They think it’s all over…it is now

Employment Tax



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Anton Lane considers the impact of the long running *Rangers* case

Key Points

What is the issue?

The *Rangers* case identified that payments to third parties could be earnings at the time contributed even if not received by an employee at that time. The scope however, may extend to ‘arrangements’ for self-employed persons.

What does it mean to me?

The use of EBTs and similar trusts has limited upside and considerable risks.

What can I take away?

Establish the purpose of the legislation and analyse the facts in light of those statutory provision so construed. Income tax on emoluments or earnings is due on money paid as a reward or remuneration for the exertions of the employee. Legislation doesn't require the individual to receive remuneration. *Rangers* does not apply to trusts for self-employed persons (unless the recipient is actually an employee), and trusts for self employed persons may be attacked by arguing income is suppressed or the expense (contribution) is not incurred wholly and exclusively for the trade.

The door has pretty much closed on EBTs but what about the trusts that benefit self-employed persons?

The *Rangers* case (RFC 2012 PLC (in liquidation)(formerly *The Rangers Football Club PLC)(Appellant) v Advocate General for Scotland (Respondent) (Scotland)*) judgment was given on 5 July 2017. It follows the judgements of *Dextra (Macdonald (HMIT) v Dextra [2005]* UKHL 47*)* and *Sempra (CIR v Sempra Metals Ltd [2007]* STC 1559), which were relied upon by many for promoting remuneration structures for around a decade. The difference between advising an EBT before *Dextra* and after was simply that following the decision, it was clear a deduction for the contribution to the EBT was not allowed until the beneficiary received emoluments. In the House of Lords the only argument on which there was a decision was the question of whether or not there is a deduction against profits chargeable to corporation tax. In *Dextra*, the issue considered was whether the company's contributions to the EBT were potential emoluments within the meaning of FA 1989 s 43(11)(a):

'11)This section applies in relation to potential emoluments as it applies in relation to relevant emoluments, and for this purpose—
(a) potential emoluments are amounts or benefits reserved in the accounts of an employer, or held by an intermediary, with a view to their becoming relevant emoluments;
(b) potential emoluments are paid when they become relevant emoluments which

are paid.’

The computation for taxable profits under then Schedule D would allow or deny a deduction dependent on whether within the period of account or the period of nine months beginning with the end of the period of account, the emoluments are paid. The House of Lords held that the contributions were potential emoluments because there was a realistic possibility that the trustee would use the trust funds to pay emoluments. Therefore, the deduction against profits was denied. For good measure and before the final decision, the law was changed by FA 2003 sch 24. The legislation came into effect after 27 November 2002 and provided that payments made by an employer to another person for the provision of benefits to employees under a trust, scheme or other arrangement for the benefit of employees (and associated persons) are only deductible when they give rise to an employment income tax charge and a liability to pay National Insurance. There were however ‘loop holes’ within Schedule 24 and new planning, often involving sub trusts permitted deductions without incurring the corresponding income tax and national insurance (although with hindsight this statement is now not correct).

Sempra followed *Dextra* although it was argued that there was a PAYE charge at the point of allocation of funds by the EBT to the employee. The Special Commissioners followed the case of *Dextra* and denied the corporation tax deduction. No appeal followed.

As at 2007, the position with EBTs was known – no corporation tax deduction unless a corresponding income tax and national insurance charge. It appeared that for employees receiving loans, they were treated as benefits although that was until ITEPA 2003 Part 7A was introduced following an announcement on 9 December 2010 and with effect from 6 April 2011. That legislation and subsequent amendments sought to charge new loans or amended loans to income tax and NIC. At this time, it was believed that further clarity was being provided: Future loans would be earnings and historic ones, if renewed, could become chargeable. The indication was that the legislation accepted that historic loans were not earnings, although that was not to be.

The introduction of Part 7A resulted in the providers of EBT ‘solutions’ identifying a simple hole in the legislation: It only applied to employment related loans. This meant that a loan not provided by virtue of employment or where there was no employment would be outside the scope of Part 7A. It is quite astonishing that those

responsible for writing the legislation appear to not know that structures existed at that time for self-employed persons as well as employed.

A number of the structures for ‘self-employed’ persons could be challenged by looking at the employment status of the worker. Alternatively, the contributor, if within the scope of UK tax could be challenged on the deductibility of the expense against profits.

Meanwhile the *Rangers* case was unfolding through the courts. The judgment given on 5 July 2017 specifically deals with the following question: ‘Is whether an employee’s remuneration taxable as his or her emoluments or earnings when it is paid to a third party in circumstances in which the employee had no prior entitlement to receive it himself or herself?’

Lord Hodge in the judgement sets out judicial development in the interpretation of taxing statues is towards a purposive approach. The approach is first to establish the purpose of the legislation and second to analyse the facts in light of those statutory provision so construed (purposively). In considering the interpretation of the legislation Lord Hodge stated that ‘the central issue in this appeal is whether it is necessary that the employee himself or herself should receive, or at least be entitled to receive, the remuneration for his or her work in order for that reward to amount to taxable emoluments’. ITEPA 2003 s 13 defines the taxable person who is liable for any tax on employment income and provides ‘If the tax is on general earnings, the “taxable person” is the person to whose employment the earnings relate’ – it is not necessarily the recipient that is taxed. Lord Hodge considered whether other sections of ITEPA and ICTA restricted the concept of emoluments by requiring payment to a specific recipient and with one exception – they did not.

The decision in *Sempra* related to the deductibility of the company’s expenditure for the purpose of corporation tax. The Special Commissioners were not presented with the argument which HMRC advanced in *Rangers* case.

In summary, income tax on emoluments or earnings is due on money paid as a reward or remuneration for the exertions of the employee. Legislation doesn’t require the individual to receive remuneration and Parliament sought to tax remuneration paid in money or money’s worth. Sub trust held value for family members and therefore if the loans were repaid, the family would benefit.

Sums paid to the principal trust for the footballer constituted emoluments or earnings. Bonuses not being contractual was irrelevant and what mattered was that the sum given was in respect of employees work as an employee. Lord Hodge found that the legislative code for emoluments has primacy over the benefits code in relation to loans. The PAYE regulations and responsibilities for collecting the tax were also considered and although ITEPA 2003 s 13 sets out the individuals liability, the responsibility to deduct and pay over is that of the employer.

Decades after EBTs were used as remuneration tools and after a long silence from cases heard and the introduction of anti-avoidance legislation, the tax status of payments to EBTs is now clearer. There is probably much upset at the inability of the law writers to first agree how those rewarded through EBTs were to be taxed and write suitable legislation. HMRC also had plenty of time to write their own guidance. Instead, many taxpayers have been caught by not only the ruling in *Rangers* but also the strict legislation being introduced to charge tax on outstanding loans.

The *Rangers* case considers the legislation applying to those with an employment, however, as alluded to earlier following the introduction of ITEPA 2003 Part 7A, there was a shift to promote similar trusts, remuneration trusts, to self-employed persons and businesses. These trusts were generally established preventing the trustees from providing any benefits by virtue of employment. Instead they provided benefits for suppliers to the business.

Under ITTOIA 2005 s 8, ‘The person liable for any tax charged under this Chapter is the person receiving or entitled to the profits.’ Furthermore, under ITTOIA 2005 (1) s 25(1) ’The profits of a trade must be calculated in accordance with generally accepted accounting practice, subject to any adjustment required or authorised by law in calculating profits for income tax purposes.’ Is it therefore possible that where there is a genuine self-employed person benefitting from a remuneration trust, the benefit is not taxable?

Remuneration trust were promoted to many although mainly business owners and contractors. Some would have created a self-employed trade in order to facilitate the use of planning. HMRC may in these situations find it easier to establish that there was an employment and the contribution to the remuneration trust was to remunerate that employee although the documentation is unlikely to support that contention. Others were created by inserting an unconnected party specifically for contracting with a trade and contributing to remuneration trust. There are even pre-

funded remuneration trusts as well as trusts created by one business for suppliers to another and so on and so forth. HMRC certainly have more obstacles to successfully challenging remuneration trusts although it would appear that asserting the income is understated (by an amount received by an intermediate and paid to a trust) or the expense is disallowed (the amount paid to an intermediate or direct to a trust).

The calculation of trading profits brings into account receipts and expenses and also includes transactions involving money's worth. Generally accepted accounting principles are the basis for ascertaining those profits and herein lies an issue for HMRC. How will HMRC successfully contend that the amount received by an intermediate is actually the income due to a trade?

HMRC might find it easier to challenge remuneration trusts where a trade is contributing directly because it is relying on the ability to deduct the cost of the contribution. Expenses incurred wholly and exclusively for the purpose of the trade are allowed in order to reduce the taxable amount.

In the *Scotts Atlantic case (Scotts Atlantic Management Ltd v HMRC* [2015] UKFTT 0066 (TCC)) two associated companies used a scheme to transfer value to employee benefit trusts (EBTs). The beneficiaries of the EBTs were the common employees and directors of the two companies. The companies sought a deduction for the amounts contributed to the EBTs. The Upper Tribunal held that the deductions were not allowable because one of the purposes of the arrangements 'was to implement a pre-arranged scheme in order to obtain a tax deduction; the purpose was not simply to benefit employees and directors through the medium of an employment benefit scheme'. The deduction was denied because the expense had a dual purpose.

So in the context of a contribution to a remuneration trust, if one of the purposes is to provide funds to an individual in a tax advantaged manner, the duality of purpose may deny the expense in arriving at the profits.

Legislative changes are being introduced to tax loans from remuneration trusts although given the approach adopted by HMRC for EBTs, preventative measures and deterrents are less than that for EBTs. We anticipate this is likely to change!