For many employers, 2013 should be the year that they begin to make progress in dealing with the potential tax liabilities in respect of their employee benefit trust (EBT) arrangements.

That will mark a change from 2012, which was in most cases a ‘wait and see’ year in this regard. When not waiting for the publication of HMRC’s FAQs on the EBT Settlement Opportunity (EBTSO), employers and their advisers were trying to find out on what terms other settlements were being reached and speculating as to what the First-tier Tribunal’s decision in the Rangers case (Murray Group Holdings v HMRC [2012] UKFTT 692 (TC)) might be.

We have now had HMRC’s FAQs for nearly five months and, whether one agrees or disagrees with HMRC’s view of the law and its application, it cannot be denied that the document is helpful in explaining the parameters of the EBTSO. And as more and more negotiations near or reach settlement, those of us helping clients with EBT settlements are developing a better understanding of what is achievable in practice.

As for the tribunal’s decision in Murray Group Holdings, it is difficult to see that as much more than a red herring in the settlement context. The question for any employer looking at the possibility of settlement – will I be better off by choosing not to settle? – has not changed and the continuing threat of a disguised remuneration charge on the taking of any ‘relevant step’ means that for the majority the answer will not have changed either.

WHAT NEXT?

Most employers should therefore now find themselves well placed to decide whether settlement is, at least in principle, appropriate. And for many settlement will make good sense. Success in litigation will do nothing to mitigate the threat of a disguised remuneration charge on accessing trust funds in the future and will potentially be pyrrhic. The EBTSO, on the other hand, offers a disguised remuneration ‘credit’ (i.e. an agreement within paragraph 59(1)(d)(i) of Schedule 2 to Finance Act 2011 effectively to negate the disguised remuneration charge that would otherwise apply on the taking of a future relevant step) to those that settle, including in respect of years that are ‘out of time’. Litigants are also likely to face a more aggressive stance from HMRC on determining the amount of tax payable – not least when it comes to discovery – and may find it more difficult to recover sums held for the benefit of former employees who have left the UK.

But what should an employer deciding that settlement is appropriate do next?
The best first step towards settlement – once it has been decided that settlement is potentially desirable but before engaging in substantive discussions with HMRC – is to explore in depth the issues that will need to be resolved in order to get there. Doing so will not only help to make future discussions with HMRC more focussed and productive but also to give the employer a clearer view as to how negotiations are likely to pan out and potentially result in a smaller payment.

**HOW MUCH IS PAYABLE?**

This is the question that most employers are (justifiably) interested in above all others. The answer will typically turn on the extent to which beneficiaries are willing to participate. Whilst that will often be impossible to ascertain prior to beneficiaries being approached in that regard (as to which, see below), a necessary prior step is to calculate the maximum potential liability. That can be done at an early stage.

The FAQs make it clear that HMRC will expect to receive all of the PAYE income tax, NICs and interest that is ‘due’ in respect of periods that they have protected or are able to protect. The starting point in calculating an appropriate settlement sum is therefore to establish the periods that HMRC have managed to protect (and can be assumed to protect if they have not done so already). That will require not only going over the PAYE determinations, NIC decisions and NIC-related court claims that have been issued to date to determine which otherwise ‘closed’ periods remain ‘open’, but also thoroughly testing any such determinations, decisions or claims to ensure that HMRC’s position is in fact protected. Attention should be paid to, amongst other things, the person (e.g. specific group entity) in respect of which it was issued and any description of the purported liability.

The next step is to determine what was ‘paid’ to employees through the EBT in the protected period.

The point at which a tax charge can (on HMRC’s view of things) be said to have arisen (i.e. on contribution, allocation or some other event) can be significant in this regard. For example, where contributions or allocations were made in March or April, or material communications to beneficiaries were made separately to the actual making of allocations to them, there may be scope for debate as to whether or not the precise tax point fell within a protected year. Consideration should in any such case be given to how to argue and evidence the preferred timing.

Unfortunately, however, establishing what HMRC have ‘protected’ is by no means the end of the matter. A major attraction of the EBTSO is the opportunity to obtain a disguised remuneration ‘credit’ in respect of unprotected periods. But unless HMRC could have protected those periods but failed to do so, they will give a disguised remuneration credit only to the extent that the tax that (in their view) should have been paid for those period is paid voluntarily as part of the settlement – even though there is strictly no ‘liability’ in respect of ‘unprotected’ periods.

A significant part of any settlement preparations must therefore be to establish whether or not HMRC could have protected its position but failed to, which HMRC will accept to be the case in respect of 1999-2000 and later years where they were aware that allocations to sub-funds were being made (irrespective of whether the amounts allocated were ever disclosed). That requires collating all EBT-related correspondence between HMRC and the employer and its advisors and conducting a thorough review of that material. In the absence of written evidence pointing in either direction, interviews with personnel responsible for dealing with HMRC may be required.
HOW MUCH IS RECOVERABLE?

As noted, the process described above will help to determine the maximum amount payable on settlement. But the settlement amount will typically be limited to what is recoverable from beneficiaries.

That will depend first on what indemnity protection is available to the employer under the trust documentation. This will be a crucial question in any exploration of the possibility of a settlement. In the absence of an indemnity covering tax liabilities of the employer that arise as a result of contributions to or allocations by the trust, it will be difficult for an employer to recover its settlement costs – the trustee will be unlikely to pay voluntarily, given its duties to beneficiaries, and beneficiaries are unlikely to consent to their funds being applied in the employer’s favour.

Where an indemnity does exist it should be examined to ensure that the trustee (and thus beneficiaries) can be given a sound basis for using EBT funds to reimburse some or all of the employer’s costs. But attention should also be paid to the existence and terms of indemnities in respect of contributions made by the EBT trustee to other trusts, for example in relation to pension arrangements.

PRACTICALITIES OF SETTLEMENT

Recovery from beneficiaries will then turn on whether they wish to participate in the settlement and how much each of them will be asked to contribute. Appetite will be affected by a range of factors, including how much they have ‘trapped’ in the EBT (and thus the maximum that can be forceably recovered under the indemnity). It will be difficult for the employer to gauge this without disclosure by the trustee of the amounts held in trust funds and the cooperation of the trustee will be imperative.

It may be necessary for the employer to offer an incentive to beneficiaries in order to encourage them to fund the settlement and that can be achieved by the employer making its own contribution. However, care needs to be taken in that regard to avoid prejudicing the secondary NIC ‘gross down’ that HMRC are prepared to recognise where contributions were made subject to an indemnity covering secondary NICs. If, for example, the employer promises to make a contribution to the settlement in such a way that indicates that the indemnity for secondary NICs will be waived, HMRC are likely to regard that as conferring a taxable benefit on the beneficiaries.

Even where it is clear that some (if not all) beneficiaries will participate, it will then be necessary to decide on how much they should be asked to contribute. The employer has a range of options in this regard: spread the portion of the maximum amount attributable to those individuals evenly among them, so that each pays the same (the employees with funds falling in ‘protected’ years effectively enjoying a ‘discount’ funded by other beneficiaries wishing to take advantage of the disguised remuneration credit); make each person pay the tax ‘due’ on his own benefits (so that those with no funds falling in ‘protected’ years pay nothing); or negotiate contributions on a case-by-case basis. Which to choose will depend on (amongst other things) the employer’s relationship with beneficiaries and how beneficiaries’ funds are spread across protected and unprotected periods.

In particular, where there are beneficiaries with funds falling entirely in unprotected periods (and thus not strictly giving rise to any liable to income tax or NICs), the employer will have to give careful thought to whether and how to ask them effectively to subsidise beneficiaries with funds falling in protected years. That may come down to whether a disguised remuneration credit – arising because of the settlement of protected liabilities – can be presented as something to be paid for.
New points are likely to arise in the course of negotiating with HMRC, drafting a settlement agreement and communicating proposed settlement terms to beneficiaries. But identifying and analysing known issues – which will include ones in addition to those described above, such as corporation tax deductions and inheritance tax – in advance will give the employer a sound basis for approaching its CRM or HMRC’s central EBT settlement team with an informed proposal and a better chance of enjoying more focussed and productive settlement discussions.

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