

UNWINDING

Armed with the Rangers' judgment on employee benefit trusts, HMRC can issue accelerated payment notices requiring PAYE and NIC liabilities, warns **Peter Rayney FCA**

Over the last two decades or so, numerous companies have used employee benefit trusts (EBTs) and similar trust structures to 'pay' their directors and senior employees with the intention of saving PAYE income tax and national insurance contributions (NICs). However, such tax avoidance arrangements were firmly blocked by the Finance Act 2011 'disguised remuneration' rules (Income Tax (Earnings & Pensions) Act 2003 (ITEPA 2003), Part 7A).

Broadly, the Part 7A legislation – which applied from 6 April 2011 – creates a PAYE and NICs charge where funds transferred to an EBT/trust are simply 'earmarked' for a particular employee (this would therefore apply to funds set aside for an employee using a sub-fund or sub-trust). Similarly, any loans provided to an employee from an EBT, etc, would also be taxed (subject to relief for any prior 'earmarking' charge).

Given this, why is the (so-called) 'Glasgow Rangers' EBT case so important? Well, the disguised remuneration provisions only deal with EBT transactions (broadly speaking) after 5 April 2011. HMRC has been making substantial efforts to pursue PAYE and NICs relating to EBT cases that pre-date 6 April 2011. However, its EBT litigation journey has not been an easy one.

Despite succeeding in *Aberdeen Asset Management plc v HMRC* [2013] CSIH 84, it failed to impress in *Dextra Accessories Ltd v MacDonald* [2005] STC 1111 and *Sempra Metals v HMRC Commissioners* [2008]. Furthermore, in the *Glasgow Rangers* case,

HMRC had lost at both the First Tier and Upper Tribunals. Despite its only modest success in the courts/tribunals, HMRC was still pursuing companies for the PAYE and NICs due that it still considered to be payable in relation to their pre-6 April 2011 EBT cases. Companies have been encouraged to settle (without any penalties) under the employee benefit trust settlement opportunity (EBTSO). Significant amounts of tax are involved.

According to HMRC, about 800 companies have so far paid around £1bn using this settlement opportunity, which expired on 31 March 2015. It is estimated that there are about a further 5,000 EBT cases that have yet to settle with HMRC. It is these taxpayers who eagerly awaited the Scottish Court of Session decision in the *Glasgow Rangers* case (*Advocate General for Scotland (representing R & C Commrs) v Murray Group Holdings Ltd & Ors* [2015] BTC 36 [2015] CSIH 77).

RANGERS FC

Between 2001 and 2008 Murray Group Holdings Ltd (MGHL), the parent company of RFC 2012 plc (in liquidation) (formerly Rangers Football Club plc), (Rangers FC), made contributions of £55.5m and a separate payment of €5.3m (£4.4m) to its employees' remuneration trust (the EBT).

The EBT trustees subsequently transferred the contributed funds to 108 sub-trusts. The sub-trusts were set up in the name of a particular employee, with the beneficiaries being their close family members. Each employee completed a 'letter of wishes' that named the family members that could benefit. The player/employee became the protector of 'their' sub-trust but they could not directly benefit from the sub-trust as they were excluded from being a beneficiary.

The trustees then granted unsecured loans to

EBTs

the players/employees for a term of 10 years at a commercial interest rate (Libor plus 1.5-2%). Between 2001 and 2010, loans of £47.65m were paid to the players/employees. These facts are illustrated in the diagram overleaf.

NEW HMRC ARGUMENT

The Scottish Court of Session was persuaded to consider a new argument from HMRC as this legal issue had not been argued in the First Tier or Upper Tribunals. This is not normally permitted. However, the court felt able to do this as it raised an important point of principle and did not involve any new finding of fact.

When it considered this principle, the judges concluded that the monies contributed by MGHL to its EBT or the appointment of funds to a sub-trust were taxable earnings in the hands of the relevant players/employees 'whose services were so rewarded' – ie, the cash payment was in consideration for services provided by the employee. These arrangements simply involved the employees 'redirecting' their earnings but this did not eradicate their personal income tax liability.

'REDIRECTION' PRINCIPLE

The court relied on a number of authorities to reach this important conclusion. *Hadlee v Commissioner of Inland Revenue* [1993] AC 524 involved an assignment of a partnership share to a trust to benefit the (transferor) partner's wife and child. It was held that 'the income derived from the personal exertions of the taxpayer is his income for tax purposes, even if it was paid to a third party'. Other cases supporting the 'redirection' principle included *HMRC v Collins* (2009) 79 TC 524 and *Sloane Robinson Investment Services Ltd v HMRC* [2012] UK FTT 451.

Furthermore, the analysis of the House of

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In the Rangers FC case, the trustees granted unsecured loans to the players/employees for a term of 10 years at a commercial interest rate (Libor plus 1.5 to 2%)

CASE: RANGERS FC

Advocate General for Scotland (representing R & C Commrs) v Murray Group Holdings Ltd & Ors [2015] BTC 36 [2015] CSIH 77

Judges: Lord Justice Clerk, Lords Menzies, Drummond Young

Decision released: 4 November 2015

Income tax and NICs – avoidance scheme involving payment of discretionary bonuses to a remuneration trust structure and appointed onto individual sub-trusts – whether payments to remuneration trust amounted to a redirection of earnings – yes; whether appointment onto sub-trusts placed monies at the unreserved disposal of the employee – no; appeal allowed. The Scottish Court of Session allowed HMRC's appeal against the decision of the Upper Tribunal (UT) in Murray Group Holdings Ltd v R & C Commrs [2014] BTC 521 finding that the payment of discretionary bonuses to a remuneration trust structure constituted the mere redirection of emoluments or earnings subject to income tax and national insurance under PAYE.

The judgment is available at <http://bit.ly/1RSqKM0>

Lords and Court of Appeal rulings in *Brumby v Milner* [1976] 1 WLR 29 was found to be based on a realistic appraisal of the true nature of the transaction – effectively, a prefigure to the 'substance over form' *Ramsay* principle. The key principle deduced from the relevant jurisprudence is income that represents 'consideration' for an employee's services (as an employee) represents taxable earnings in their hands. Importantly, this remains the case where an employee requests or agrees that the income be redirected to a third party.

Consequently, as in the *Glasgow Rangers* case, it does not therefore matter if the relevant monies are passed to trustees who then have a genuine discretion about the ultimate distribution of those funds. The court indicated that this arguably simple principle had been overlooked by the First Tier and Upper Tribunals.

ANALYSIS

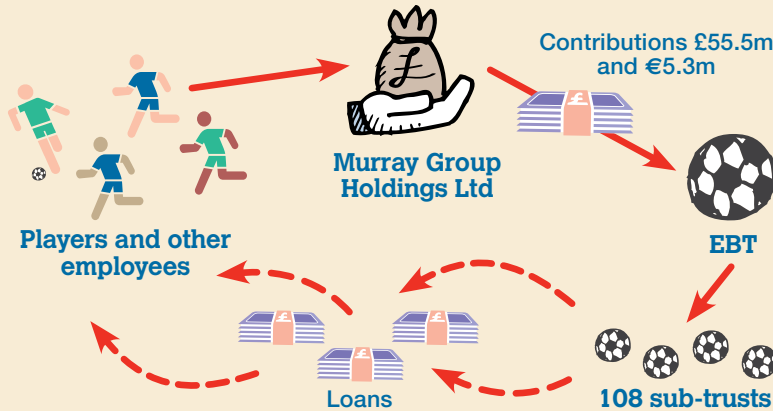
A number of leading cases require that a realistic view of the true nature of the transaction must be established (notably, *Barclays Mercantile Business Finance Ltd v Mawson* [2004] UKHL 51, *Collector of Stamp Revenue v Arrowtown Assets Ltd* [2003] HKCF 46).

In *Glasgow Rangers*, each footballer had a 'side-letter', which provided for their 'bonuses' to be paid via discretionary trust payments. The court concluded that the 'obligation in the side-letter amounted to the "discharge" of an employer's obligation to an employee' – it formed part of the footballer's remuneration

KEY TRANSACTIONS

GLASGOW RANGERS CASE

Murray Group Holdings Ltd set up an employees' remuneration trust (EBT) which then transferred the contributed funds to 108 sub-trusts



package. This characterised the relevant payments as earnings.

Consequently, the bonus payments represented consideration for the footballer's services as employees and were therefore taxable in their hands. A similar view was taken of the arrangements for the other employees, whose bonuses were determined by their performance and the company's profitability.

In summary, the court accepted HMRC's primary argument. The footballers/employees completed a letter of wishes naming the family members who were to benefit under the sub-trust. 'The redirection of earnings occurred at the point where the employer paid a sum to the trustee of [the EBT]'.

What happened to the monies after that, including the creation of the sub-trusts and the loans to the employees, was therefore entirely irrelevant. The 'earnings' had been 'received' (albeit in a redirected form) when MGHL contributed the monies to the trust and thus the PAYE and NIC liability was triggered at that point.

HMRC lost its secondary argument but this is not material as HMRC won on the primary 'redirection' of earnings argument.

DRAWING CONCLUSIONS

HMRC will be well satisfied with the Scottish Court of Session ruling. This now poses some real problems for the estimated 5,000 users of EBT and similar tax avoidance arrangements. Many consider the *Rangers* case to represent the most straightforward EBT arrangement and hence the ruling must set a strong precedent.

The court has concluded that an employee's earnings for income tax and NIC purposes are triggered when the company contributes the monies to the EBT. Armed with this firm judgment, HMRC will now be able to issue accelerated payment notices (APNs) requiring



HMRC has been making substantial efforts to pursue PAYE and NICs relating to EBT cases that pre-date 6 April 2011 but its litigation journey has not been easy

those users who have not settled their prior 'EBT-related' PAYE and NIC liabilities to pay up. Some of them may regret that they did not take advantage of the EBTSO, which is now closed.

Based on this very strong ruling supported by three judges, I do not fancy MGHL's chances of mounting a successful appeal. Some would argue that an employee cannot be entitled to the 'monies' paid into the EBT and hence this cannot be regarded as taxable earnings.

The First Tier and Upper Tribunals did not consider this argument and hence their focus was to consider whether the loans made to the players/employees were in substance earnings. Both tribunals rejected this 'substance' point in favour of the legal form analysis, ie, the EBT made legitimate loans and therefore these amounts were not taxable as earnings in the employees' hands.

Looking at the detailed Scottish Court of Session case report, the 'redirection' principle looks very persuasive and therefore very difficult to counter. Had it been raised before the Tribunals, I suspect that their ruling may have been different. The strength of the court's 'common sense' decision in the *Rangers* case is almost in line with the main 'earmarking' principle of the Part 7A 'disguised remuneration' rules. We are therefore left wondering why the complex and labyrinthine Part 7A legislation is still necessary.

Murray Group Holdings may well appeal the decision at the Supreme Court, although in my view, there is little chance of success.



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