# EMPLOYEE REMUNERATION TRUSTS: A DISCUSSION OF PART 7A ITEPA 2003[1]

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*Introduction*

In this article I can only consider in detail the core provisions of the 66 pages of legislation in Schedule 2 to the Finance Act 2011 headed 'Employment income provided through third parties' and introducing Part 7A ITEPA 2003.The provisions and multiple exemptions relating to employee share schemes are not considered, nor the specific provisions relating to FURBS.

The pre-FA 2011 distinctions between beneficial loans and other benefits in kind are now swept away by the primary taxing provisions of Part 7A ITEPA 2003. Part 7A carves out all matters in its own ambit from the ordinary benefit in kind regimes.

HMRC explained the need for Part 7A as follows:

> "In relation to the arrangements known to HMRC, there are approximately 5,000 employers who are currently using these schemes, with an estimated 50,000 employees thought to be indirectly benefiting. The take up is likely to be wider than this as there has been extensive marketing and widening accessibility of these arrangements over the last few years."
>
> (http://www.hm-treasury.gov.uk/d/disguised_remuneration.pdf)

HMRC published a Consultation Document containing Frequently Asked Questions dated 21 February 2011 (http://www.hmrc.gov.uk/budget-updates/disguised-remuneration-faqs.pdf). The document is freely available online,

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so we do not reproduce it in full here. However, some interesting points of principle do emerge from it.

Part 7A is, in essence (to borrow a now statutory phrase), an anti-*Dextra* law. *Dextra Accessories Ltd V Macdonald* [2005] STC 1111 was the *locus classicus* of an Employee Remuneration Trust (ERT), funded out of salary sacrifice by owner directors, the funds then going to directors in the form of loans from the trust. Yet HMRC said:

> "FAQ10. New section 554G(4) requires that there be no tax avoidance purpose; what is the position in relation to salary or bonus sacrifice arrangements involving a third party where the third party allocates tax exempt/favoured benefits in return for the sacrifice?
>
> We would accept that on its own, sacrificing salary in favour of provision of tax-exempt or tax-advantaged benefits does not constitute tax avoidance. However, we would not rule out the possibility that particular salary sacrifice arrangements could involve tax avoidance so we cannot say that there is never a tax avoidance purpose in the context of salary sacrifice arrangements." (emphasis added)

So if salary sacrifice in favour of tax-exempt or tax-advantaged benefits – the *Dextra* arrangement in a nutshell - "does not constitute tax avoidance", then there is nothing wrong with the HMRC-claimed 50,000 employees benefiting from 5,000 ERT schemes.

Some more general points of principle arise from the FAQ's:

> "FAQ6. The wide definition of "trustee" in section 554A(8) means that there doesn't need to be third-party involvement. Accordingly, a direct employer/employee transaction will be caught if the employer is holding a sum of money as part of an arrangement. We agree that, as drafted, Part 7A would have this unintended consequence. The intention is therefore to narrow the definition of "trustee" in section 554A(8)."
>
> "FAQ7. Where there is a change of trustees of a trust does HMRC agree that this should not itself trigger any charges under new Part 7A?
> A change of trustees will not in itself give rise to any charge under new Part 7A."

*The Limiting Factor: application to employee trusts only*

Such is the transactional width of Part 7A that, if its statutory scope were not limited to employment relationships, then all its baroque complexity would apply

to any economic relationship whatsoever. It would apply to all trusts: charities, healthcare trusts, statutory state trusts.

The crucial limiting factor – the line in the fiscal sand – is drawn almost with exaggerated emphasis, upon there being an emolumental transaction in relation to a past, present or future employment relationship:

> 554A Application of Chapter 2
>
> (1) Chapter 2 applies if—
>
> (a) a person ("A") is an employee, or a former or prospective employee, of another person ("B"),
>
> (b) there is an arrangement ("the relevant arrangement") to which A is a party or which otherwise (wholly or partly) covers or relates to A,
>
> (c) it is reasonable to suppose that, in essence—
>
> (i) the relevant arrangement, or
>
> (ii) the relevant arrangement so far as it covers or relates to A,
>
> is (wholly or partly) a means of providing, or is otherwise concerned (wholly or partly) with the provision of, rewards or recognition or loans in connection with A's employment, or former or prospective employment, with B,

Sub-sections 554A(1)(a) to (c) are a "read no further" label for the entire legislation. The legislation could just as well have stated "This legislation applies only where there is an arrangement to provide emoluments in respect of a past, present or future employment": rather as section 43 FA 1989 did.

I do labour this point a little, due to the avalanche of angst amongst professional advisors following the publication of the December 2010 draft legislation. Suddenly it was feared that over 20 million employees in the UK had overnight become subject to disguised remuneration rules. That is not so.

As a matter of definition, Part 7A marks no new fundamental departure in the principles of assessing income tax on employment earnings. An employee is liable tax tax on emoluments of his employment: and has been so for generations. Part 7A merely adds some new categories of deemed employment income.

If a trust is an ERT, then Part 7A matters. If a trust is a Non-Employee Remuneration Trust, then Part 7A is utterly irrelevant.

In order fully to make sense of what follows, I set out the general interpretation provisions for Part 7A:

554Z Interpretation: general

(1) This section applies for the purposes of this Part.

(2) "A" and "B" are defined in section 554A(1)(a).

(3) "Arrangement" includes any agreement, scheme, settlement, transaction, trust or understanding (whether or not it is legally enforceable).

(4) "Market value" has the same meaning as it has for the purposes of TCGA 1992 by virtue of Part 8 of that Act.

(5) Section 170(2) to (11) of TCGA 1992 applies for the purpose of determining whether a company is a member of a group of companies.

(6) And for that purpose, section 170(2) to (11) is to be read as if for "75 per cent" (wherever occurring) there were substituted "51 per cent" (with section 1154(2) of CTA 2010 applying accordingly).

(7) References to the payment of a sum of money include (in particular) references to the payment of a sum of money by way of a loan.

(8) "Pension scheme" has the same meaning as in Part 4 of FA 2004 (see section 150(1) of that Act).

(9) "Relevant step" is defined in section 554A(2).

(10) References to a relevant step which involves a sum of money are references to—

(a) a step within section 554B where the subject of the relevant step is a sum of money,

(b) a step within section 554C(1)(a), or

(c) a step within section 554C(1)(d) where the subject of the relevant step is a sum of money.

(11) References to the asset which is the subject of a relevant step are, in the case of a step within section 554C(1)(e), references to the lease granted.

(12) For this purpose, the lease granted is to be treated as including any extensions of the lease, or any later lease, which by virtue of section 554C(7) or (8) is taken into account in determining the likely effective duration of the lease for the purposes of section 554C(1)(e).

(13) "Tax avoidance arrangement" means an arrangement which has a tax avoidance purpose.

(14) For the purposes of subsection (13) an arrangement has a tax avoidance purpose if subsection (15) applies to a person who is a party to the arrangement.

(15) This subsection applies to a person if the main purpose, or one of the main purposes, of the person in entering into the arrangement is the avoidance of tax or national insurance contributions.

(16) The following paragraphs apply for the purpose of determining whether any relevant step or any other step is connected with a tax avoidance arrangement—

(a) the step is connected with a tax avoidance arrangement if (for example) the step is taken (wholly or partly) in pursuance of—

(i) the tax avoidance arrangement, or

(ii) an arrangement at one end of a series of arrangements with the tax avoidance arrangement being at the other end, and

(b) it does not matter if the person taking the step is unaware of the tax avoidance arrangement.

554Z1 Interpretation: persons linked with A

(1) In this Part references to any person linked with A are references to—

(a) any person who is or has been connected with A,

(b) a close company in which A or a person within any other paragraph of this subsection is or has been a participator,

(c) a company in which A or a person within any other paragraph of this subsection is or has been a participator and which would be a close company if it were a UK resident company, or

(d) a company which is a 51% subsidiary of a company within paragraph (b) or (c).

(2) In applying section 993 of ITA 2007 for the purposes of subsection (1)—

(a) a man and woman living together as if they were spouses of each other are treated as if they were spouses of each other, and

(b) two people of the same sex living together as if they were civil partners of each other are treated as if they were civil partners of each other.

(3) In subsection (1) "participator"—

(a) in relation to a close company, means a person who is a participator in relation to the company for the purposes of section 455 of CTA 2010 (see sections 454 and 455(5) of that Act), and

(b) in relation to a company which would be a close company if it were a UK resident company, means a person who would be such a participator if the company were a close company.

*The Relevant Step*

First, find an emolumental purpose in connection with an employment relationship. Then, find a "relevant step", which is a step within section 554B, 554C or 554D:

554A Application of Chapter 2

(1) Chapter 2 applies if—

…

(d) a relevant step is taken by a relevant third person, and

(e) it is reasonable to suppose that, in essence—

(i) the relevant step is taken (wholly or partly) in pursuance of the relevant arrangement, or

(ii) there is some other connection (direct or indirect) between the relevant step and the relevant arrangement.

(2) In this Part "relevant step" means a step within section 554B, 554C or 554D.

(3) Subsection (1) is subject to subsection (4) and sections 554E to 554Y.

(4) Chapter 2 does not apply by reason of a relevant step within section 554B taken on or after A's death.

(5) In subsection (1)(b) and (c)(ii) references to A include references to any person linked with A.

(6) For the purposes of subsection (1)(c) it does not matter if the relevant arrangement does not include details of the steps which will or may be taken in connection with providing, in essence, rewards or recognition or loans as mentioned (for example, details of any sums of money or assets which will or may be involved or details of how or when or by whom or in whose favour any step will or may be taken).

(7) In subsection (1)(d) "relevant third person" means—

(a) A acting as a trustee,

(b) B acting as a trustee, or

(c) any person other than A and B.

(8) If B is a company and is a member of a group of companies at the time the relevant step is taken, in subsection (7) references to B are to be read as including references to any other company which is a member of that group at that time.

(9) If B is a limited liability partnership, in subsection (7) references to B are to be read as including references to any company which is a wholly-owned subsidiary (as defined in section 1159(2) of the Companies Act 2006) of B at the time the relevant step is taken.

(10) Neither subsection (8) nor subsection (9) applies if there is a connection (direct or indirect) between the relevant step and a tax avoidance arrangement.

(11) For the purposes of subsection (1)(e)—

(a) the relevant step is connected with the relevant arrangement if (for example) the relevant step is taken (wholly or partly) in pursuance of an arrangement at one end of a series of arrangements with the relevant arrangement being at the other end, and

(b) it does not matter if the person taking the relevant step is unaware of the relevant arrangement.

(12) For the purposes of subsection (1)(c) and (e) in particular, all relevant circumstances are to be taken into account in order to get to the essence of the matter.

Section 554A provides a simple logic tree, albeit expressed in the words of modern legislative drafting:

| NO | YES | TEST |
|---|---|---|
| N | Y | 'A' is an employee of 'B' |
| N | Y | An 'arrangement' covers A, or has 'A' as a party |
| N | Y | The relevant 'arrangement' is to provide emoluments in respect of a past, present or future employment |
| N | Y | A 'relevant step' is taken within 554 B, C or D |
| N | Y | By a 'relevant third person' |
| N | Y | There is a connection between the relevant step and the relevant arrangement |
| All answers 'Yes': | | Chapter 2 applies and there is a tax bill |
| Any answer 'No: | | Chapter 2 does not apply. Read no further |

*The 3 Types of Relevant Step*

This is what all the legislative fuss is about:

554B: earmarking etc of sum of money or asset

554C: payment of sum, transfer of asset etc

554D: making asset available

Really, the fuss is limited to imposing income tax on the capital amount of a loan: even if later repaid, and attempting to impose income tax on "earmarking" of money and assets. Pretty much everything else included in the Relevant Step regime was already taxable under existing legislation.

It could all have been done so much more easily. The draftsman could simply have provided that income tax is now exigible on the capital value of any sum constituting a loan within section 173 ITEPA 2003. And he could have added that the test of whether the provision of the loan is emolumental is to be considered without regard to the identity of the person facilitating the loan, or that person's relationship to the employee.

Instead, the draftsman did not simply reinvent the wheel. He threw overboard the benefits in kind legislation code, which has proved perfectly serviceable for generations, and built a whole new benefits code from scratch. One suspects there is more to this than merely a desire to keep civil servants busy.

What Part 7A demonstrates to the seasoned observer is an expression of HMRC's burden of distrust of the Courts. In the old halcyon days of *IRC v Ramsay* and *Furniss v Dawson*, HMRC could confidently expect the judiciary to rectify what HMRC might from time to time like to call "defects" in legislation, in favour of the taxman. But the "generate a tax liability out of invented judicial opinion" approach to taxing statutes has gone.

Following the decisions in cases such as *HMRC v David Mayes* [2011] EWCA Civ 407 HMRC now feels bound to spell out in the most minute detail every conceivable aspect and permutation of a taxing statute, in relation to future circumstances. That is a good thing. But when done as badly as Part 7A, one has a suspicion that HMRC may be shy to litigate. Concepts like "relevant" circumstances, "arrangements", "reasonable to suppose", "essence of the matter" are bad drafting. There is no right answer. There is only subjective opinion.

HMRC have devised for themselves the worst of both worlds. They have created a matrix of transactions, defined, and redefined to the last conceivable permutation. Then wrapped that exactitude inside a collection of vacuous sound bites.

*554B: earmarking etc of sum of money or asset*

I have already commented on the inherent absurdities of this new benefit in kind concept in s554B ITEPA 2003; 'a sum of money or asset held by or on behalf of P is earmarked (however informally) by P with a view to a later relevant step being taken by P or any other person'.

The fundamental problem is the transactional test: "earmarked (however informally)." Whatever textbook or legal dictionary one consults, there is no extant definition in English law of "earmarked". It is not a term of art in law. It is slang.

HMRC has been reckless as to the consequences of using this slang term in tax legislation which, in principle, affects every past, present and future employee in the UK. The sort of consequences in litigation can be gauged from the case of *Alan David Cameron v M & W Mack (Esop) Trustee Ltd* (2001) HC 0002658: LTL 14/11/2001. Decided a decade ago, it was little more than a curiosity for ESOP train spotters. Now section 554B has catapulted it into the front ranks of "must read" tax cases.

The judgment of Jonathan Gaunt QC was meticulous, basing itself on principles of documentary construction which are going to be revisited should any assessment under Chapter 2 Part 7A ITEPA 2003, founded on section 554B ever be litigated.

> '7. On 29th June 1994 the Company instituted a share bonus scheme ("the SBS") which was to be operated under the umbrellas of the Employee Benefits Trust. The essence of the scheme to the detail of which I will return, was that senior managers, including Mr Cameron, would be invited each year to forego a part of the bonus to which they were entitled under their contract of employment as part of their remuneration and the portion of the bonus which was foregone would be used to fund the "purchase" of shares in the Company at the price prevailing at the date of the notional purchase. Subject to satisfying certain criteria an employee "purchasing" these "bonus shares" would become entitled to an equal number of "matching shares". At the end of 3 years, these shares would "mature" in the sense that a request could be made by the employee for their transfer to him. In the meantime they would continue to be held on discretionary trusts.
>
> 9. …In Mr Cameron's case the letter stated that the Board had agreed that for the financial year ended April 1994 Mr Cameron could forego up to £5,000 of his bonus entitlement, which amount would be used to calculate the number of shares that would be "earmarked" for him under the scheme. This was the first occasion on which any of the employees of the Company were introduced to the use of the word and the concept "earmarking", which is central to the dispute in this case.
>
> **The Issue**
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> 37. The issue which I have to decide is whether, by the resolution of 26th September 1997, alternatively Mr Mack's letter of 22nd October, alternatively Mr Hobson's letter of 30th October 1997, the Trustee

> Company constituted or declared itself Trustee of the 52,250 shares in the Company upon trust for Mr Cameron absolutely, alternatively granted Mr Cameron an unconditional option to call for the transfer of shares to himself (as the Claimant contends) or whether (as the Defendant contends) the decision whether to transfer the shares, once a request for their transfer was received from Mr Cameron, remained within the discretion of the Trustee.'
>
> His conclusion was as follows:
>
> 'In my judgment, the evidence clearly demonstrates that the word "earmark" or its cognates was habitually used by the Company in the context of the SBS to describe the process of identifying shares for which a member was entitled to apply. The expression "earmarked" described the status of such a share both during the 3 year period, before the end of which a member was not qualified to apply, and after the end of the 3 years period while the share continued to be held on discretionary trust pending application for it by the qualified member.
>
> **Conclusion**
>
> I therefore conclude that, on the true construction of the resolution read in the context of the whole Minute of the relevant meeting and in the context of the background to that meeting and the dealings between the Company and its senior management, the intention of the Trustee as expressed by that resolution was that the earmarked shares should continue to be held on the discretionary trusts of the settlement until the persons nominated in the resolution requested that the shares be transferred to them. In the meantime the nominees had no beneficial interest in the shares. This is consistent with the fact that they were subsequently paid no dividends and exercised no voting rights and paid no tax until the shares were transferred into their names.'

Here was a case in which all the parties to the dispute talked repeatedly of "earmarking". But at the end of the day, a High Court judge was unable to work out what legal relationship or transaction or state of affairs that slang phrase actually meant to all the parties. He was compelled to use the proper legal terms of art of "discretionary trust", beneficial interest", "appointment", "entitlement" and so on.

The starting point then, for any assessment raised pursuant to section 554B, is for the relevant taxpayer to say "There has been no 'earmarking'." It is then for HMRC to prove that 'earmarking' has taken place. The lesson of *Cameron v Mack* is that a party to litigation cannot prove the existence of a state of affairs which has no external objective definition.

At least in *Cameron v Mack* the relevant parties talked about earmarking. There was communication. But section 554B imposes no requirement of communication of an 'earmarking' decision.

So, an ERT trustee in Jersey unilaterally decides while at lunch to effect an appointment of some part of the trust assets (he hasn't decided which) in some way (he hasn't decided what) in favour of someone (he hasn't decided who). And there is no communication of that idle lunch time thought to anyone. But there and then, a "Relevant Step" has arisen.

Let us apply the logic tree:

| **YES** | **TEST** | |
|---|---|---|
| Y | 'A' is an employee of 'B' | |
| Y | An 'arrangement' covers A, or has 'A' as a party | |
| Y | The relevant 'arrangement' is to provide emoluments in respect of a past, present or future employment | |
| Y | A 'relevant step' is taken within 554 B, [C or D] | |
| Y | By a 'relevant third person' | |
| Y | There is a connection between the relevant step and the relevant arrangement | |
| All answers 'Yes': | | Chapter 2 applies and there is a tax bill |

So, now Chapter 2 applies and under s 554Z2 ITEPA in the year of assessment 2011-2012 the ERT trustee had his lunch and committed the uncommunicated Relevant Step. So: "the value of the relevant step (see section 554Z3) counts as employment income of A in respect of A's employment with B". And the value is determined thus

554Z3 Value of relevant step

(1) If the relevant step involves a sum of money, its value is the amount of the sum.

(2) In any other case, the value of the relevant step is—

  (a) the market value when the relevant step is taken of the asset which is the subject of the step, or

  (b) if higher, the cost of the relevant step.

(3) Subsection (2)(a) is subject to sections 437 and 452.

(4) Subsection (2)(b) is to be ignored if—

(a) the relevant step is within section 554C(1)(c), and

(b) any of Chapters 2 to 4A of Part 7 apply by virtue of the acquisition.

(5) Subsection (2)(b) is also to be ignored if section 554Z7 applies.

(6) In subsection (2)(b) the reference to the cost of the relevant step is to the expense incurred in connection with the relevant step (including a proper proportion of any expense relating partly to the relevant step and partly to other matters) by the person or persons at whose cost the relevant step is taken.

(7) Subsections (1) and (2) are subject to sections 554Z4, 554Z5, 554Z6, 554Z7 and 554Z8, which, so far as applicable, are to be applied in that order.

It looks rather difficult to assess the "market value", or "cost", of an undeclared intention to do something with some part of the trust assets (he hasn't decided which) in some way (he hasn't decided what) in favour of someone (he hasn't decided who). Perhaps it is the cost of the trustee's lunch itself, since that does seem to be an "expense incurred in connection with the relevant step (including a proper proportion of any expense relating partly to the relevant step and partly to other matters)". Or maybe on *Mallalieu v Drummond* principles, it is only part of the cost of the lunch.

However, relief is at hand. Riding to the rescue, if you apply within 4 years, is section 554Z14:

554Z14 Relief where earmarking not followed by further relevant step

(1) An application for relief may be made by A (or, if A has died, A's personal representatives) to an officer of Revenue and Customs if—

(a) this Chapter has applied by reason of a relevant step ("the original relevant step") within section 554B taken by a person ("P"),

(b) there occurs an event ("the relevant event") which is not a relevant step in relation to a relevant sum or asset,

(c) by reason of the relevant event no further relevant step is or will be taken by P or any other person in relation to any relevant sum or asset, and

(d) there is no connection (direct or indirect) between the relevant event and a tax avoidance arrangement.

(2) In section 554Z(15) the reference to the avoidance of tax includes (in particular) a reference to the avoidance of tax by way of obtaining relief under this section.

(3) In subsection (1) "relevant sum or asset" means—

(a) the sum of money or asset which is the subject of the original relevant step, or

(b) a sum of money or asset which (directly or indirectly) has arisen or derived, or may arise or derive, from the sum of money or asset mentioned in paragraph (a).

(4) The application for relief must be made within four years from the time when the relevant event occurs.

(5) If an officer of Revenue and Customs is satisfied that the requirements in subsection (1) are met, the officer must give such relief as the officer considers just and reasonable (if any) in respect of income tax paid on any previously charged amount.

(6) In subsection (5) "previously charged amount" means—

(a) the amount which counted as employment income of A under this Chapter as a result of this Chapter applying by reason of the original relevant step, or

(b) any amount treated by section 222 as earnings of A in relation to the notional payment (within the meaning of that section) which B is treated as having made by virtue of the original relevant step.

(7) Subsection (8) applies if, by virtue of this Chapter having applied by reason of the original relevant step, any tax liability of A or any other person arising from another event is reduced (including to nil) by virtue of section 554Z5 or 554Z13 or otherwise.

(8) In determining what is a just and reasonable amount of relief, the officer of Revenue and Customs must have regard (in particular) to the reduction in the tax liability and reduce the amount of relief which would otherwise have been given accordingly (including to nil).

(9) The relief is to be given by repayment or otherwise as appropriate.

(10) In relation to times after the relief is given, the Tax Acts have effect as if this Chapter had never applied by reason of the original relevant step.

Our trustee changes his mind and decides to give a trust asset to charity. So, the employee A could claim relief from the tax bill he did not know he had (arising from the trustee's original lunchtime earmarking). We say "could", because of course employee A will have no knowledge of the gift to charity and no right to know of it.

But get over all that, and there is still a problem: "(c) by reason of the relevant event no further relevant step is or will be taken by P or any other person in

relation to any relevant sum or asset". There might possibly be circumstances in which the donee charity might take a relevant step in relation to that asset: A might become an employee of the charity. One can never say for certain. So the officer of Revenue and Customs can consider it "just and reasonable" that the relief to which A is entitled is nil.

This is a matchstick tower of absurdities. And all founded upon the use of the slang word "earmarked". We understand why HMRC did not want to use terms of art from contract or trust law. Because they fear that people will make arrangements which do not give rise to legal relationships or transactional rights / obligations known to trust or contract law. Yet if people do that, then they create no legally enforceable rights or obligations. In the absence of those, there is nothing to tax. That used to be axiomatic. Now, with FA 2011, HMRC has decided for the first time to tax economic transactions – and even subjective uncommunicated decisions – which have no existence at law at all. It is regrettable that HMRC can waste so much time and money in pursuit of this ultimately futile enterprise.

*554C: payment of sum, transfer of asset*

This is the kernel of Part 7A. Taxing the capital element of a loan charged at interest, as if it were a gift, then denying a refund of income tax if the loan is actually repaid:

554C Relevant steps: payment of sum, transfer of asset etc

(1) A person ("P") takes a step within this section if P—

- (a) pays a sum of money to a relevant person,
- (b) transfers an asset to a relevant person,
- (c) takes a step by virtue of which a relevant person acquires an asset within subsection (4),
- (d) makes available a sum of money or asset for use, or makes it available under an arrangement which permits its use—
  - (i) as security for a loan made or to be made to a relevant person, or
  - (ii) otherwise as security for the meeting of any liability, or the performance of any undertaking, which a relevant person has or will have, or
- (e) grants to a relevant person a lease of any premises the effective duration of which is likely to exceed 21 years.

(2) In subsection (1) "relevant person"—

(a) means A or a person chosen by A or within a class of person chosen by A, and

(b) includes, if P is taking a step on A's behalf or otherwise at A's direction or request, any other person.

(3) In subsection (2) references to A include references to any person linked with A.

(4) The following assets are within this subsection—

(a) securities,

(b) interests in securities, and

(c) securities options,

as defined in section 420 for the purposes of Chapters 1 to 5 of Part 7; and in subsection (1)(c) "acquires" is to be read in accordance with section 421B(2)(a).

(5) For the purposes of subsection (1)(d)—

(a) references to making a sum of money or asset available are references to making it available in any way, however informal,

(b) it does not matter if the relevant person has no legal right to have the sum of money or asset used as mentioned, and

(c) it does not matter if the sum of money or asset is not actually used as mentioned.

(6) Subsections (7) and (8) apply for the purpose of determining the likely effective duration of a lease of any premises granted to a relevant person ("the original lease") for the purposes of subsection (1)(e).

(7) If there are circumstances which make it likely that the original lease will be extended for any period, the effective duration of the original lease is to be determined on the assumption that the original lease will be so extended.

(8) Further, if—

(a) A is, or is likely to become, entitled to a later lease, or the grant of a later lease, of the same premises, or

(b) it is otherwise likely that A will be granted a later lease of the same premises,

the original lease is to be treated as continuing until the end of the later lease (and subsection (7) also applies for the purpose of determining the duration of the later lease).

(9) In subsection (8)—

(a) references to A include references to—

(i) any person linked with A, and

(ii) the person to whom the original lease was granted where the original lease was not granted to A or any person linked with A, and

(b) references to the same premises include references to any premises which include the whole or part of the same premises.

(10) In this section "lease" and "premises" have the same meaning as they have in Chapter 4 of Part 3 of ITTOIA2005.

For all the apparent width of scope of section 554C, there are some doubts as to whether HMRC has legislated for what it actually wanted to achieve. This is "anti-*Dextra*" legislation. As we saw in Chapter 4, in *Dextra* there was an ERT which made loans to directors. The High Court held that the capital amount of such loans was not liable to income tax.

How does a *Dextra* type loan now work with section 554C ? Section 554A(1)(d) requires a "relevant step" within (in this case) 554C by a "relevant third person", and:

554A

(7) In subsection (1) (d) "relevant third person" means—

(a) A acting as a trustee,

(b) B acting as a trustee, or

(c) any person other than A and B.

So in 554C, it is 'P' who:

…takes a step within this section if P—

(a) pays a sum of money to a relevant person,

(b) transfers an asset to a relevant person,

(c) takes a step by virtue of which a relevant person acquires an asset within subsection (4),

(d) makes available a sum of money or asset for use, or makes it available under an arrangement which permits its use—

(i) as security for a loan made or to be made to a relevant person, or

(ii) otherwise as security for the meeting of any liability, or the performance of any undertaking, which a relevant person has or will have, or

(e) grants to a relevant person a lease of any premises the effective duration of which is likely to exceed 21 years.

The ERT trustee lends money to A. That transaction is caught:

> (2) In subsection (1) "relevant person"—
>
> (a) means A …

The ERT trustee lends money to a member of A's family. That transaction is caught:

> (3) In subsection (2) references to A include references to any person linked with A.

However, the catch-all provisions of 554C(2)(a) depend on some act of selection and communication by A:

> (2) In subsection (1) "relevant person"—
>
> (a) means A or a person chosen by A or within a class of person chosen by A, and
>
> (b) includes, if P is taking a step on A's behalf or otherwise at A's direction or request, any other person.

It may well not be 'A' who chooses the class of beneficiaries of the ERT. The ERT trustee may choose someone to receive a loan, without any act of selection or communication by A. Then, so long as the loan recipient is not 'A' or a person linked with 'A', there is no section 554C relevant step. These are probably matters of academic interest only.

For what it is worth, there is an exclusion in s554F for "commercial transactions". However, given the additional –and vague - test for application of the exclusion that: "(b) there is no connection (direct or indirect) between the relevant step and a tax avoidance arrangement", the exclusion is of little use:

Of more use is the "consideration for relevant step" exclusion: s554Z8-

> 554Z8 Cases where consideration given for relevant step
>
> (1) Subsection (2) applies if—
>
> (a) the relevant step is a step within section 554C(1) (a) to (c) ,
>
> (b) the relevant step is for consideration given by A in the form of the transfer of an asset to P from A,
>
> (c) the transfer by A of the asset is made before, or at or about, the time the relevant step is taken and is not by way of a loan, and

(d) there is no connection (direct or indirect) between the transfer by A of the asset and a tax avoidance arrangement.

(2) The value of the relevant step (after any reductions under sections 554Z4 to 554Z6) is reduced (but not below nil) by—

(a) the market value of the asset transferred by A at the time of its transfer, or

(b) if the value of the relevant step was reduced under section 554Z4, X% of that market value.

(3) For the purposes of subsection (1) (d) it is (in particular) to be assumed that the transfer by A of the asset is connected with a tax avoidance arrangement if—

(a) before the transfer, the asset was transferred to A by another person by way of a loan, or

(b) the asset is, or carries with it, any rights or interests under the relevant arrangement or any arrangement which is connected (directly or indirectly) with the relevant arrangement.

(4) In subsection (3) (b) "the relevant arrangement" has the meaning given by section 554A(1) (b).

(5) Subsection (6) applies if—

(a) the relevant step is a step within section 554C(1) (b) or (c) or (e) or 554D and does not also involve a sum of money,

(b) the relevant step is for consideration given by A in the form of the payment of a sum of money to P by A, and

(c) the payment is made before, or at or about, the time the relevant step is taken.

(6) The value of the relevant step (after any reductions under sections 554Z4 to 554Z6) is reduced (but not below nil) by—

(a) the amount of the consideration given, or

(b) if the value of the relevant step was reduced under section 554Z4, X% of the amount of that consideration.

(7) In subsections (2) (b) and (6) (b) "X%" means the proportion of the value of the relevant step (as determined under section 554Z3) left after the reduction under section 554Z4.

(8) In this section references to A include references to any person linked with A.

So, if an employee buys an asset for full market value from an ERT, then there is no Part 7A tax charge. But a loan provided by an ERT for full consideration in the form of interest and repayment of capital has no similar exclusion.

This is what makes 554C uniquely unfair and asymmetric: the absence of any relieving provision upon the repayment of a loan. If a close company directors takes a loan from his own close company then Section 458 CTA 2010 (and its statutory predecessor) provides for repayment of the tax upon repayment of the loan. HMRC is well aware that Part 7A contains no such relieving provision:

> "FAQ 14. There don't appear to be any relieving provisions if a loan is repaid. What is the tax position where a loan, which has been subject to PAYE on the full amount advanced, is repaid in full?
>
> The anti-forestalling rules allow credit for repayment of any part of a loan made in the period from 9 December 2010 to 5 April 2011 (inclusive). Where such a loan is made the Part 7A charge will be based on the amount of the loan less any repayments made before 6 April 2012. Version 1 – 21 February 2011
>
> However, there is no provision for credit to be given for the repayment of any loan made by a third party on or after 6 April 2011."
> http://www.hm-treasury.gov.uk/d/disguised_remuneration.pdf

There must be some doubt as to whether a tax which is levied on an amount deemed to be "income", which amount has (on loan repayment) ceased to be in any sense property of or a benefit to the employee recipient, is a tax which is compatible for UK human rights legislation. One can see some difficulty in the British government seeking to argue that is is "necessary" to impose tax on fictional benefits.

*554D: making asset available*

Section 554D revisits the familiar benefits in kind territory of houses, cars and the like, being provided for the use of an employee.

554D Relevant steps: making asset available

(1) A person ("P") takes a step within this section if, without transferring the asset to the relevant person, P—

(a) at any time, makes an asset available for a relevant person to benefit from in a way which is substantially similar to the way in which the relevant person would have been able to benefit from the asset had the asset been transferred to the relevant person at that time, or

(b) at or after the end of the relevant period, makes an asset available for a relevant person to benefit from.

(2) If—

(a) before the end of the relevant period, P makes available an asset for a relevant person to benefit from, and

(b) at the end of the relevant period, P continues to make the asset available for the relevant person to benefit from,

P is treated as taking a step within this section by virtue of subsection (1)(b) at the end of the relevant period.

(3) For the purposes of subsections (1) and (2)—

(a) references to making an asset available are references to making it available in any way, however informal,

(b) it does not matter if the relevant person has no legal right to benefit from the asset, and

(c) it does not matter if the relevant person does not actually benefit from the asset.

(4) In subsections (1) and (2) "the relevant period" means the period of two years starting with the day on which A's employment with B ceases.

(5) In subsections (1) and (2) "relevant person"—

(a) means A or a person chosen by A or within a class of person chosen by A, and

(b) includes, if P is taking a step on A's behalf or otherwise at A's direction or request, any other person.

(6) In subsection (5) references to A include references to any person linked with A.

(7) The following factors (among others) may be taken into account in determining whether a step within this section is taken by virtue of subsection (1)(a)—

(a) any limitations on the way in which the relevant person may benefit from the asset,

(b) the period over which the asset is being made available and (if relevant) the extent to which that period covers the expected remaining useful life of the asset,

(c) the extent to which the relevant person has, or is to have, a say over the disposal of the asset, and

(d) the extent to which the relevant person may benefit from any proceeds arising from the disposal of the asset or otherwise have a say in the way the proceeds are used.

HMRC's Consultation Document containing Frequently Asked Questions dated 21 February 2011 (http://www.hmrc.gov.uk/budget-updates/disguised-remuneration-faqs.pdf) provides some useful guidance:

> "FAQ8. What does the term "substantially similar" in section 554D(1)(a) mean? For example, would the normal provision of a company car under a

> lease agreement or the occasional use of a holiday home be capable of meeting the test in section 554D(1)(a)?
>
> The test in section 554D(1)(a) is intended to cover circumstances that are, in essence, the same as the way in which the employee could have benefited from the asset had the employee been the outright owner. This requires more than the asset simply being at the employee's disposal or being available for the employee's private use. Examples of the "something more" that would point to the employee being able to benefit from an asset in much the same way as the outright owner include:
>
> - where the employee (in their capacity as an individual) can directly influence decisions about whether to sell or replace an asset;
> - where it is clear that the employee is likely to benefit from any eventual disposal proceeds of an asset (for example, because they will be ploughed back into the employee's sub-trust).
>
> The normal provision of company cars on short term leases to employees for their private use or the occasional non-exclusive use of a holiday home while in employment would not be a relevant step under section 554D(1)(a).
>
> We are also considering whether section 554D needs to be amended in order to qualify the meaning of "substantially similar"."

HMRC did not amend 554D in order to qualify the meaning of "substantially similar". It has been left in a state of complete vacuity. One notes that the "substantially similar" test is referenced to: "the way in which the relevant person would have been able to benefit from the asset had the asset been transferred to the relevant person at that time" HMRC chose to use the word "transferred". But transfer is not the same as ownership.

This test amounts to: if an employee has use of an asset, then that is to count as deemed ownership if the use is substantially similar to possession of an asset transferred to him. HMRC claims in its FAQ's that the comparison words are intended to denote ownership. However, tax professionals now know full well that no reliance at all can be placed on what HMRC says about such things. After all, *Dextra* itself only started because HMRC reneged in 2000 in a representation it had made in 1989 about the relevant FA 1989 legislation.

One repeats the old principle: a taxpayer should be taxed by legislation, not untaxed by discretion. Perhaps a new principle should be enacted by statute: in the interpretation of any taxing Act, a taxpayer shall be entitled to refer the Court to any publicly published statement by HMRC.

*Overlaps*

Tracing is the equitable principle in which you follow value from one ownership to another, so as to fix an ultimate owner with an equitable obligation to account for that value to the claimant. Section 554Z5 creates a novel statutory from of tracing:

554Z5 Overlap with earlier relevant step

(1) This section applies if there is overlap between—

(a) the sum of money or asset ("sum or asset P") which is the subject of the relevant step, and

(b) the sum of money or asset ("sum or asset Q") which was the subject of an earlier relevant step ("the earlier relevant step") by reason of which this Chapter applied in respect of A's employment with B.

(2) The value of the relevant step (after any reductions under section 554Z4) is reduced (but not below nil)—

(a) if the overlap covers the whole of sum or asset Q, by the value of the earlier relevant step, or

(b) if the overlap covers only part of sum or asset Q, by the part of the value of the earlier relevant step which corresponds to the part of sum or asset Q covered by the overlap as determined on a just and reasonable basis.

(3) In subsection (2) references to the value of the earlier relevant step are to that value—

(a) after any reductions made to it under section 554Z4 or this section or section 554Z7, but

(b) before any reductions made to it under section 554Z6 or 554Z8.

(4) For the purposes of this section there is overlap between sum or asset P and sum or asset Q so far as—

(a) they are the same sum of money or asset, or

(b) sum or asset P, essentially, replaces sum or asset Q.

(5) Further, if any reductions were made under this section to the value of the earlier relevant step, sum or asset P is treated as overlapping with any other sum of money or asset so far as the other sum of money or asset was treated as overlapping with sum or asset Q for the purposes of this section.

There are real practical problems with applying this further statutory fiction of "overlap". Money is fungible. It is in modern commercial practice transferred electronically. And there are transactional charges within the banking system. HMRC might be tempted to argue that a "sum" of money paid out by a bank does

not, to some extent, "overlap" with the sum of money which left some other fictional (or actual) trustee's account.

Suppose that an ERT buys a house and places it in a sub-trust for A and his family, such that there is a section 554B "earmarking", and thus a "relevant step". Suppose then that the house is extended because a planning permission is granted. Nevertheless, the value of the house stays the same in a falling property market. Does "the overlap covers the whole of sum or asset Q"? By value, yes. By physical description: no.

These examples – and the arguments which may be had about them - could be replicated a thousandfold. Having created this Alice in Taxland legislation, one can hardly have confidence that HMRC would not indulge in such arguments.

*Retirement Benefit Undertakings*

The cardinal concept of any Remuneration Trust, whether an employee remuneration Trust or a Non–Employee Remuneration Trust is discretion in relation to contributions and the absence of obligation.

I therefore only mention, in order to disregard any further consideration of Chapter 3 headed 'Undertakings Given By Employer Etc In Relation To Retirement Benefits Etc' and in particular s554Z16.

This is fortunate for the reader. Sections 554Z17 to 21 then proceed to construct a statutory construct in which the employer 'B' is now (in effect) a trustee of a trust (or arrangement) which does not actually exist, save as a fictional creation of statute for taxing purposes:

> 554Z17 Employer etc to be treated as relevant third person etc
>
> (1) If B takes a step within section 554Z18 or 554Z19, Chapters 1 and 2 have effect in relation to the step—
>
> (a) as if B were a relevant third person for the purposes of section 554A(1)(d), and
>
> (b) as if the step were a relevant step within section 554B (if it would not otherwise be).

The busy draftsman then spends the next sections amending the already tortuous framework of 554A-Z to accommodate this new fiction. Perhaps the taxman has done his work well here. No sensible employer or employee would ever want to be party to anything which involves having to make sense of this fasciculus of distorted statutory provisions. If this legislation were a film, it would be The Amityville Horror at Somerset House.