Analysis

# The practical issues outstanding following *Rangers*


**Speed read**

**In what was the final decider between HMRC and Rangers in their long-running litigation, the Supreme Court awarded victory to HMRC by upholding the Court of Session's decision to treat loans made from employee benefit trusts (EBTs) as taxable earnings. The Supreme Court accepted that payments to the Rangers trusts amounted to an employee's 'redirection of earnings' and were therefore subject to income tax and NICs. The decision undoubtedly provides a green light for HMRC to pursue companies which did not take up the EBT settlement opportunity and to challenge other contrived structures designed to avoid PAYE and NICs contributions. Clarification is now needed from HMRC on how it intends to use this new approach in the context of not just historic EBT structures, but also genuine employee incentive arrangements.**



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The facts in *RFC 2012 Plc (in liquidation) (formerly The Rangers Football Club) v General Advocate for Scotland* [2017] UKSC 45 (the *Rangers* case) are as follows. The Murray Group established an offshore discretionary employee benefit trust (EBT) in 2001 (the 'principal trust') to which various employing companies within the group made contributions during the tax years 2001/02 to 2008/09, totalling more than £56m. Within the principal trust were 108 sub-trusts, established for individual employees and their family members. The relevant employees were appointed 'protectors' of their sub-trusts and could nominate the beneficiaries, who typically received benefits in the form of unsecured loans. HMRC raised assessments to income tax under PAYE and NICs on various Murray Group employers in respect of payments into the sub-trusts.

The First-tier Tribunal (*Murray Group Holdings v HMRC* [2017] UKFTT 692) held that the scheme was effective in avoiding liability to income tax and NICs. The Upper Tribunal ([2014] UKUT 0292 (TCC)) upheld the FTT's decision, because it detected no error of law in the majority's reasoning. The next instalment was the judgment of the Court of Session ([2015] CSIH 77), which went in HMRC's favour. We now have the decision of the Supreme Court, which upheld the Court of Session's decision to treat loans made from employee benefit trusts (EBTs) as taxable earnings. The Supreme Court accepted that payments to the Rangers trusts amounted to an employee's 'redirection of earnings' and were therefore subject to income tax and NICs. (For further background and a review of the Supreme Court's judgment, see the article 'The *Rangers FC* case: payments to remuneration trust were themselves remuneration' (David Goldberg QC and Nigel Doran), *Tax Journal*, 14 July 2017.)

## The historic context

In order to deal with Rangers type arrangements, in 2011 HMRC introduced Part 7A of ITEPA 203), known as the disguised remuneration rules. The rules effectively prevented any new loan planning as, from 9 December 2010, loans made by trustees and other third parties to employees became subject to an immediate charge to income tax and NICs on the principal amount.

HMRC encouraged employers to settle pre-Part 7A outstanding PAYE and NICs liabilities in relation to EBTs on beneficial terms (the 'EBT settlement opportunity'). Although the EBT settlement opportunity closed on 31 March 2015, HMRC has continued to encourage voluntary settlements, in accordance with its guidance published on 31 August 2016.

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The decision remains of most significance to companies which to date have not settled liabilities in relation to EBTs; and which may (or may not) be in an ongoing dialogue with HMRC regarding their tax treatment prior to the implementation of Part 7A.

## Impact of the decision on similar EBT structures

Following the decision, it is likely that HMRC will issue follower notices to employers with unresolved EBT enquiries. Employers in receipt of such notices will risk significant penalties if they do not take corrective action. HMRC will then (subject to certain conditions) be able to serve accelerated payment notices requiring payment of specific amounts.

Whilst a number of cases have been brought challenging the legality of accelerated payment notices, they have largely been unsuccessful. Given there is a requirement on professional advisors who are involved in the setting up offshore EBTs to notify HMRC under IHTA 1984 s 218, it is reasonable to assume that HMRC will have issued enquiries in the vast majority of EBT cases which had the potential to involve tax avoidance.

The judgment leaves employers with little room for defence. It is now clear that HMRC can take a purposive approach in looking at whether sums contributed to EBTs represent remuneration for employment. If they do – an issue which was given very little consideration in the case and almost taken as read – it is not necessary that the employee should actually receive payment (or even be entitled to receive it), for it to be taxable. HMRC will consider structures in the round and it will no longer be necessary to show that remuneration was 'unreservedly placed at the disposal of employees' for it to be taxable income. The Supreme Court held therefore that the cases of *Sempra Metals Ltd v HMRC* [2008] STC (SCD) 1062 and *Dextra Accessories Ltd v MacDonald (Insp. of Taxes)* [2002] STC (SCD) 413 (*Dextra*) were wrongly decided on the point.

In his judgment, Lord Hodge referred to three possible exceptions to the 'redirection of earnings principle'. These include the taxation of perquisites and certain benefits in kind taxed under the benefits code in ITEPA 2003 Part 3 Chapters 2–11, and where the employer's payment to a third party does not give the employee an immediate vested interest, but is subject to a contingency. Whilst the Supreme Court was of the view that no contingency applied on the basis of the facts before it, practitioners and employers will need to focus on whether the payments to third party trustees have any contingent element. The judgment provides little or no analysis of what might be an effective contingency for these purposes and the dividing line is not particularly clear, as the cases of *Smyth v Stretton* (1904) 5 TC 36 and *Edwards v Roberts* (1934) 19 TC 618 demonstrate. Both involved contingent retirement funds, but the courts reached opposite conclusions. Ultimately, therefore, the employer and its advisers will need to consider whether they have made a payment of earnings to a third party or a payment which will become earnings on the satisfaction of some other future contingency.

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### HMRC's approach to assessments

Without further clarification from HMRC, the basis on which HMRC will issue follower and accelerated payment notices is not clear. The following are areas which will need to be addressed.

#### Income tax and NICs

The judgment stated that the 'payment of money into the principal trust was a component of remuneration of the footballers and other employees'. It therefore seems open to HMRC to seek interest and penalties for unpaid PAYE and NICs from the date of the funding of the trust, where it is open for them to do so.

#### ITEPA 2003 s 222

The judgment categorised the contributions to the principal trust and allocations of funds to the sub-trusts as taxable earnings in the hands of the employee, as they had been 'redirected' by the employee. On this basis, there should be no issues in relation to ITEPA 2003 s 222. Section 222 levies an additional income tax charge on 'notional payments' that are not 'made good' by the employee within 90 days of the end of the tax year in which they are made. Notional payments are taxable amounts that are subject to PAYE, even though there is no cash payment made at the time. HMRC's position has been that the allocation of an amount to an employee's sub-trust would be treated as a notional payment by a trustee. Its frequently asked questions, published on 5 September 2012 in relation to the EBT settlement opportunity, draws a distinction between payments made by an intermediary in relation to a contribution by the employer to an EBT, which are treated as earnings by the employer (and are not therefore notional payments); and payments made by an intermediary in relation to the allocation of amounts into a sub-fund, which will be notional payments to which s 222 will apply. The case drew no such distinction and it remains unclear what HMRC's approach will be in light of the decision.

#### Corporation tax

Following the decision in *Dextra*, and in line with CTA 2009 ss 1290–1296 (originally FA 2003 Sch 24), the availability of corporation tax relief for amounts contributed to EBTs is now restricted to the time when qualifying benefits or qualifying expenses are paid out of the EBT, and not when the contribution is made to the EBT.

Qualifying benefits are provided where there is a payment of money, or a transfer of assets (this would not include a loan to an employee), which:

- gives rise to a charge to income tax and NICs;
- is made in connection with the termination of the recipient's employment; or
- is made under an employer financed retirement benefits scheme.

Given the case established that the contribution to the EBT was a payment of earnings for PAYE purposes, the deduction should no longer be deferred. The challenge for employers, however, may be that they are out of time for making an overpayment claim (which is usually four years, subject to HMRC's discretion to accept late claims under its collection and management of tax powers), which are unlikely to be used in this context.

#### IHT

HMRC has maintained that the allocation of assets into sub-trusts gives rise to a loss of an EBT's status as a 's 86 trust' for the purposes of the IHT legislation; and since the closure of the EBT settlement opportunity, it has pursued companies for IHT charges in relation to these types of arrangement. However, given that the *Rangers* decision categorised the contributions into the trust as earnings, it is arguable that any subsequent allocation is on the direction of the employee and for their benefit, and should not therefore give rise to a loss of s 86 relief. However, HMRC may treat the redirection of earnings as a transfer of value by the employee for IHT purposes. This would potentially defeat one of the key advantages of the loan structure, which excluded outstanding amounts owed to the EBT from the employee's estate on death for the purposes of IHT.

#### Recovery from employee

Most employee trusts arrangements contain indemnities provided by the employee in favour of the employer in respect of PAYE and NICs liabilities which arise. However, there are obvious practical and commercial difficulties in employers recovering such amounts from employees, either when they remain in the business, but particularly when they have left employment or are no longer UK resident. Interestingly, in the *Rangers* case, it was the employer that provided the indemnity in favour of the participating footballers, should the tax treatment of the arrangements be successfully challenged.

#### ITEPA 2003 Part 7A

The judgment poses questions about the need for the highly complex disguised remuneration rules and the proposals to extend the rules to tax outstanding loans in 2019. The judgment made clear that redirected earnings would be held by the trustee as capital and no longer as an employment-related payment. On the basis that the Part 7A legislation requires there to be an arrangement for the provision of rewards and loans from employment (which following the decision will no longer be the case), HMRC will need to consider the structure and drafting of the legislation if it wishes to use it to tax legacy loan arrangements.

### Salary sacrifice and other deferred payment arrangements

There has been concern for employers since the Court of Session decision that employees who have sacrificed salary or a bonus in lieu of the provision of other benefits might be caught by the 'redirection principle'. Following the decision, HMRC was asked to clarify its position, but it refused to do so until the litigation concluded.

It should be possible to argue that in genuine salary sacrifice arrangements (for example, in relation to pension contributions), a clear contingency exists (such as meeting the relevant retirement date).

However, in the case of discretionary bonus waivers (for example, in the form of deferred share awards or remuneration which is paid in the form of non-cash instruments to meet the requirements of the Financial Conduct Authority remuneration code for financial institutions), there will be concern that remuneration could be taxed at a much earlier point than intended.

It is hoped HMRC will quickly provide much needed clarification on how it intends to use this new approach in the context of not just historic EBT structures, but genuine employee incentive arrangements

The impact of the decision on outstanding employer funded retirement benefit schemes (EFURBs) will need careful analysis. Whilst Part 7A was introduced to tackle tax avoidance, it was also there to curb unapproved pension planning in light of the reduction in the annual and lifetime allowances applicable to registered pension schemes. Again, it should be arguable that historic funded EFURB arrangements contain sufficient 'contingencies' to avoid the redirection principle, but this will depend on their structure and how rigorously they have been implemented.

### Conclusion

The case is a triumph for HMRC but did little to guide practitioners. In the words of Lord Hodge, 'the tax code is not a seamless garment. As a result, provisions imposing specific tax charges do not necessarily militate against the existence of a more general charge to tax which may have priority over and supersede or qualify the specific charge'.

The redirection of earnings principle gives HMRC a pragmatic substance over form approach, enabling it to look at the composite effect of an arrangement and tax it under general principles, irrespective of how the specific provisions of the tax code should treat it.

It is hoped HMRC will quickly provide much needed clarification on how it intends to use this new approach in the context of not just historic EBT structures, but genuine employee incentive arrangements. ■

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