The final score

DAVID GRAHAM reviews the Supreme Court's decision in Rangers Football Club and its possible implications.

The long-running dispute about the tax treatment of the Murray Group's funding of a remuneration trust for its employees has been resolved at the Supreme Court and on 5 July Lord Hodge delivered its judgment in favour of HMRC. The case was *RFC 2012 plc (in liquidation) (formerly The Rangers Football Club plc) (Appellant) v Advocate General for Scotland (Respondent) (Scotland)* [2017] UKSC 45 and the full decision can be found at tinyurl.com/k57pdts.

Although much will be written about the Supreme Court's decision reinforcing the grounds highlighted by the Inner House of the Court of Session, the latter's approach had sat uncomfortably with many commentators, albeit perhaps not as many seemed to disagree with the end result. Lord Hodge did at least seek to provide further detail on how the court had reached its decision but that, in turn, seems to have raised many more questions, some of which are beyond the scope of this article.

The Supreme Court identified some earlier judgments as support for its decision, others were distinguished and other cases were seen as having arrived at the wrong decision altogether. Time will tell, but this may prove to be a landmark decision in many important respects, but not necessarily in the way originally expected.

At the very least, the court concluded that the remuneration was indeed taxable as emoluments or earnings in these circumstances. Lord Hodge referred to existing legislation and case law as support for this decision and in so doing made several important points about how the courts should interpret legislation and the specific facts of cases in future.

KEY POINTS

- The Supreme Court finds in favour of HMRC on payments to employment benefit trusts.
- The definition of 'employee' within the subordinate legislation also proved persuasive.
- It was not necessary for an employee to receive remuneration for it to constitute emoluments.
- Could this concept result in a tax charge if the employee is not entitled to receive the money?
- How will this judgment influence other cases with equivalent arrangements?

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Background

Various entities within the Murray Group, including Rangers Football Club, paid funds through a remuneration trust from 2001 until 2009. Individuals borrowed money from the trust subject to a matching obligation to repay in the future. The intention was that payment through the trust in this manner would avoid liability to income tax and class 1 National Insurance contributions (NICs).

After HMRC assessed the companies to income tax and NICs on the amounts paid, various group entities appealed to the First-tier Tribunal. In 2012, the tribunal held that the arrangements were successful in avoiding any liability to income tax or NICs on the basis that the steps involved were not shams and the amounts transferred were merely loans to employees. In 2014, the Upper Tribunal upheld this decision because it could not identify any error of law in the original reasoning of the First-tier Tribunal.

However, the position changed in 2015 after HMRC appealed against the decision to the Inner House of the Court of Session. Here, for HMRC, the Advocate General for Scotland raised a new argument or at least a clearer version of an earlier one. This was that the payment of sums to the remuneration trust simply involved a redirection of an employee's earnings and this did not exclude those sums from tax. The Inner House agreed and allowed the appeal in 2015.

The Supreme Court

Of the group entities, only RFC 2012 plc (RFC) appealed to the Supreme Court and it was referred to alongside its previous incorporation, Rangers Football Club plc. The robustness of the arrangements was challenged and the Supreme Court took a critical view of some of the facts.

The fundamental issue for the court was whether an employee's remuneration was taxable as emoluments or earnings when it had been paid to a third party (here, the remuneration trust) but the employee had no previous entitlement to receive it.

Lord Hodge stated that the payment of money into the trust was part of the remuneration of the footballers and fellow employees. In relation to the footballers, their contracts and side letters referring to the remuneration trust were negotiated with employers on a net remuneration basis. Thereafter, the footballers could take loans from their sub-trust any time they wished, also recognising they would never have to repay the loans. Funds held in the sub-trust were available to their respective families and the individual employee could act as protector over their own personal sub-fund with powers to remove or replace trustees and beneficiaries as they deemed fit. Further, the Supreme Court concluded that the scheme relied on lax administration by the trustees without any evident intention to secure repayment.

Law

Although comments were made about the facts of the case, the court also delivered various points relating to the law in this area itself, in light of the decision reached by the Court of Session.

- *Emoluments.* During the first two years of the arrangements being in place, the relevant legislation was found in ICTA 1988, particularly s 19 which charged income tax under Schedule E on emoluments derived from any office or employment. 'Emoluments' were defined widely in ICTA 1988, s 131 as including 'all salaries, fees, wages, perquisites and profits whatsoever'. ICTA 1988, s 202B stated that income tax was chargeable on a receipts basis at the earlier of 'the time when payment is made of or on account of the emoluments' or 'the time when *a person* becomes entitled to payment of or on account of the emoluments' (emphasis added).
- *Earnings.* From 2003 – in other words, after the first two years of payments to the remuneration trust – ICTA 1988 was replaced by ITEPA 2003. Section 6 of that act charges tax on 'general earnings', according to the definition in ITEPA 2003, s 7 which refers to s 62. Section 62(2) states: 'Earnings in relation to an employment, means – (a) any salary, wages or fee … *(c) anything else that constitutes an emolument of the employment*.' Section 18 explains when earnings are treated as being received as at 'the earliest of … the time when payment is made of or on account of the earnings … the time when *a person* becomes entitled to payment of or on account of the earnings' (emphasis added).
- *National Insurance.* Liability to pay Class 1 NICs on earnings in respect of employment was governed by SSCBA 1992, s 6. Both parties agreed that the income tax determination would also govern the NICs position.

PAYE Regulations

The definition of 'employee' within the subordinate legislation also proved persuasive.

Before 2003, employers who paid emoluments that were chargeable to income tax were required to deduct the tax from their payments to their employees under the PAYE regime. ICTA 1988, s 203 provided for the deduction to be made under the Income Tax (Employments) Regulations SI 1993/744 on the payment of emoluments to the employee. This is treated as occurring at the earlier of 'the time when the payment is actually made' and 'the time when a person becomes entitled to the payment'. Regulation 2 defined 'employee' as 'any person in receipt of emoluments', not necessarily just the employee.

From 2003 onwards, the Income Tax (PAYE) Regulations SI 2003/2682 required the employer to deduct income tax on making 'a relevant payment to an employee' under reg 21. These regulations defined 'employee' more narrowly by reference to ITEPA 2003, s 4 and s 5, but they did allow for receipt by an 'other payee'. Under reg 2 this was treated as 'a person receiving relevant payments in a capacity other than employee' and reg 12 then deemed these 'other payees be treated as employees'. In other words, there were plenty of indicators in both sets of regulations that led the court to believe that the definition of 'employee' for these purposes may well also extend to other persons.

> ***"Before the Supreme Court, RFC argued that the Inner House had erred in applying the 'redirection principle' in these circumstances."***

Application

Before the Supreme Court, RFC argued that the Inner House had erred in applying the 'redirection principle' in these circumstances because it did not matter what the purpose of the payment was for (in other words, performance of the duties of an employment). Instead, there had been no payment of earnings (or emoluments) because the employee did not have a legal right to receive payment and therefore they could not have directed that these be paid to the trust. They relied on *Heaton v Bell* (1969) 46 TC 211, a House of Lords decision where entitlement on the part of the employee was seen as crucial.

Lord Hodge perceived both ICTA 1988, s 19 and ITEPA 2003, s 62 to contain the same concept in both 'emoluments' and 'earnings' that income tax should be charged on the remuneration an employer pays to its employee for their services.

The court went on to confirm that it could see no such argument in the legislation that required the employee to first receive or be entitled to receive the remuneration for it to constitute emoluments. In particular, there was nothing in either ICTA 1988, s 131 or ITEPA 2003, s 62 (other than s 62(2)(b)) that specified who the recipient needed to be. ICTA 1988, s 202A, which applies the receipts basis, is silent on who the recipient needs to be and s 202B simply refers to 'a person' without saying that person must also be an employee. ITEPA 2003, s 18, as highlighted above, treats earnings of money as received when a person (for example, a trustee) becomes entitled to payment.

Further, on the PAYE Regulations, the court drew support for the same approach because they could not identify anything in ITEPA 2003, s 686 or ICTA 1988, s 203, nor in the related subordinate legislation (see above), that required the employee to be the recipient.

Taking the wider purpose of the legislation, the court concluded that this concept was correct otherwise an employment contract could stipulate that remuneration going to the employee's Aunt Agatha may not be taxed if she were not herself an employee.

The Privy Council decision in *Hadlee v CIR* [1993] STC 294 was identified by the court in support of its approach. In that case, a partner in a New Zealand accountancy firm assigned a proportion of his partnership interest to a trust under which his family members were the main beneficiaries. The Privy Council held that income tax was a tax on income which was the product of the partner's work and services and this could not be avoided by assigning a partnership interest to a third party.

The Supreme Court applied the concept to conclude that any explicit or similar reference in the legislation to 'a payment to an employee' should be treated as including a payment to a third party regardless of whether the recipient was the employee, or in this case, a remuneration trust.

> *“The Supreme Court also decided that there had been ‘misplaced reliance’ in the case law in relation to the concept of ‘payment’.”*

On the face of it, this concept may widen what was previously thought to be the correct approach, particularly given the comments made by Lord Hodge about other remuneration-based cases that relied on 'gloss' rather than the correct principle (see the 'Payments' section below). In some circumstances, this concept may result in a charge to tax when the employee themself is not entitled to receive the money, although it is likely to require an analysis of the facts in each case. In this particular instance, the court formed the view that the tax charge could apply to payments made to trustees of a remuneration trust.

Lord Hodge referred to three key aspects of statutory interpretation which he felt important in reaching the conclusion:

- 'The tax code is not a seamless garment'. Provisions imposing specific tax charges do not necessarily prevent a more general tax charge taking priority.
- Attention must be paid to the statutory wording rather than relying on interpretations of the same wording already adopted in other factual contexts.
- The courts must adopt a purposive approach to interpreting the rules when analysing the factual context as stated by Lord Nicholls in *CIR v Scottish Provident Institution* [2005] STC 15.

Constraints

The rule the court arrived at may prove to have a very wide definition that could, on the face of it, question the treatment of some types of common arrangements, such as salary sacrifice schemes. However, Lord Hodge did acknowledge that, although this was a general rule, it should not follow that every payment made to a third party by an employer should be affected by this treatment. Although there may be more exceptions, Lord Hodge went on to name three situations that would be excluded from this rule, specifically:

- the taxation of perquisites since ITEPA 2003 was enacted;
- the use of money to give a benefit in kind that is not earnings; and
- arrangements by which the employer's payment provides a contingent interest for the employee, rather than an immediately vested beneficial interest (as was held to be the case for employees of RFC).

Lord Hodge referred to the third exception and stated this was consistent with *Forde and McHugh Ltd v HMRC* [2014] STC 724. Here, sums paid by an employer, other than out of an employee's salary, and which were to provide contingent benefits to an employee, did not fall within the charge to NICs (this case related to SSCBA 1992) before the contingency occurred and any payment was made. The alternative view expressed by HMRC would have entailed double taxation at both the contribution to the pension and the future payment of benefits.

Payment

The Supreme Court also decided that there had been 'misplaced reliance' in the case law leading up to the appeal in relation to the concept of 'payment'.

It referred to the interpretation taken by Walton J in *Garforth v Newsmith Stainless Ltd* [1979] STC 129. The judge said that 'payment' takes its colour from its context and as meaning 'money placed unreservedly at the disposal' as being both practical and sensible in the context of those circumstances. It also thought the same regarding the interpretation taken by the Inner House in *Aberdeen Asset Management plc v CRC* [2014] STC 438.

However, the court stated neither case had been faced with the argument that the Advocate General had raised here. Therefore, this should not lead to a general wider rule that a payment is made for the purposes of PAYE only if the money is paid to or placed unreservedly at the disposal of the employee.

Sempra Metals and *Dextra*

Lord Hodge expressed a view that *Sempra Metals Ltd v CRC* [2008] SSCD 1062 had been wrongly decided, referring to the same reasons as provided in this current judgment. This rationale was seemingly also applied in Lord Hodge's views on *Dextra Accessories Ltd v Macdonald (Inspector of Taxes)* [2005] STC 1111.

Lord Hodge disagreed with the special commissioners' decision that employees were not taxed on the funds held in the trust because they did not belong to them. He felt it sufficient that the special commissioners in that case had not been presented with the same arguments that HMRC had raised in the Court of Session in this case.

Summary finding

We can summarise the court's findings as follows:

- Income tax was due on the funds paid as a reward or remuneration for the exertions of the employee.
- Nothing in ICTA 1988, s 131 nor ITEPA 2003 (except for s 62(2)(b), see below) requires that the employee must themselves receive or be entitled to receive the remuneration.
- The PAYE regulations can be met by a payment to another person with the employee's agreement or acquiescence or by their arrangement.
- The specific rule in ITEPA 2003, s 62(2)(b) on gratuities, profits and incidental benefits applies only to such benefits.
- The cases referred to do not address the questions of the taxability of remuneration paid to a third party.
- *Hadlee v CIR* [1993] AC 524 supports the view reached by the Supreme Court.
- The Special Commissioners in *Sempra* and *Dextra* reached the wrong decision because they were faced with arguments that (wrongly) relied on the findings in *Garforth* helping to form a principle, rather than being applied only in the right set of circumstances.

What it means for the future

Other than the general view of the courts of late, it is unclear as to what extent the concept highlighted by Lord Hodge will apply to other arrangements, including those that are closely aligned to RFC's facts. Unsurprisingly, the latter are likely to be at least nearer the threshold but the question may remain as to the prospects for a case where the facts that were criticised in this case are not present.

The judgment picks up both findings of fact and findings of law, but does not seem to reach a clear conclusion as to the decisive factors. Perhaps a combination of the concept, the facts and the general landscape were enough. However, it is likely most stakeholders reviewing this judgment from the Supreme Court would not have expected to be left with as many questions as answers in trying to understand how this principle might apply.

It remains to be seen how this judgment will influence similar cases. No doubt, attention will be given to follower notices and their potential application particularly around the related penalty regime. The proposed rules requiring individuals who have loans outstanding to trusts to repay by April 2019 may also be subject to further scrutiny following this ruling.

Practitioners may simply take note of the case headlines and assume that all trusts or similar remuneration planning may be treated in the same way. While HMRC will see this as a victory, more widely the ruling revealed in the decision may prove problematic for advisers, HMRC and clients in the future, including in circumstances where the tax treatment was previously thought to be relatively well established.

A particular difficulty will concern what amounts to a contingency. Most beneficiaries of employee benefit trusts have only contingent rights. Does this mean they are not taxable? ■

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