

# GAAR ADVISORY PANEL

## Redacted and sub-panel approved version of the Opinion Notice issued on 11 April 2019

**Subject Matter:** Disguised remuneration. Reward passed to employee/shareholder via joint acquisition by company and employee of a second hand bond, and use of gilt options, additional contributions and “cooling off” rights.

**Taxes:** Income Tax, National Insurance contributions.

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

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 20 February 2018 relating to an individual taxpayer (the “Individual”).

The sub-panel received written material from HMRC under paragraph 7 Schedule 43 FA 2013 and written representations under paragraphs 4 and 9 Schedule 43 FA 2013 on behalf of the Individual and the Company jointly.

### **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 a taxpayer: the Individual.
- 2.2 In addition to the Individual this case also involves:
- a) A company of which the Individual was the sole director and the sole shareholder when the actions set out in Section 3 and Section 4 took place (the “Company”). A separate reference was made to the Panel in relation to the Company and we are today issuing an opinion notice in relation to that reference;
  - b) A company (“Participant A”) which acted as the promotor of the arrangements and took part in those arrangements as described below;
  - c) A limited liability partnership (“Participant B”) which worked in conjunction with Participant A and took part in the arrangements as described below;
  - d) A life assurance company established in Gibraltar (the “Bond Manager”);
  - e) A financial trader (the “Option Counterparty”);
  - f) A company which provided tax advice (the “Tax Advisor”); and
  - g) A company which assisted in sourcing the insurance bond (the “IFA”).
- 2.3 References to the “taxpayers” are to the Company and the Individual.
- 2.4 When we refer to “Guidance” we mean the GAAR Guidance approved by the Panel with effect from 15 April 2013.

## **3. Background to the arrangements**

- 3.1. At all material times, the Individual was the sole director and shareholder in the Company.
- 3.2. At some point, between 25 September 2014 and the commencement of the transactions described in section 4, the Company and the Individual consulted the Tax Advisor on the series of transactions which had been proposed to them by Participant B.
- 3.3. The Tax Advisor advised that “the purpose of this planning is to enable an employer to reward an employee in a tax efficient way and look to secure a corporation tax deduction for the payment. The taxable benefit on the employee is anticipated to be negligible”.
- 3.4. On 25 September 2014 the Individual and the Company instructed the IFA to find a suitable second hand bond investment for them to satisfy specific requirements.
- 3.5. In its instruction, the Company confirmed that it was relying on the guidance of the Tax Advisor and, in his instruction, the Individual informed the IFA that he (the Individual) had also been advised by the Tax Advisor to enter into a gilts option of the kind described below.

3.6. The Individual also said *“I should re-iterate that I am acquiring my interest in the Bond and entering into the Option primarily for fiscal rather than investment purposes and I understand the advice being given to me by my Tax Advisor and the risks involved.”*

**4. Outline of the arrangements**

4.1. The arrangements involve three interconnected sets of steps:

1. steps involving the establishment of and investment into an insurance bond;
2. steps involving a loan, liability for which is assumed by the Company and satisfied by the Individual;
3. steps involving a gilts option initially undertaken by the Individual and immediately novated into the bond arrangements which provided the Individual with an asset to use to satisfy the Company’s liability to Participant B.

4.2. The initial steps establishing the bond arrangements were:

1. On 11 November 2014 Participant A set up an offshore life assurance bond (the “Bond”) with the Bond Manager. The initial lives assured were those of three individuals all of whom were directors of Participant A.
2. An initial premium of £5,000 was paid to establish the Bond.

4.3. The initial steps establishing the loan arrangements were:

1. On 17 November 2014 Participant B (as lender) entered into a loan facility for up to £11,515,000 with Participant A (as borrower).
2. Also on 17 November 2014 Participant A granted to Participant B a charge over its interest in the Bond as security for any borrowings under the loan facility.
3. On 9 December 2014 Participant A drew down £1.5 million on the loan facility and contributed a top up premium of £1,518,331.65 to the Bond Manager to hold as part of the assets represented by the Bond.

4.4. The Company and the Individual were brought into the loan arrangements and the bond arrangements:

1. On 10 December 2014 the Company and the Individual jointly acquired the Bond from Participant A.
2. The Company
  - a) paid £ 179,000,
  - b) assumed Participant A’s liability to Participant B for the £1.5 million drawn under the loan facility, and
  - c) became bound by the charge over its interests in the Bond.
3. The Individual
  - a) paid £1,000,
  - b) guaranteed the Company’s liability under the loan facility, and

- c) became bound by the security granted over the assets held for the Bond by the Bond Manager.
- 4.5. The IFA had advised that the only suitable bond available was the Bond. The IFA advised that he could not recommend the purchase of the Bond but that he had been told the purchase was “*the only way of securing the cash outcome required*”.
- 4.6. The steps involving the gilts option were:
  1. On 11 December 2014 the Individual entered into an option with the Option Counterparty (the “Gilts Option”). The Gilts Option:
    - a) required the Option Counterparty to pay to the Individual a premium of £1.5 million in gold on the option settlement date, 16 December 2014 and
    - b) exposed the Individual to the risk of being required to deliver Gilts to the value of £30 million to the Option Counterparty in certain circumstances. The probability of the payment being required was considered to be approximately 5%.
  2. Also on 11 December 2014 the Individual novated his position in the Gilts Option to the Bond Manager (so that he was no longer entitled to the premium or exposed to the risk).
  3. The Individual also contributed a further £1,000 into the Bond assets.
  4. Additional contributions to a life assurance bond can be subject to “cooling-off rights”, that is the right to cancel if the investor so chooses, and the Individual’s contribution of the Gilts Option and the £1,000 was subject to a 30 day cooling-off period.
  5. Also on 11 December 2014 the Bond Manager entered into a mirror image gilts option with a counterparty (the “Mirror Option”) so that the Bond Manager became obliged to pay away a premium on the option settlement date and became entitled to receive an amount that would enable it to satisfy its liability to pay the £30 million if the specified conditions were met.
- 4.7. On 16 December 2014 the Gilts Option and the Mirror Option expired without the conditions for the £30 million payments being satisfied.
- 4.8. The participation of the Company and the Individual in the bond arrangements, the loan arrangements and the Gilts Option could then be brought to a close:
  1. On 16 December 2014 the Individual exercised his cooling off rights and required a re-novation of the Gilts Option and a re-transfer of the £1,000 contributed on 11 December 2014.
  2. The effect of requiring a withdrawal of the contribution of the Gilts Option was to entitle the Individual to receive the £1.5 million premium in gold.
  3. If the Bond Manager needed to pay a premium under the Mirror Option, it must have used all or part of the contribution made to it by Participant A on 9 December 2014 as it would not otherwise have had sufficient funds at its disposal.

4. The Individual directed that the £1.5 million premium should be paid to Participant B in discharge of the loan from Participant B for which the Company had assumed liability (see paragraph 4.4.2(b) above). The discharge of the loan also eliminated the Company's exposure under the charge and the Individual's own contingent liability under the guarantee.
- 4.9. The Bond was subsequently cancelled or otherwise disposed of.
- 4.10. The Company treated the discharge by the Individual of the Company's liability under the loan arrangement as a new loan to it by the Individual and accordingly credited the Individual's loan account with the Company.
- 4.11. The Company claimed a corporation tax deduction for the difference between the value it gave for the Bond on 10 December 2014 and the much lower value of the Bond after the transactions on 16 December 2014, describing the deduction as "director's remuneration".

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

- 5.1. Once the series of transactions was complete, the outcome for each of the participants in the transactions was as follows.
- 5.2. The Individual had paid £1,000 to acquire his interest in the Bond. He had also received or obtained the right to receive £1.5 million from the Company.
- 5.3. The Company had paid £179,000 for the Bond and had paid or become liable to pay £1.5 million to the Individual.
- 5.4. Participant A had made an initial investment in the Bond of £5,000 and had received £180,000 on sale of the Bond to the Company and the Individual.
- 5.5. Participant B loaned £1.5 million and was repaid £1.5 million.
- 5.6. The Bond Manager received cash contributions of £5,000, £1,518,331.65 and £1,000. It is likely that it paid a premium under the Mirror Option of £1.5 million and returned the £1,000 premium contributed by the Individual on 11 December 2014. It did not receive the £1.5 million premium under the Gilts Option as this was received by the Individual (and directed to Participant B).
- 5.7. Although the Individual had entered into the Gilts Option, the novation of the Gilts Option to the Bond Manager had the effect that the Individual was not exposed to a potential loss under the Gilts Option.
- 5.8. Although the Company jointly acquired the Bond with the Individual, the combination of the premium payable under the Mirror Option and the exercise by the Individual of his cooling off rights in respect of his contribution to the Bond had the effect that the Company could not make a gain.

## **6. The likely comparable transaction**

- 6.1. Given the substantive result of the arrangements, in our view the most likely comparable commercial transaction is that the Company would have paid a cash bonus to the Individual as remuneration. This is also

consistent with the statement by the Tax Advisor that “*the purpose of this planning is to enable an employer to reward an employee in a tax efficient way and look to secure a corporation tax deduction for the payment.*”

**7. The tax advantage**

- 7.1. HMRC’s position is that the Individual received, or was put in a position in which he could receive, from the Company £1.5 million in a form that the Individual and the Company could seek to argue was not earnings for the purposes of income tax or national insurance contributions even though the Company claimed a deduction for an amount described as “director’s remuneration”.

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

- 8.1. Our understanding is that the taxpayers’ position is that the Individual has funded a payment which would otherwise have been a liability of the Company and that the credit to the Individual’s loan account with the Company reflects that and therefore does not represent employment income or earnings subject to income tax and national insurance contributions.
- 8.2. The Company also considers that it is entitled to a corporation tax deduction for the amount of its loss on the Bond.
- 8.3. Representations were made to us on behalf of the Company and the Individual to the effect that:
1. There was nothing inherently abusive in an individual deciding to undertake a derivative transaction such as a gilts option and there was nothing inherently abusive in his employer providing him with a hedge for that transaction.
  2. The Company did intend to provide the Individual with a benefit in kind, being the benefit of a hedge for the Gilts Option that the Individual wished to enter into and the value of that benefit in kind has been appropriately reported for the purposes of income tax and national insurance contributions.
  3. The £1.5 million which the Individual used to discharge the Company’s debt to Participant B was generated by the Individual from his own personal option transaction.
  4. In correspondence with Participant A concerning the requirement for disclosure under Part 7 Finance Act 2004 (DOTAS) HMRC accepted that there was no tax advantage and that this could reasonably be understood by a reasonable taxpayer as HMRC having indicated their agreement with the tax planning.
  5. Certain case-law, notably the decision in *Ensign Tankers (Leasing) Ltd v Stokes (HM Inspector of Taxes) [1992] 1 AC 655* and *IRC v Willoughby [1997] STC 995*, establishes that back to back transactions, such as “bed and breakfasting” transactions are an acceptable form of tax mitigation and that the current transactions could therefore reasonably be regarded by a reasonable taxpayer as acceptable tax mitigation.

6. The tax free status of gilts transactions, such as the Gilts Option in this instance, is consistent with the policy of the legislation.

**9. *Disputed facts***

9.1. We have relied on the information provided to us by HMRC and the taxpayers for the description of the transactions set out in section 3 and section 4. We are not aware that any of the facts set out in section 4 above are disputed.

9.2. In reaching our conclusions we have had no need to consider whether any of the transactions described in section 4 could be characterised as a sham transaction or as involving non-commercial terms or pricing and express no view on these matters.

9.3. There were certain aspects of HMRC's submission and the taxpayers' representations which were not fully explained or were not wholly consistent. For example,

1. There is some uncertainty as to whether the Bond was ultimately cancelled or disposed of.
2. HMRC refers to a premium of £1.5 million under the Gilts Option whereas the taxpayers' representations refer to a premium of £1,530,000.
3. We have not seen the Mirror Option or been provided with a detailed explanation of its terms.

We have not found it necessary to resolve these matters in order to reach our conclusions.

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

10.1. HMRC consider the relevant legislation to be the general earnings charge under section 62 Income Taxation (Earnings and Pensions) Act 2003 ("ITEPA") or Part 7A ITEPA and the corresponding provisions relating to PAYE and to national insurance contributions.

10.2. In the light of the stated intention of the participants (as reflected in the advice from the Tax Advisor): "to reward an employee in a tax efficient way and to secure a corporation tax deduction for the payment" we agree that these provisions are relevant.

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

1. A general charge to income tax on earnings under section 62 ITEPA:  
Income tax on the sum of money (or value of an asset) made available under the disguised remuneration rules in Part 7A ITEPA;
2. Charges of national insurance contributions corresponding to those income tax charges.

10.4. The general charge to tax on earnings reflects the policy objective that money paid as a reward or remuneration for the exertions of an employee or director should be subject to income tax on emoluments

or earnings

- 10.5. The thinking behind Part 7A is set out in the 9 December 2010 Ministerial Statement: *“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”*.
- 10.6. We have also considered the taxpayers’ representation that the provisions of section 115 and section 144 (8) Taxation of Capital Gains Act 1992 (“TCGA”) relating to gilts options are relevant.
- 10.7. We note that for the transactions described in section 4 above to have the overall result intended, it was necessary for the receipt of the option premium not to be subject to taxation.
- 11. Does what was done involve contrived or abnormal steps (section 207(2)(b) FA 2013)?**
- 11.1. The transactions appear to be without any commercial purpose other than to secure a beneficial tax treatment for the Individual in comparison with receiving remuneration in cash whilst enabling the Company to claim a corporation tax deduction.
- 11.2. We have considered Examples D13 and D14 from the Guidance. Example D13 is an example of a transaction where every element of the transaction is contrived and abnormal. Example D14 is an example of a transaction where limited amounts of uncertainty were built into the sequence of events and were priced at a market rate but which, in the overall context of the transaction had no real commercial function.
- 11.3. We consider each of the Bond arrangements, the Loan arrangements and the Gilts Option arrangements to be contrived and abnormal.
- 11.4. We also consider the transactions viewed as a whole to be contrived and abnormal.
- 11.5. We appreciate the representations made on behalf of the taxpayers that none of the transactions was unlawful and that, the terms and pricing of the Gilts Option were comparable to arm’s length, non-tax motivated, transactions. However, it does not follow that the transactions cannot therefore be regarded as contrived or abnormal
- 11.6. We regard the arrangements concerning the Bond as contrived and abnormal in particular the arrangements for the Bond to be purchased second hand jointly by the Company and the Individual for a price that exceeded its surrender value. We also note the advice of the IFA that he could not recommend the purchase of the Bond.
- 11.7. We regard the arrangements concerning the Loan as contrived and abnormal noting in particular that the Loan served two purposes:
1. its assumption by the Company created a liability which, in due course, could be satisfied by the Individual and so enable the



- Individual to receive funds in a form that could be argued to be free of income tax and national insurance;
2. the use of the drawn down funds to provide an additional premium into the Bond arrangements meant that the Bond Manager had sufficient funds to pay the premium due under the Mirror Option even though the premium received under the Gilts Option was “returned” to the Individual by being paid to Participant B.
- 11.8. We have considered the representations made on behalf of the taxpayers to the effect that the Bond arrangements were entered because the Individual was proposing to enter into the Gilts Option and wished to hedge the contingent downside to his option and the Company was willing to provide that hedge.
  - 11.9. We accept that, taken together, the Bond arrangements and the Loan arrangements made it possible for the Bond Manager to accept the novation of the Gilts Option and enter into the Mirror Option. We also accept that the novation of the Gilts Option from the Individual to the Bond manager had the consequence that the Individual ceased to be exposed to risk under the Gilts Option. We therefore accept that the Bond arrangements and the Loan arrangements thus could, rather loosely, be described as “hedging arrangements” for the Individual’s participation in the Gilts Option (although, strictly speaking, the novation meant that the Individual ceased to have an exposure rather than having an exposure and an off-setting hedge). We also accept that, in commercial contexts, derivative contracts are entered into and that many are hedged for non-tax reasons.
  - 11.10. However we do not agree that it follows that the Bond arrangements and the Loan arrangements were made because the Individual was proposing to enter into the Gilts Option. We have seen nothing to suggest that the Individual would have entered into and immediately novated the Gilts Option except for the purposes of the tax planning. If, apart from the tax planning, there had been a desire to enter into the Gilts Option, it would have been simpler for the Bond Manager to enter into the Gilts Option itself and find a suitable hedge for itself. The Bond arrangements, the Loan arrangements and the Gilts Option transactions were all entered into in response to the tax planning and each of them needed to be entered into if the desired outcomes for the Individual and the Company (including the insulation of the Individual from risk under the Gilts Option) were to be achieved.
  - 11.11. We consider the arrangements concerning the Gilts Option to be contrived and abnormal. Although the Individual entered into the Gilts Option, it was novated to the Bond Manager on the same day. Apart from the need to provide the Individual a form of asset which he could use to repay the loan and thus the need to contribute the Gilts Option to the Bond Manager in a manner that would allow the Individual to exercise his cooling-off rights, we can see no reason why the Individual should enter into the Gilts Option only to novate out of it in such short order.
  - 11.12. We have considered the representations made on behalf of the taxpayers to the effect that the £1.5 million which the Individual used to

discharge the Company's debt to Participant B was generated by the Individual from his own personal option transaction. However, viewed in the wider context, it is clear that the Individual entered into the Gilts Option solely in order to have an asset to satisfy the Company's debt to Participant B.

**12. *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)?***

- 12.1. It is clear that the Individual and the Company intended the arrangements described in section 4 to have the same overall commercial effect as a payment to reward the Individual for his work as a director of the Company. It is also clear that, apart from adding the need to pay the Participants and other transaction costs, that is the economic effect of the arrangements.
- 12.2. We therefore consider that it would be contrary to the policy of the general charge on earnings if these arrangements were not to be subject to income tax and national insurance contributions.
- 12.3. Part 7A was introduced as a wide-ranging anti-avoidance measure to tackle arrangements seeking to avoid or defer the payment of income tax or national insurance contributions on rewards to employees through the involvement of third parties. We consider that this reinforces our view that the general policy objective of the legislation is that rewards to employees for their work should be taxable as employment income and that it would thus be contrary to that general policy and to the principles reflected in Part 7A if the arrangements described in section 4 were not to be subject to income tax and national insurance contributions.
- 12.4. We also consider that the general policy objective underlying the taxation of employment income is that that a deduction for remuneration should be available to an employer only to the extent that the expense in question gives rise to liability to income tax in the hands of the employee and, where applicable, to national insurance contributions.
- 12.5. As regards the application of section 115 and section 144 (8) TCGA (or, to the extent relevant, the provisions of section 779 Income Tax (Trading and Other Income) Act 2005) (the "Options Legislation") to the transactions involving the Gilts Option, we consider that viewed in isolation, the application of those provisions to the transactions involving the Gilts Option is not necessarily contrary to the policy of those provisions.
- 12.6. However, the transactions involving the Gilts Option form part of the wider series of transactions to which other legislative provisions, in particular section 62 ITEPA and Part 7A ITEPA are relevant. The fact that the transactions involving the Gilts Option may not be contrary to the Options Legislation, does not mean that effect of those transactions taken together with the other transactions which make up the arrangements described in section 3 and section 4 cannot be contrary to the policy of the legislation as expressed in section 62 ITEPA and Part 7A ITEPA.

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

13.1. We do not consider that the arrangements described in section 3 and section 4 sought to exploit any specific shortcoming in any particular piece of legislation. If there is a shortcoming, it is of a more general nature as the legislation simply does not envisage the contrived interaction of the abnormal transactions brought together by these arrangements.

**14. *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)?***

14.1. The planning, if successful, would result in a director (the Individual) receiving, or being put in a position where he could receive, from his employer (the Company) cash of £1.5 million.

14.2. Although the transactions were structured so that the £1.5 million premium (which was paid to Participant B to bring into existence the director's entitlement to receive the cash referred to in paragraph 14.1) could be said to be generated from the Gilts Option entered into by the Individual; for economic purposes, the Individual did not provide value as:

1. He did not bear the economic risk of being party to the option as the option was immediately novated to the Bond Manager;

2. Although he provided the Gilts Option to the Bond Manager, he did so at a time when it was of a nil value (on the basis that the option premium accurately reflected the risk of having to pay £30 million);

3. But for the cash that was already held by the Bond Manager as a result of the premium contributed by Participant A including the cash sourced by drawdown of the loan from Participant B, the Bond Manager would have been unable to return the £1.5 million under the Gilts Option as the Bond Manager would have needed those funds to pay a premium under the Mirror Option.

14.3. Thus the £1.5 million of cash received (or receivable) by the Individual represents income of the Individual for economic purposes.

14.4. However it is argued that that amount is not income of the Individual for the purposes of income tax or national insurance contributions.

14.5. As regards the Company, the net result of the transactions is that it has paid or has become due to pay £1.5 million to its director, the Individual.

The deduction which it has claimed for tax purposes is the write-off of its £1,679,000 investment in the Bond which is equal to the economic cost that it has incurred on providing funds to the Individual and on fees and other costs relating to the tax planning.

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

15.1. HMRC has said there is no relevant established practice and that it has not indicated its acceptance of the tax planning represented by the transactions.

15.2. However in the representations made on behalf of the taxpayers it has been argued that in correspondence with Participant A concerning the requirement for disclosure under Part 7 Finance Act 2004 (DOTAS) HMRC accepted that there was no tax advantage and that this could reasonably be understood by a reasonable taxpayer as HMRC having indicated their agreement with the tax planning.

15.3. The taxpayers supplied us with copies of the DOTAS notification by the scheme provider (Participant A) and other correspondence referred to in their representations.

15.4. We are required by Paragraph 11 (4) Schedule 43 FA 2013 to assume that arrangements referred to the GAAR Advisory Panel for an opinion are “tax arrangements” as defined by section 207 (1) FA 2013. The relevance of the DOTAS disclosure and the correspondence to this opinion is therefore confined to the question which we are required to answer under paragraph 11 (3) Schedule 43 FA 2013 and the definition of abusive tax arrangements in section 207 Finance Act 2013 including the example given by section 207 (5) of something that might indicate that the arrangements are not abusive.

15.5. We have therefore thought about whether the DOTAS disclosure and subsequent correspondence could give reasonable grounds for assuming that HMRC accepted, or at least did not disapprove of the proposed tax planning.

15.6. We note that the DOTAS notification by the scheme provider (Participant A) does not mention the possibility that the planning might be entered into in connection with, or in replacement of, a bonus taxable as employment income or a credit to a director’s loan account. We further note that the only statutory provisions that are mentioned in relation to the tax outcome are sections 115 and 144 (8) TCGA.

15.7. Nothing in the correspondence supplied to us indicates that HMRC was subsequently provided with an explanation sufficient to enable HMRC to appreciate how the planning was to be used or that the fundamental purpose of the arrangements was to arrange for there to be a non-taxable credit to a director’s loan account whilst enabling the company in question to claim a corporation tax deduction. This crucial element was omitted from the DOTAS disclosure and all subsequent correspondence. Instead, the planning was presented as involving no relevant tax advantage.

15.8. We also note that the Tax Advisor expressly warned the Individual and

the Company that “*HMRC will view the arrangements as tax avoidance and attempt to argue that no corporation tax deduction is available and that the payment received by [the Individual] is taxable remuneration.*”

- 15.9. We do not see in the DOTAS correspondence an “acceptance” by HMRC of the tax planning as established practice as envisaged by section 207 (5) FA 2013. We cannot even see how the correspondence could reasonably have been considered to support a view that HMRC might not disapprove of the tax planning and we note that the Tax Advisor did not draw that conclusion.
- 15.10. The representations made on behalf of the taxpayer also argued that certain case-law establishes that back to back transactions, such as “bed and breakfasting” transactions are an acceptable form of tax mitigation and that the current transactions could therefore reasonably be regarded by a reasonable taxpayer as acceptable tax mitigation.
- 15.11. As stated above we are required to assume that arrangements referred to us are tax arrangements so we can only consider the question of whether that case law could suggest that the transaction set out in section 4 can be regarded as an “established practice” or otherwise as a reasonable response to the relevant legislation.
- 15.12. The transactions set out in section 4 extend much further than a simple bed and breakfasting of shares and include the transactions with the Bond, the transactions with the Loan and the application of the option premium by the Individual in repayment of a liability of the Company.
- 15.13. The representations on behalf of the taxpayers did not explain how the transactions set out in section 4 could, when viewed as a whole, be said to be simple back to back transactions or how it could be said that the cited case law indicated that the transactions taken as a whole could reasonably be regarded as acceptable (i.e. reasonable) tax mitigation.

## **16. Discussion**

- 16.1. The Company and the Individual entered into a packaged tax scheme to provide an amount which might otherwise have been paid by the Company to the Individual as remuneration in a tax efficient form.
- 16.2. We consider that the tax scheme and the various transactions that it involved must be seen as a whole and that it is important to look at the intended outcomes for each of the participants.
- 16.3. Put very simply, the outcomes were:
1. The Company paid or became liable to pay £1.5 million in cash to a Director:
  2. The Individual received or became entitled to receive that amount but had no material costs or expenses;
  3. The Company also paid £179,000 to Participant A.
- 16.4. We note that the option contract included a market condition based on the UK/US exchange rate, which was designed to have a 95% chance of producing the desired outcome, i.e. the outcome which was achieved in this instance. If the alternative outcome had materialised, the

employee would not have been entitled to the £1.5m premium and the employer would have remained exposed to a £1.5m debt. However, a market condition involving only an 85% chance of success was built into the arrangements in Example D14 of the Guidance (again based on the US/UK exchange rate). The Guidance records that “the artificial market condition (called ‘market change’ but in fact meant no change) contingency and the fact that a buyer of the note would readily be found meant that on a realistic view of the facts the scheme would proceed as planned that is, to create the loss. This is what participants understood, expected and paid fees for. It is clear that the substantive tax result (a large tax loss) is not consistent with the principles or policy objectives of the relevant tax provisions.” We consider that similar reasoning applies here, particularly given the even smaller chance of failure of the market condition in this case.

- 16.5. A payment from a company to an employee or director as a reward for their services is normally taxable as employment income and is normally deductible by the payer company in calculating its own corporation tax liability.
- 16.6. We have considered above the various aspects of the statutory tests and they indicate that 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 relevant statutory provisions.
- 16.7. We have considered whether the fact that the “shortcoming” in the legislation is of a general nature, that is that the legislation simply does not have specific provisions designed to apply to the arrangements described in section 3 and section 4, as opposed to there being a defect or omission in a specific statutory provision, should affect our conclusion and we consider that it should not.
- 16.8. The other aspects of the statutory test, in particular the question of whether the arrangements are contrived and abnormal and the question of whether the arrangements are consistent with principles and policy objectives of the legislation, are so clearly met that we consider it clear that 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 relevant statutory provisions.

## 17. **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.