

Another opinion from the GAAR Advisory Panel

(Lecture P1078 – 27.23 minutes)

On 11 December 2017, the GAAR Advisory Panel published three further opinions. Two of these cases involved employees receiving rewards as gold bullion – they are very similar to the first case heard last summer and the Panel came to the same conclusion, i.e. that the tax arrangements in question did not represent a reasonable course of action.

However, it is the other case which is of interest and which may prove to be of considerable importance. Two (anonymous) taxpayers are involved: Mr A and his company. Mr A is the sole director of, and shareholder in, the company.

The relevant tax planning arrangements were entered into over the course of 2013 and 2014. At the time, Mr A owed his company £460,000. Had that loan remained in place, the company would have incurred a charge to tax under S455 CTA 2010.

The planning advice was designed to allow Mr A to extract cash from his company with:

- no charge to income tax for Mr A, either on a dividend or on a close company loan write-off under S416 ITTOIA 2005;
- no loan to participator charge on the company under S455 CTA 2010; and
- no participator benefits charge on the company under S464A CTA 2010.

In outline, the tax planning involved the following steps:

- On 16 and 17 July 2013, two trusts were created by an offshore company settlor and funded with £325,000 each. The money was then lent back to the settlor.
- On 26 August 2013, a Cyprus company took over as sole trustee of the trusts.
- On 7 July 2014, the assets of one of the trusts (together with the corresponding loan to the settlor) were reduced by £150,000 and the assets of both trusts (now worth £500,000) were combined under a single deed.
- On 16 July 2014, the settlor assigned to Mr A the settlor's interest in the trust for £500,500, the settlor repaid its £500,000 loan to the trust and the trust made a loan of £500,000 to Mr A. These steps did not involve the incurring of any cost by Mr A other than a £500 trust set-up expense.
- On 31 October 2014, Mr A's company purchased the 'primary interest' in the trust from Mr A for £500,000. The purchase price was paid via a credit to Mr A's loan account with his company, thus eliminating the overdrawn loan account balance of £460,000.
- On 11 November 2014, another company (which was the trustee of a separate family trust of Mr A) acquired the 'secondary interest' in the trust in return for a payment of £100.

The 'primary interest' entitled the holder to income from the trust's assets until 2135.

The 'secondary interest' entitled the holder to the remaining capital after 2135.

The terms of Mr A's loan from the trust were that it would be interest-free for as long as Mr A held the 'primary interest' and thereafter interest would become payable by reference to a rate derived from a formula involving the Bank of England's base rate.

On 25 September 2014, the company's board minutes recorded that the trustee had the power to make an outright distribution of the underlying assets of the trust to the holder of the 'secondary interest', thus effectively ending the holder of the 'primary interest's' right to income.

The result of all this is that:

- Mr A received £500,000 from the company, of which £460,000 was used to discharge his company loan;
- until the loan from the trust to Mr A is repaid on his death (or is otherwise unwound), Mr A funds the annual income which the company receives from the trust;
- the company reflects the right to receive annual income from the trust as a £500,000 asset in its accounts; and
- the trustee has the power to make an outright distribution of trust assets to the holder of the 'secondary interest' (Mr A's family trust).

These arrangements seek to provide Mr A with £500,000 on a tax-free basis, and with no charge arising on the company under either S455 CTA 2010 or S464A CTA 2010. The £500,000 received on the sale of Mr A's 'primary interest' enables him to repay his existing £460,000 company loan, thereby avoiding the loan to participator charge. The Panel summed up the position as follows:

'The arrangements in other words seek to get round the taxing provisions by steering a course away from the distributions legislation (which charges to income tax shareholder extractions of value from a company), away from the loan to participator legislation (which levies tax on a close company providing loans to participators) and away from the other participator benefits legislation (which levies tax on a close company providing, as part of tax avoidance arrangements, an otherwise untaxed or undertaxed benefit).'

The Panel continued:

'The tax position of hypothetical normal transactions is as follows:

- (i) A dividend paid by the company to Mr A gives rise to a charge to income tax on the amount of the dividend.
- (ii) A loan by the company to Mr A gives rise to a loan to participator charge in the company by reference to the amount of the loan.

(iii) The sale of a valuable asset by Mr A to the company at overvalue gives rise to a charge to income tax under the distributions legislation on the difference between the value received by Mr A and the market value of the asset received by the company (in essence, the charge is on the value extracted from the company).

(iv) The sale of a valuable asset by Mr A to the company has potential capital gains consequences for Mr A.'

The argument of Mr A's tax advisers was that the £500,000 which he received from the company was a market value purchase price for an asset (the 'primary interest' in the trust). Accordingly, as no value was extracted from the company, no charge to income tax under the distributions legislation should arise. In addition, it was asserted that Mr A's CGT base cost was at least £500,000 so that there was no capital gain on the sale of his 'primary interest' to the company. As far as the company is concerned, the £460,000 loan was repaid and was not replaced by another loan. Therefore, there should be no charge under S455 CTA 2010 or S464A CTA 2010.

Unsurprisingly, the Panel found that the tax arrangements described above did not represent a reasonable course of action. There was no commercial non-tax rationale for involving a trust in the desired goal of extracting cash from the company.

One unsatisfactory feature of the opinion given by the Panel is that, in the GAAR Guidance, much is made about the importance of the taxpayer's safeguard – the so-called double reasonableness test ('the arrangements cannot reasonably be regarded as a reasonable course of action') – and the fact that this test exists specifically for the purpose of setting a high threshold. It is a pity that, when it comes to the Panel, they do not have to apply this same high threshold. They merely have to decide whether the arrangements are a reasonable course of action (which places the bar at a much lower level).

In this case, the Panel, having examined the relevant legislation, conclude that the purpose of the rules is to charge tax on benefits received by a participator in a close company. This is perhaps a little too broad. As has already been mentioned, there are three different ways in which the regime imposes a charge to tax on participator benefits (via the distribution legislation, via S455 CTA 2010 and via S464A CTA 2010). It is not illogical to suggest that, if a taxpayer's arrangements do not fall within the scope of these provisions, then they are not intended to be taxed.

However, the GAAR Guidance provides a response to this riposte: a taxpayer is not permitted to exploit shortcomings in the legislation. One of the basic principles of the GAAR is to deter or counteract the deliberate exploitation of statutory defects or lacunae. It is therefore interesting to read the following passage in the Panel's review (see Para 10.1):

'We do not consider there to be a shortcoming in any of the three separate sets of rules charging tax on benefits conferred by close companies.'

This sounds like a let-out for the taxpayer, but unfortunately the verdict does not pan out that way. The thrust of the Panel's opinion seems to be that, if Mr A could have received his money differently (e.g. as a dividend) and if this would have given him a liability to tax, he should pay tax on that basis.

Although the legislation and the GAAR Guidance are clear about the meaning of 'exploit' in this context, the Panel seem to have extended the sense of the word so that it includes the circumstance, as one commentator has put it, that 'you have "exploited the fact" that the legislation was not designed to tax your transaction'. In other words, it could potentially cover virtually everything. And that makes one wonder what protection or safeguard now exists for the embattled taxpayer.

An opinion of the Panel is not of course binding, but it will be a brave (or seriously aggrieved) taxpayer who is prepared to challenge such a finding.

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