HMRC hunt for contractors EBT tax avoidance

In recent years, HMRC have been actively engaged in hunting down and plugging the “loopholes” on many tax avoidance schemes. They are particularly interested in Employee Benefit Trusts (EBTs) because there appears to be trusts, which have either not been set up properly, in accordance with regulations and guidelines, and some that are being used to manage ‘Disguised Remuneration’.

An EBT is generally set up by a company as a benevolent fund and used to hold cash and other assets such as shares. The purpose of the trust is to provide employees with benefits and incentives. However, as a separate entity from the company, the existence of a trust means the company would pay less corporation tax due to the way they account for deductions to the trust. The trust could also offer interest free loans to employees, which in essence were contractual or set up in such a way as they would never be paid back.

HMRC have issues with such contractor loan practices especially when there is evidence that ‘Disguised Remuneration’ is, or has become, the sole purpose of the EBT. It has taken steps to recover taxes an NI at the corresponding PAYE rates for loans that have been received in this manner, which is having a devastating effect on those caught up in the scheme. Offshore trusts offer no protection against the powers of HMRC.

Muddy waters and wide ranging implications

Many top earners have already been ill advised into using EBTs as a means for paying less tax and may now face huge penalties. For example, a business owner might have been advised to pay themselves a huge bonus of £1 million for making their company a success. By receiving the payment transfer via an EBT they were led to believe they would not be liable to pay any tax or NI on the bonus. However, now they find they are liable to pay PAYE on the bonus, at the highest rate, plus personal NI and employer’s NI contributions. They are also likely to face financial penalties for tax avoidance.

For years the Government and HMRC have tried to curtail the actions and processes of EBTs only to create more complex legislation. In recent years attempts have been made to clarify and simplify procedures for the operation of EBTs culminating in elements of the 2016 Finance Bill. In the Bill, the disguised remuneration issue has been identified as having a value and therefore was liable to a tax charge. The anti-avoidance rule, which specifically targets schemes such as EBTs, makes it clear that from 2017 it will be extremely difficult for anyone to devise schemes, which allow for funds to be withdrawn from EBTs without triggering a PAYE liability.

Under proposals put forward by the government, any loans to beneficiaries, outstanding on 5th April 2019, will be liable to a PAYE charge on the full value of the loan, irrespective of when the loan was taken out. This has wide ranging implications for individuals who will more than likely be personally liable, rather than the company. There will no exceptions and HMRC have even taken to using innovative technology in order to track down individuals who may be planning to avoid detection or avoid paying any taxes due.

No hiding from HMRC's super software

'Connect' is the latest software developed specifically for HMRC, which is able to communicate with huge data banks and retrieve information on any individual. This advanced and highly effective program was first introduced in 2010, clawing back over £1.4 million in taxes a year later. The software searches for financial information such as business, income, assets and transactions linked to individuals, then looks deeper for any discrepancies. If found, the individual could be faced with a COP9 investigation.

A COP9 (Code of Practice) investigation often includes a thorough search of all financial transactions on the assumption that ta tax fraud has been committed. The investigation can lead to a criminal investigation with possibly lead to prosecution and serious financial penalties. There is little hope of concealment from HMRC's Connect program, which has literally far reaching capabilities. For example, anyone with undisclosed incomes from properties or businesses abroad can also be easily found and flagged up on the system.

HMRC can go back 20 years or more in their search for evidence of disguised remuneration, with their software programmed to seek out keywords such as 'benefit in kind', which suggests the individual probably had a tax free loan through an EBT scheme. There will then be subsequent checks to see if the benefit was declared on any tax returns. If it wasn't, then more penalties can be expected. HMRC have declared they want to impose penalties totalling 100% of the tax liability, which was avoided and that includes liabilities from off shore havens.

What to do now…

In a statement, the Financial Secretary to the Treasury, Jane Ellison said, "These tough new sanctions will make would-be enablers think twice and in turn reduce the number of schemes on the market." So, any advice received previously by financial advisors or accountants about EBT and tax avoidance schemes is now almost certainly redundant and in some cases, criminal. So what now for those caught up in the fallout?

Virtually all EBTs will close as a result of this new aggressive stance by the government and HMRC so the only options available to any entrepreneurs, who may have paid themselves huge bonuses, or any company directors who declared themselves contractors and reaped the benefits of such schemes, is to come clean. Trying to avoid detection is futile and will only make matters worse for those involved, and so it's better to seek professional help now rather than later.

Are there alternatives to paying up? Is there any way out? The simple answer is no. However, one thing individuals do have on their side is time. The new legislation doesn't come into effect until April 2019 so there is still time to consult with a specialist tax advisor and find out exactly what your options are. If you are a beneficiary of an EBT or similar trust such as FURBS or EFRBS, then best to think about seeking advice now.