Analysis

Boyle and contractor loan schemes

SPEED READ ***Boyle*** **was a First-tier Tribunal decision on a 'contractor loan' scheme of the kind currently being challenged by HMRC, in which an offshore company provided an individual's services to an end user for a commercial fee paid to the individual as a combination of salary and soft-currency loans. HMRC succeeded in arguing that the amount received by way of 'loan' was in fact taxable as employment income. An alternative argument that the arrangements were caught by the 'transfer of assets abroad' provisions was also upheld by the tribunal. An alternative argument that the arrangements were caught by the transfer of assets abroad' provisions at ICTA 1988 s 739 (now ITA 2007 s 720) was also upheld. The tribunal decision suggests that it is those provisions which are potentially relevant to a much broader range of 'contractor loan' schemes.**

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Contractor loan schemes have been promoted in different versions for many years. The details have varied, but all have involved individuals signing an employment contract with an offshore company, which then provides the individual's services to an 'end-user' for a commercial fee. The offshore company pays the individual a relatively small salary and delivers the remainder of the fee (minus the operator's charges, of course) in one of a number of supposedly tax-free ways, typically involving a loan. In September 2013, HMRC announced its general intention to challenge such schemes and recently the First-tier Tribunal handed down its decision in *Boyle* [2013] UKFTT 723 (TC). HMRC's description of the decision as one which 'comprehensively and robustly dismissed all the arguments put forward by an IT contractor to persuade them that his contractor loan tax avoidance scheme worked' is not wholly inaccurate; but there is much more to this case than meets the eye.

The facts

Put simply, Mr Boyle, an IT contractor of some years' standing, claimed to have become concerned that by continuing to operate through his own company he might fall foul of IR35, and was persuaded to sign up to a 'contractor loan' scheme operated by a Manx company called Sandfield Consultants Ltd (SCL). He became an employee of SCL, which in turn supplied his services to end users. He was paid a salary (on which PAYE was accounted for) equal to about one third of the income SCL derived from selling his services. The remainder of the income was, according to the documentation, loaned by SCL to Mr Boyle, the loans being made in the currencies of Romania, Belarus or Uzbekistan and repayable after one year. The loans were, immediately on being made, converted into sterling at spot rate and the proceeds transferred to Mr Boyle's bank account, net of the sterling cost of appropriate forward purchases of currency to meet the obligation to repay to SCL the capital of the foreign currency loan (together with interest at the official rate) one year later. The 'profit' on the loans (the difference between the sterling value of the initial loans and the sterling cost of repaying them) was claimed to be tax-free.

Three things in particular seem to have struck HMRC (and subsequently the tribunal) as questionable about the bona fides of the loan arrangements. First, the brokers through which the currencies were allegedly bought and sold appear to have been closely connected with SCL and to have had no customers other than SCL. Second, no evidence was produced to HMRC to show that the foreign currency ever existed or that the broker was a genuine dealer independent of SCL. Third, and perhaps most important, the forward rate did not correspond with any historical data or rates generally available in the market but always assumed that the currency in question would depreciate against sterling by between 76% and 78%; in other words the 'tax-free profit' enjoyed by Mr Boyle was always around 76% to 78% of the amount of the 'loan'. That figure matched the 'loan retention rate' quoted by the promoters of the scheme, the remaining 22% to 24% being in effect the cost to Mr Boyle of participating in the scheme.

The decision

The tribunal had no difficulty in holding that the financial benefit derived by Mr Boyle from the arrangement constituted a taxable emolument from the employment. Beyond that, exactly what the tribunal decided is somewhat obscure. Indeed, HMRC's case as reported in the published decision is also far from clear. Was it that the whole notion of loans should be swept aside and the sterling amount paid into Mr Boyle's bank account simply be treated as a payment of earnings? Or did the charge arise because loans had been made and (effectively) released?

It seems that HMRC's initial case had been that the loans should be ignored. Para 61 of the decision recites that: 'It was HMRC's primary case that Mr Boyle was personally liable under the employment income code for the tax that should have been charged on the full remuneration he received for his work for the UK businesses by way of the Scheme, and should have been subject to PAYE and national insurance.' However, at a late stage in the proceedings, Mr Boyle's advisers raised the argument that, if the payment should indeed have been subject to PAYE, Mr Boyle would have been entitled to credit for the tax which should have been deducted.

PAYE applies, of course, not to all emoluments but only to emoluments which are 'payments'; HMRC was thus forced to argue that, although the financial benefit which arose to Mr Boyle was an 'emolument', it did not give rise to a 'payment' for the purposes of PAYE. The part of the tribunal decision dealing with whether the arrangements involved a 'payment' is, frankly, confused and confusing. The tribunal asserted at para 101 that there were never any genuine loans, which one would have thought would inevitably lead to the conclusion that the amounts in question were 'payments'. Yet the tribunal also concluded (at para 112) that the moneys were not 'payments' subject to PAYE 'because [Mr Boyle] was under an obligation to repay the monies within a year'. It will be interesting to see what a higher court makes of this apparently novel class of receipts, which are not loans but which are nonetheless repayable.

However, this very unsatisfactory analysis as regards 'payments' is ultimately irrelevant (and just as well), since the tribunal also held that SCL had no UK tax presence and that PAYE was not for that reason applicable even if SCL had made 'payments'.

Section 739

It would be a very grave mistake to suppose that *Boyle* failed on badly-documented loans, the taxpayer's lack of credibility or 'an exchange rate which was manipulated', leaving contractor loan schemes which lack these characteristics untouched. In fact, by far the most interesting part of the case is in regard to ICTA 1988 s 739 (now ITA 2007 s 720) which, since it has nothing to do with loans (whether in sterling or soft currencies) or the operation of PAYE, is potentially relevant to a much broader range of contractor loan schemes.

As long ago as 1986, the application of s 739 to employment with offshore companies was considered in *CIR v Brackett* [1986] STC 521. Mr Brackett was a chartered surveyor who was short of cash. He established a Jersey trust which in turn established a Jersey-resident company, which employed him to provide his services to clients in the UK. The company paid him modest amounts of salary from time to time but most of the profits were used to assist him in other ways, notably by buying real property from him in a difficult market. HMRC successfully sought to assess Mr Brackett under the predecessor provision to s 739. The High Court agreed that entering into the contract of employment constituted a 'transfer of assets' from Mr Brackett to the company and that the trading profits arose to the company as a result of the transfer. Mr Brackett had 'power to enjoy' the income of the company and could not invoke the 'escape clause', so was liable to pay income tax on the company's profits.

HMRC asserted that the principles established in *Brackett* applied equally to Mr Boyle. By entering into the employment contract with SCL, Mr Boyle had made a 'transfer of assets' to a person abroad; as a result of the transfer, income (in the form of payment of fees for Mr Boyle's services) became payable to SCL. Mr Boyle palpably had the 'power to enjoy' that income, if only because he had as a matter of fact enjoyed a benefit (namely, the 'loans') which derived from the assets transferred. And, importantly, there was nothing in the transfer of assets code which would allow a credit for any tax which ought to have been deducted by the employer; the PAYE 'payments' argument was simply irrelevant.

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On the face of it, the s 739 argument is a knock-out blow. So what counterarguments were offered? First, that Mr Boyle had not transferred an asset abroad because his employment contract was initially with a UK company; second, that he had no 'power to enjoy' the income of SCL since he had no contractual entitlement to anything other than the salary; and, third, that the arrangements were genuine commercial transactions not designed to avoid tax. The tribunal pointed out that the first of these was factually untrue and rejected the second and third. Thus, even if the purported loans were not employment income and should properly be considered to be capital, they were nonetheless deemed to give rise to income by reason of s 739(3) (which brings into account 'all benefits which may at any time accrue to the individual irrespective of the nature or form of the benefits').

In principle, therefore, it seems that, although the s 739 point takes up in total less than a dozen of the 122 paragraphs of the case, it is s 739 more than anything else which holes *Boyle* and a number of broadly similar cases below the waterline.

Finally, it is interesting to note one further sidelight cast by *Brackett*, albeit on an aspect not before the tribunal in *Boyle*. It is fundamental to schemes of this kind that the offshore company should not itself have any liability to UK tax on its profits, for if the 'loan' has to be made out of post-tax profits, the numbers do not add up. But this point, too, was considered in *Brackett*. It was held that Mr Brackett did himself constitute a UK 'branch or agency' of the Jersey company through which it conducted its trade and that he was liable to tax in that capacity on its profits.

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Note: HMRC has published a 'spotlight' on contractor loan avoidance schemes following the decision in Boyle. See www.hmrc.gov.uk/avoidance/spotlights.htm.

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Cases: *Philip Boyle v HMRC* (11.12.13)

News: HMRC challenges contractor loan schemes (19.9.13)