Employment Benefit Trust Tax avoidance schemes and the Supreme Court death knell

Partner, Stephen Reilly reviews this month’s Supreme Court decision in the Glasgow Rangers “big tax” case¹, highlighting an important success for HMRC in the ongoing tax avoidance war.

They thought it was all over in the Scottish Court of Session in 2016 and it is now. Rangers football club (or more specifically Rangers’ previous owner, in liquidation) has finally lost its several year running litigation saga with HMRC about some edgy Employment Benefit Trust (EBT) tax planning they entered into with numerous footballers from 2000-2010.

Vanilla EBT tax planning for the potential benefit of all of a company’s employees is recognised by HMRC as legitimate but an income tax/PAYE avoidance variant aimed at benefitting specifically targeted employees grew up alongside. In retrospect the EBT tax planning entered into now appears to have given Rangers an unfair advantage in having been able to pay their players significant salaries with limited (if any) tax exposure, making Rangers a more attractive destination to those footballers who were able to calculate what an effective tax rate of 0% meant. During the relevant years Rangers won the Scottish Premiership title on more than one occasion and wider sporting questions now arise as to whether those successes should still be viewed as legitimate.

EBTs and changes to the legal landscape

For many years, tax advisers were advising wealthy clients on how to avoid paying taxes through the use of EBTs. In return many of those advisers charged their clients a material % of the tax “saved”. HMRC have been attacking this type of tax planning for numerous years and from as early as

the end of 2010 there were changes in the law aimed at curbing perceived abuses in connection with EBT tax planning.

While this Supreme Court decision did not ultimately rely on it, EBT tax planning and the connected loans arising from salary related income have been subject to PAYE and NICs since late 2010 under anti-avoidance legislation (Part 7A of the Income Tax (Earnings and Pensions) Act 2003 (Part 7A)). This is commonly referred to as the disguised remuneration tax rules. HMRC’s view has consistently been, however, that many EBT arrangements did not work, even before Part 7A was introduced and Part 7A simply removed any arguable doubt as to that.

The Supreme Court’s decision is that Rangers’ tax planning did not work based on the law as it was pre-2010 and regardless of the subsequent disguised remuneration changes in the law.

How the EBT planning worked

In summary, like many other EBT “salary” schemes, Rangers set up and paid monies (monies that otherwise would likely have been paid as salary or bonus payments) into an English law discretionary EBT trust with a Jersey-resident Trustee. From there numerous sub-trusts were set up, each in the name of individual players and potentially for the benefit of the player and his named family beneficiaries. From the sub trusts, the EBT Trustees made very significant commercial “loans” to the individual players, loans said to be at arms length and on commercial terms. £50m+ was loaned out to over 80 players between the early 2000s and 2010. The loans were never repaid and no material tax was paid on the monies loaned to the players. Had the monies been paid direct to the players, higher rate tax (circa 40%) would have been payable.

HMRC argued that the loans were really disguised salary. HMRC lost in both the First and Upper Tier Tribunals on the basis that the payments were not "emoluments" or "earnings" under the legislation in force at the time as the players had no absolute legal entitlement to the monies (being subject the discretion of the Trustee), interest was being charged and repayment of the "loan" could (at least theoretically) be demanded at any time. The Tribunals did not accept that the EBT Trust loan arrangements were an artificial scheme to place salary sums unreservedly at the players’/employees’ disposal.

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The Court of Session overturned these decisions and found in favour of HMRC and now the Supreme Court has unanimously dismissed the appeal. In short, the Supreme Court agreed with HMRC that the amounts contributed by the employer to the EBT were “redirected earnings” and were therefore subject to tax and NICs when the monies were made to the EBT.

The Supreme Court has made it clear that PAYE tax on income extends to money that the employee is entitled to have paid as remuneration whether that money is paid direct to the employee or to a third party. Per Lord Hodge:

"I see nothing in the wider purpose of the legislation, which taxes remuneration from employment, which excludes from the tax charge or the PAYE regime remuneration which the employee is entitled to have paid to a third party... The breadth of the wording of the tax charge and the absence of any restrictive wording in the primary legislation, do not give any support for inferring an intention to exclude from the tax charge such a payment to a third party..."

The Supreme Court also importantly said that the previous cases of (i) Dextra Accessories Ltd v Macdonald (HMIT) [2002] Spc00331 (25 July 2002) and (ii) Sempra Metals Limited and HMRC [2008] Spc000698 (7 July 2008), on whether contributions to EBTs were employment income, had been decided wrongly.

HMRC will likely now seek to use this decision in order to pursue other cases involving EBTs and related EFRB schemes.

At Beale & Company we act in tax litigation matters and we are actively advising on EBT and related ERFBS tax planning issues and in the defence of accountants, tax advisers and IFAs (and their insurers) involved in such issues.

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