contractor loans. 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 N.

The sub-panel received written material from HMRC under paragraph 7 Schedule 43 FA 2013 and representations from Mr N 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 taxpayer Mr N.

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

a) E Ltd, the company to which Mr N's services (for a project at D Ltd) are provided;
b) an agency employer, a company acting as trustee of a trust employing Mr N ("ABC"); and
c) an employer financed retirement benefit scheme (EFRBS) with beneficiary Mr N.

2.3. By "National Minimum Wage" we mean the salary rate referred to as such in the recitals to Mr N's employment contract with ABC.

2.4. In this opinion when we refer to "Guidance" we mean the GAAR Guidance approved by the Panel with effect from 15 April 2013, and statutory references without a statute are to ITEPA 2003.

3. *Outline of the arrangements*

3.1. ABC employs Mr N from April to November 2014.

3.2. ABC provides Mr N's services to E Ltd during that period.

3.3. E Ltd pays ABC about £110,000 (net of VAT) for Mr N's services.

3.4. ABC pays Mr N a gross salary of about £8,000 (the National Minimum Wage).

3.5. ABC makes (starting in late July 2014) interest free, repayable on demand monthly loans of, in aggregate, about £83,000 to Mr N.

3.6. The EFRBS is established in early September 2014.

3.7. ABC transfers (starting in late September 2014) the creditor rights in the loans to the EFRBS.

3.8. Prior to the arrangements Mr N's services were provided to a third party via his own personal services company.

3.9. Following termination of the arrangements Mr N was employed by E Ltd direct at a basic salary (before bonuses and commission) of about £96,000.

4. *Summary of substantive result of the arrangements*

4.1. As a result of the arrangements:

a) Mr N receives about £91,000 of the about £110,000 paid by E Ltd to Mr N's agency employer, ABC, for Mr N's services; and
b) Mr N has an obligation to repay (in an aggregate amount of about £83,000) loans to the EFRBS of which he is a beneficiary.

4.2. The post tax return to Mr N of these arrangements is consistent with the promise in marketing material associated with ABC's schemes of 79% - 82%, against a standard employment post tax return of 48% - 56%.

5. *The tax advantage*

5.1. HMRC's position is Mr N as a result of his employment with ABC receives substantial sums of money (about £91,000) and that the whole amount, rather than only the National Minimum Wage element (about £8,000), is liable to Income Tax (and the associated PAYE and National Insurance contributions charge).

5.2. HMRC considers the liability owed to the EFRBS by Mr N, will not be met, and was never intended to be met. Mr N disputes this contention. In the absence of conclusive evidence one way or the other we proceed on the basis that the arrangements give rise to a debtor creditor relationship between Mr N and the EFRBS.

5.3. HMRC goes on to maintain the arrangements were deliberately structured in such a way that if liability to account for PAYE and National Insurance contributions on the whole amount were to fall on ABC, there would not be adequate funds to meet that obligation.

6. *Tax results argued for by the taxpayer*

6.1. Mr N argues that, save in relation to the National Minimum Wage payment (about £8,000) and the loan interest benefit charge, no liability arises under either section 62 (as the arrangements do not constitute remuneration) or under Part 7A (as the steps taken mean the detailed requirements for falling within Part 7A are not satisfied, and the arrangements are accordingly outside of the charge).

6.2. In relation to the possible inadequacy of funds for ABC to meet its PAYE and National Insurance contributions obligations, Mr N says he had no involvement in overseeing ABC's finances and no way of influencing ABC's actions so "*cannot be expected to comment*" on HMRC's assertion.

6.3. Mr N says he did not view the particular scheme webinar referred to in HMRC's notice issued under paragraph 3 Schedule 43 FA 2013. For the purposes of our opinion we have assumed that Mr N did not view that webinar.

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

7.1. The overall scheme of taxation for sums derived from employment is a patchwork including:

a) Income Tax on "money's worth" earnings under section 62;
b) Income Tax on the sum of money (or value of the asset) made available under the disguised remuneration rules in Part 7A;
c) a charge to tax on beneficial loans made by the employer; and
d) in the case of a loan or advance by a close company to a participator, a tax charge on the company on the amount of the loan or advance "as if it were an amount of Corporation Tax".

7.2. In this opinion we are concerned, against this legislative patchwork background, with Part 7A in particular.

7.3. Mr N argues that "*All that has been done is to take steps to ensure that no one is taxed on more than their true economic gain. The arrangements prevent unfair and unjust anti-avoidance provisions from operating by taking advantage of express exceptions and exemptions from those laid down by Parliament. Taking advantage of such express exceptions and exemptions is not aiming, "to achieve a favourable tax result that Parliament did not anticipate"".*

PART 7A

7.4. The 9 December 2010 Ministerial Statement sets out the thinking behind Part 7A. *"The legislation [Part 7A introduced by FA 2011] ensures that where* ***a third party makes*** *provision for what is* ***in substance*** *a reward or recognition, or* ***a loan****, in connection with the employee's current, former or future employment, an Income Tax charge arises. Income Tax is charged on the sum of money made available and on the higher of the cost or market value where an asset is used to deliver the reward or recognition … The amount concerned will count as a payment of employment income and the employer will be required to account for PAYE".* (emphasis added)

7.5. 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.

7.6. Part 7A operates by treating amounts that would not otherwise be treated as taxable remuneration as employment income.

7.7. For example, the principal amount of a loan made available to the employee by an employee trust (including by an EFRBS) is fully chargeable under Part 7A as income even though, being a loan, there is a requirement for the principal of the debt to be repaid.

7.8. Mr N argues that in relation to loans Part 7A imposes a charge to tax on "non-existent" income so is arbitrary, unjust and capricious and he is therefore justified in structuring his loan arrangements in a non-taxable way.

7.9. 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. The arrangements here seek 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 N by ABC (not a third party for the purposes of Part 7A) with a subsequent assignment of the loan to the employee trust.

7.10. The Guidance sheds light on how anti-avoidance provisions should be considered under the GAAR.

Paragraph D2.7.1 states:

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

And Paragraph D2.7.2 continues:

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

Paragraph B11.1 states:

"It is recognised that under the UK's detailed tax rules taxpayers frequently have a choice as to the way in which transactions can be carried out, and that differing tax results arise depending on the choice that is made. The GAAR does not challenge such choices unless they are considered abusive. As a result in broad terms the GAAR only comes into operation when the course of action taken by the taxpayer aims to achieve a favourable tax result that Parliament did not anticipate when it introduced the tax rules in question and, critically, where that course of action cannot reasonably be regarded as reasonable."

"Bear Traps"

7.11. Mr N argues that Part 7A has obvious "bear traps' and that the "*simple and uncontrived arrangements … ensured I was not affected by [the bear traps]"*

Paragraph B12.2 states:

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

7.12. Where Paragraph B12.2 indicates that contrived steps taken to ensure the taxpayer is not taxed on more than the economic gain would not "generally" be regarded as abusive, it is recognising there can be exceptions to the "general" case. An exception arises where (as with Part 7A) Parliament clearly intends to discourage "a particular type of behaviour" by imposing a tax charge on an amount in excess of the economic gain. For loans taxable under Part 7A the charge is intended to apply to the principal amount of the loan rather than to the market value benefit.

Conclusion on Part 7A and "Bear Traps"

7.13. Part 7A when introduced in 2011 was headed "Employment income provided through third parties". The principle underlying Part 7A is that a taxpayer should not be able to avoid a charge to tax on employment income by entering into arrangements with a third party that make provision for what is in substance an employment related reward (including a reward by way of loan). Paragraphs D2.7.1 and D2.7.2 of the Guidance make it quite clear the GAAR is designed to put a stop to the game of legislative catch-up where, for example, taxpayers have sought to devise contrived ways of avoiding the disguised remuneration rules.

7.14. The policy and intent behind the legislation charging tax on employee benefits and the charge under Part 7A are clear; a final tax charge is imposed on what is received, rather than on the apparent economic benefit, which may well be lower.

7.15. There is no economic difference between the arrangements in this case and a loan made to the employee by an employer funded EFRBS; in that straightforward case it is clear Parliament intended the principal amount of the loan to be recognised as an economic gain and treated as if it were income.

7.16. A tax charge intended by Parliament cannot in the context of the GAAR be said to be a "bear trap" that it is reasonable to avoid by adopting contrived steps.

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

8.1. 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.

8.2. Mr N has said he was not offered employment with E Ltd (or D Ltd) and that there were administrative benefits in being employed by ABC rather than by his personal services company.

8.3. It is not abnormal for an employer to make use of an EFRBS.

8.4. It is abnormal and contrived for an agency employer to label the bulk of an employee's recompense for his services as "discretionary".

8.5. 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.

8.6. The series of steps involving monthly loans by ABC to Mr N and the assignment of the creditor position in those loans to the EFRBS for Mr N's benefit are contrived and abnormal. Indeed on the routing of the money Mr N confirms: *"All that was done was to ensure that the loans were made by my employer [ABC] and not by the trust [the EFRBS]"*

8.7. We can see no reason, other than to seek a tax advantage, for the steps to be structured in this artificial and complex way. A person in Mr N's position would expect to direct the agency employer on how the fees for his services (less the agency employer's fees) are to be applied.

8.8. We are of the view that, taken together, the steps comprising the tax arrangements 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 resulting commercial position is one in which:

a) about £91,000 is made available by ABC to Mr N in connection with his employment; and

b) Mr N owes about £83,000 to the EFRBS, Mr N is a beneficiary of the EFRBS.

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).

9.4. Given the resulting commercial position, in our view the most likely comparable commercial transaction, if the aim of avoiding Part 7A was not an issue, is a direction by Mr

N for the net of VAT amount paid by E Ltd for Mr N's services (less ABC's fees) to be paid as to about £8,000 gross to Mr N direct, and as to about £83,000 net into an EFRBS established for Mr N's benefit and a direction for the EFRBS trustees to make a (long term) interest free loan of the £83,000 to Mr N.

9.5. Mr N has suggested the most appropriate comparable transaction is *"[ABC] could have made a loan to me and done nothing further*." That is not an appropriate comparator; a loan outstanding to an agency employer is commercially very different to a loan repayable to a trust of which one is a beneficiary. Mr N agrees the loans do not remain with the employer and the outstanding obligation on each is owed to the trust.

9.6. Another possible comparable transaction is Mr N receiving salary reflecting the fees paid for his services by E Ltd. In this comparable Mr N could be employed by E Ltd or, alternatively, by ABC. These are not our most likely comparable transactions as we are told direct employment with E Ltd was not then on offer and Mr N has made it clear a long-term loan was intended. Mr N says in his representations: "*In the case of the loans from my employer, I believe that these documents are what they purport to be with a risk of being repayable on demand should loans be called in by the trustees of the EFRBS*." (see our comments in section 5.2 above.)

9.7. The most likely comparable transaction gives rise to a charge to Income Tax under Part 7A.

9.8. The intended outcome for Mr N 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 provisions.

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

10.1. The arrangements provide Mr N with a loan from the EFRBS. A conventional loan from the EFRBS would have been taxable under Part 7A.

10.2. On its face, for the Part 7A loan charge to apply a direct provision of funds by a third party to the employee is required. Here Mr N confirms the steps seek to achieve the economic equivalence of a payment of money by the EFRBS (the third party for the purposes of Part 7A). The arrangements involve engineering the steps so the loan is initially made to Mr N by the agency employer, ABC (not a third party for the purposes of Part 7A). ABC (the non-third party) then assigns the loan to the EFRBS (the third party).

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

10.4. Paragraph C5.8.1 of the Guidance states

"*It is often the case that perceived loopholes in tax legislation are very narrow, and that to squeeze through them requires the adoption of some step or feature that would not otherwise have been taken."*

10.5. Paragraph C5.9.1 of the Guidance looks at how a shortcoming might arise

"*This may be because the tax rules have a defect that was not apparent to the drafter, or the drafter may not have contemplated that a particular type of transaction could be carried out (whether to come within the rules or to keep outside them)."*

10.6. Paragraph D2.7 of the Guidance provides guidance on this section 207(2)(c) FA 2013 circumstance. Paragraph D2.7.1 states:

"The GAAR is intended to … make sure that "keep off the grass" warnings are heeded."

Paragraph D2.7.2 sets out particular examples including "*devising contrived ways of circumventing the disguised remuneration rules".*

10.7. We think it inconceivable that Parliament wished, particularly in anti-avoidance legislation like Part 7A where the policy intent is clear, to treat the result of a series of contrived steps as tax free when the result of economically equivalent simple steps was, and was intended to be, taxed.

10.8. In our view the Income Tax position is clear. The steps in this case are designed to exploit a perceived shortcoming in Part 7A.

11. ***Does the planning result in:-***

(i) an amount of income, profits or gains for tax purposes which is significantly less than the amount for economic purposes, or

(ii) deductions or losses for tax purposes which are significantly greater than the amount for economic purposes, or

(iii) a claim for the repayment or crediting of tax which has not been and is unlikely to be paid

and, if so, is it reasonable to assume that such a result was not the intended result when the relevant tax provisions were enacted (section 207(4) FA 2013)?

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

11.2. The specific example in section 207(4)(a) FA 2013 carries little weight (one way or the other) in a case where, like Part 7A, the charge is explicitly on a position different to the economic position argued for by the taxpayer.

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

12.1. HMRC and Mr N agree that there is no relevant established practice to consider in this case.

13. Discussion

13.1. Mr N bought into a marketed tax driven arrangement under which, out of the fees paid for his services by E Ltd, he expects to receive for his use a significantly larger after tax amount than he would receive under a standard employment arrangement.

13.2. Mr N maintains that about £83,000, out of the about £110,000 fee E Ltd pays for his services, is in the form of an interest free loan falling outside of the employee benefits charging provisions and in particular falls outside of the charging provisions in Part 7A.

13.3. In our view the most likely comparable commercial transaction, if the aim of avoiding Part 7A was not an issue, is a funding by ABC of the EFRBS from the fees it receives from E Ltd followed by a loan from the EFRBS trustees to Mr N.

13.4. Mr N and the promoters of this arrangement seek to avoid tax on a commercial outcome targeted by Part 7A. The promoters identified a potential shortcoming in wide–ranging "keep off the grass" anti-avoidance legislation. That shortcoming is seen to exist because the relevant statutory provisions in Part 7A at the time dealt expressly with the straightforward position of an employee trust advancing monies to an employee. Part 7A did not however expressly deal with economically equivalent arrangements involving an initial loan by an employer followed by a loan assignment to the employee trust. Mr N and ABC adopted a series of predetermined and contrived steps to exploit this perceived weakness in the legislation.

13.5. Taxing the principal of the loans Mr N receives is consistent with the principles and policy objectives of the scheme of legislation for employees. It is inconceivable Parliament intended the contrived arrangements in this case to fall outside of the Part 7A charge.

13.6. 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 and giving deductions for employee rewards (including rewards by way of loan).

13.7. Each of the circumstances set out in section 207(2) FA 2013 point unambiguously towards both the entering into and the carrying out of the steps as not amounting to a reasonable course of action in relation to the relevant Income Tax (and associated PAYE and National Insurance contributions) provisions:

a) the substantive results of the steps taken are not consistent with the principles on which Part 7A is based;
b) the means of achieving the intended result relies on ABC, Mr N's employment agency and the recipient of the fees for the tax driven arrangement, completing predetermined contrived and abnormal steps (namely the making of "discretionary" loans to Mr N and the assigning of the creditor position of those loans to a person connected with Mr N); and
c) the steps are intended to exploit shortcomings in Part 7A, and in particular the prescriptive way in which the legislation appears, on a narrow construction, to deal with payments of money by third parties.

13.8. In this case a taxpayer bought into a marketed scheme aimed at a potential shortcoming in wide–ranging "keep off the grass" anti-avoidance legislation. By adopting a series of predetermined and contrived steps the taxpayer and the promoter sought to gain an unintended tax "win".

13.9. HMRC made arguments in relation to Mr N's intentions to enter into an arrangement that, if unsuccessful, would leave HMRC out of pocket (see sections 5.3 and 6.2 above). We do not have enough information on this point to comment further.

14. Conclusion

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

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