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Supreme Court finds for HMRC in Rangers EBT case

The Supreme Court, in a unanimous decision, has dismissed the taxpayer's appeal in what became known as the 'big tax case'.

This judgment brings to a conclusion a number of years of litigation around Employee Benefit Trusts (EBTs) and 'disguised remuneration'. While it is of direct relevance to employers who have funded EBTs or Employer-Financed Retirement Benefits Schemes (EFRBS), the breadth of the conclusion may also impact more mainstream arrangements such as salary sacrifice and flexible benefits.

In essence, this appeal concerned the question of whether amounts paid to an EBT by an employer (i.e. Rangers) for the benefit of an employee were taxable on the employee as earnings (or emoluments).

The background facts

When the appellant wished to benefit one of its employees, i.e. a footballer or senior executive, it did so by making a cash payment to an EBT in respect of that employee.

At the same time, Rangers also recommended that the trustee of the EBT resettle the sum on a sub-trust and asked that the income and capital of the sub-trust should be applied in accordance with the wishes of the employee.

Invariably the employee then requested and received a loan from the trustee of the sub-trust.

These loans tended to be repayable at the end of an extended term of ten years. Interest was not paid annually but was accrued over the life of the loan to be paid at the end of the loan period.

It was anticipated by both the employee and the appellant at the outset that come the repayment date, the loan would be renewed. It was envisaged that, ultimately, the loan may still be outstanding on the death of the employee at which point it would reduce the value of his estate for inheritance tax purposes.

Whilst the senior executives had no contractual right to any (bonus) amounts paid to the EBT, the same could not be said for the footballers.

In negotiations with the footballers, the EBT was explained to the footballer/their agent and the terms of engagement were recorded in two documents: a contract of employment which set out the remuneration which would be subject to PAYE/NIC and a side-letter in which Rangers undertook to fund the EBT in an agreed amount and to recommend to the trustee of the EBT that they fund a sub-trust for the footballer's benefit.

The law

After considering the authorities, the judgment summarises the law as below. This is with reference to the basic charging rule under s62 ITEPA 2003, not with regard to the special rules on benefits-in-kind (or any other charging provision). The parties had also previously agreed that whatever was decided for income tax purposes should apply equally for Class 1 NIC.

1. Income tax on emoluments or earnings is due on money paid as a reward or remuneration for the exertions of the employee.

2. The law (as relevant to this appeal at least) does not provide that the employee himself or herself must receive the remuneration.

3. Instead the law applies to payments to either:

    a) The employee; or
    b) A "person to whom the payment is made with the agreement or acquiescence of the employee or as arranged by the employee, for example by assignation or assignment".

4. The Special Commissioners in *Sempra Metals* (and in *Dextra*) had erred in excluding payments to a third party from being earnings.

Applying the law to the facts, the Court concluded that "the sums paid to the trustee of the EBT for a footballer constituted the footballer's emoluments or earnings." Although the senior executives had no contractual entitlement to the discretionary bonuses before they were awarded, the Court, perhaps surprisingly in light of bullet 3b above, concluded that "that does not alter the analysis of the effect of the EBT scheme. The fact that bonuses were voluntary on the part of the employer is irrelevant so long as the sum of money is given in respect of the employee's work as an employee."

KPMG view

This judgment once more demonstrates the Court taking a tough line on certain planning. After the earlier judgments in Sempra (2008) and Dextra (2002), it seemed to have been accepted that payments to EBTs were generally not earnings. Albeit that when Rangers was heard last year in the Court of Session, there were clear indications that this was not the end of the story. The Supreme Court's judgment confirms this and unfortunately for Rangers, they have come out the worse for wear at the final whistle!

The judgment also poses wider questions around the need for the highly complicated 'disguised remuneration' legislation which was introduced in 2011. But with HMRC having lost the Rangers case at both the First-tier Tribunal and the Upper Tribunal, one can understand that they felt they needed something to fall back on if they lost in the higher courts as well.

That said, the proposal to extend the 'disguised remuneration' rules and to charge tax on loans as if they were remuneration from April 2019 may face more controversy as a result. As it is now clear that HMRC has always had taxing rights over the sums involved, the 2019 loan charge may appear more like a second bite at the cherry.

A key point in this case was the Supreme Court's view that remuneration should not be excluded from tax as earnings under s62 ITEPA 2003 where the employee agrees or acquiesces that it should be paid to a third party.

Although legislation has been enacted in Finance Act 2017 which significantly curtails flexible benefit arrangements offered by many employers to their staff, many employers are still operating such arrangements because the benefits concerned are carved out of the new rules or because the transitional rules apply so that there is, as yet, no impact (e.g. company cars, school fees and living accommodation).

In these circumstances, it is unclear how this judgment will apply to the arrangements, i.e. will the choices employees make mean that they are re-directing s62 earnings which are taxable accordingly and subject to Class 1 NIC? We think it would be helpful if HMRC issued guidance clarifying the position accordingly.

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