UPDATE ON THE LOAN CHARGES

Ross Birkbeck[1]

1. What are the Loan Charges?

There are two loan charges, introduced by schedules 11 and 12 of Finance (No2) Act 2017.

- Schedule 11 is introduced by section 34: *"Employment income provided through third parties"* or the 'Employee Loan Charge' and fits into ITEPA Part 7A
- Schedule 12 is introduced by section 35: *"Trading income provided through third parties"* or the 'Self-Employed Loan Charge' and fits into ITTOIA Part 2
- The Self-Employed Loan Charge is much less known, and they are based on very different underlying charging provisions, but the provisions of the schedules themselves is very similar.

The effect of both is to charge the value of certain outstanding loans to income tax (and NICs) on 5 April 2019.

Gateways

Because the loan charges bolt on to existing legislation, it is necessary for that existing legislation to apply in the first place. Hence there are a number of gateways to the Charges:

- Re the Employee Loan Charge:
  - S554A ITEPA – 'the main case'
  - S554AA ITEPA – the new 'close companies' gateway (since 6 April 2018)
- Re the Self-Employed Loan Charge:
  - Section 23A ITTOIA

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2. Conditions

Where a Person (referred to as ‘P’) makes a “loan or quasi-loan” on or after 6 April 1999 and an amount is “outstanding” at 6 April 2019:

- P is treated as making a ‘relevant step’ for the purposes of the Part 7A ITEPA in the case of the Employee Loan Charge
- The loan is treated as a ‘relevant benefit’ for the purposes of sections 23A-23H ITTOIA in the case of the Self-Employed Loan Charge.

All these terms have defined meanings. In particular:

- “Loan or quasi-loan” captures all sorts of obligations other than loans.
- “outstanding” can include an amount that has been repaid if it was repaid not in money after 17 March 2016 (for Employee Loan Charge) or 5 December 2016 (for Self Employed Loan Charge).

3. Retrospectivity

The most glaring problem with the Loan Charges is that they are, to all intents and purposes, retrospective. As Ray McCann (now CIOT President) observed:

> *“[The loan charge] is unprecedented legislation ... From a personal viewpoint, I don’t believe it is retrospective in the conventional sense, but it has a retrospective effect. In reality, the retrospective effect actually displaces all the protections that taxpayers are given by Parliament in terms of getting certainty for their affairs of the past. We have a situation where even an individual who has disclosed the loan arrangement to HMRC will still nevertheless be caught in April for quite an extensive period back—say, to 2006 and 2007—and will have a very substantial liability in relation to that. ...*

The Revenue deny this: they claim that they tax a state of affairs on 5 April 2019. This is a highly technical position to take, and the Revenue’s defence of the loan charge belies it (see below). But it also highlights the way in which the Loan Charges are more retrospective than conventionally retrospective legislation, which would not overcome the procedural protections normally provided to taxpayers by way of time limits.

It is also notable that at the time the measures were proposed, retrospectivity was not denied. Treasury Minister David Gurke, at the committee stage of the Bill, stated:

> *“On the suggestion that the legislation is retrospective, the Government expect those who have avoided tax to pay their fair share. The Government intend to legislate for the new charge in Finance Bill 2017, following the*

consultation that I have just mentioned. The public and tax practitioners will be able to comment on that consultation."

4. Controversy

The Government estimates that up to 50,000 individuals will be affected by the charge[2]. Some estimate it could be twice this number[3].
Many are medium income workers in industries such as IT or healthcare, and many were signed onto the schemes after encouragement from tax advisors. In a large amount of cases, the employers (in the case of the Employee Loan Charge) are no longer around – the government estimates that 75% of the estimated amount is expected from employers and 25% from individuals[4].

Many, if not most, will be unable to repay the loans, and many of those will also be unable to pay the tax that will become due on 31 January 2020.

As a result, a great deal of hardship looks likely to be caused by the charges, with talk of bankruptcy, depression and suicide prevalent[5]. Indeed, in March 2019 HMRC reported itself to the IOPC in regard to an individual faced with the loan charge who had committed suicide. The IOPC has since instructed HMRC to investigate whether its behaviour towards the individual was appropriate.

5. House of Lords Economic Affairs Committee Report

As a result of this, interest in Parliament has been steadily growing, albeit from a very low base (when the measures were initially debated in Parliament in October 2017, they garnered only a few comments). It is cross party:

- Stephen Lloyd MP tabled an Early Day Motion on the loan charge on 8 May 2018, which has more than 100 signatures. It stated:

  "That this House expresses its concern at the 2019 Loan Charge; notes that it is retrospective applying back to 1999; further notes that as a result of the introduction of IR35, umbrella companies were set up and recommended by professional advisers and employment agencies; recognises that the Charge will affect contractors, freelancers and agency workers, including social

2 https://www.gov.uk/government/publications/disguised-remuneration-further-update/disguised-remuneration-further-update

3 Financial times – 'Living in the shadow of a tax scandal', 25 January 2019

4 https://www.parliament.uk/business/publications/written-questions-answers-statements/written-question/Commons/2018-10-30/185525/

5 *ibid*

workers, supply teachers and bank and locum nurses and doctors; notes that employment was not an option and in some cases the company or organisation insisted on those arrangements, including to avoid paying National Insurance; notes that these individuals did not receive sick or holiday pay; believes it is unfair that HM Revenue and Customs (HMRC) are pursuing people who acted in good faith rather than the client organisations, agencies or umbrella companies all of whom benefited significantly; notes that HMRC are aggressively pursuing individuals through Advanced Payment Notices with no independent right of appeal; further believes that the Charge is likely to cause financial distress and bankruptcies, impeding HMRC's ability to recover these tax liabilities and causing a devastating impact on people; believes that retrospectively taxing something that was technically allowed at the time, is unfair; calls on the Government to revise the legislation to avoid significant damage to independent contractors and freelancers in the UK; and calls for the Charge to apply only to disguised remuneration loans entered into after the Finance Act 2017 received Royal Assent"

- Steve Baker MP secured a Westminster Hall debate on the matter on 20 November 2018, in which more than 25 MPs from different parties raised concerns about the issue[6].
- Baroness Noakes and Baroness Kramer, both members of the Finance Bill Sub-Committee, raised the issue in the House of Lords on 13 November 2018[7]

On 4 December 2018 the House of Lords released the 4th Report of Session of 2017-2019 of the Economic Affairs Committee. It was highly critical of the loan charge noting:

"Many witnesses said they had joined these schemes without being aware of HMRC's attitude towards them. They were assured by their employers or promoters of the schemes that they were effective (sometimes with legal opinions) and that HMRC knew about the schemes and approved them. HMRC did not do enough to counter this misinformation. It used its "Spotlight" online guidance publications to make known its views, but this is little read, and one witness said these schemes were not mentioned there until as late as 2016. Some interpreted the fact that no action had been taken against these schemes, despite the fact that they may have been disclosed under the Disclosure of Tax Avoidance Scheme Rules (DOTAS), as evidence of HMRC acquiescence.

...

6 https://hansard.parliament.uk/commons/2018-11-20/debates/18112060000001/2019LoanCharge

7 Hansard/Lords debate/2018-11-13/Economy: Budget statement/Vol793/Col1854

> *The charge was also considered to be retrospective in its effect, because in many cases the tax years it relates to are closed. In normal circumstances HMRC would be unable to reopen these tax years if they could not prove failure to take reasonable care (to go back six years) or fraud (to go back 20 years). The loan charge triggers a charge in 2019/20 on the cumulative loan value advanced since April 1999 and not repaid by April 2019. Witnesses said that no additional income was generated to pay that tax and the whole liability falls in a single year ensuring that much of the tax is payable at higher rates."*

It concluded:

> *"The individuals affected by the loan charge who gave evidence to this inquiry are very different from those generally perceived to be involved in tax avoidance. While they must accept some responsibility, they are not as culpable as those who are much better off, extensively advised and whose involvement in such schemes may be regarded as more egregious. In many circumstances, individuals were being directed to use these schemes by their employer, who would have been in a better position to determine the consequences for the employee of taking a loan. It is unfortunate that the loan charge does not discriminate for different intents and circumstances.*
> *…*
>
> *The loan charge is, however, retrospective in its effect. Parliament has laid downtime limits for tax matters of four,six and 20 years which give certainty to taxpayers about their affairs. It undermines this framework to artificially trigger a future charge.*
>
> *In its retrospective effect, and its failure to pursue taxpayers proportionately to their circumstances, HMRC's approach to the loan charge diverges substantially from the principles in the Powers Review.*
>
> *We recommend that the loan charge legislation is amended to exclude from the charge loans made in years where taxpayers disclosed their participation in these schemes to HMRC or which would otherwise have been "closed".*
>
> *We were disturbed to hear accounts of HMRC threatening individuals with arrangements that could result in bankruptcy, where individuals clearly have no assets to settle liabilities. Whether these threats were explicit or perceived, they have caused considerable anguish for a number of individuals.*
>
> *We recommend HMRC urgently reviews all loan charge cases where the only remaining consideration is the individual's ability to pay."*

6. HMRC's Response

The Revenue published a response to the House of Lords report on 22 January 2019, and unsurprisingly, rejected almost all of the recommendations (they did agree to better publicise their actions, and to set up a dedicated helpline).

The odd thing about the response is the way it emphasises the Revenue's position that the kind of planning that the loan charge catches never worked.

> *"In reality, these contrived avoidance schemes disguise income as a loan and, as recognised in the report, that loan is never repaid, so it is no different to normal income. It is, and always has been, taxable. HMRC's view, supported by a number of court successes, is that these schemes have never been effective."*

They cite the Rangers case *(RFC 2012 Plc v Advocate General for Scotland* [2017] UKSC 45*)* in support of this. The argument is odd because it makes the retrospectivity even worse: they are arguing that the Loan Charges are in order because they are only needed to correct a failure of HMRC to collect the right amount of tax in time.

Settlement.

The ability to settle the liability under the Loan Charges has been a long running defence against many criticisms of the Loan Charge.

On 30 January the Treasury Committee held a further evidence session on tax enquiries with HMRC officials, in which the Settlement Opportunity was discussed. Mary Aiston (Director, Counter-Avoidance at HMRC) announced an extension in the time limits for taxpayers to pay:

> *"we have already said that if somebody is currently earning, say, less than £50,000 a year, they can have up to five years to settle their disguised remuneration without going into any more detail about their income and expenses. I can also now add to that and say that where people's current income is less than £30,000, they can have seven years to settle their bill if they need it, without questions asked. I would stress that where that does not meet people circumstances, we can discuss other options."*

She confirmed as policy that HMRC will not make anyone sell their homes to pay the loan charge, and set out the limited circumstances in which HMRC might pursue insolvency:

> *"HMRC is not going to make people sell their homes to pay their disguised remuneration tax bills. We will explore with people what the best way is and what the right timeframe is. It is possible that, for some people, we might say, "You need to take a loan out if you have equity in your property," if that is the right answer and people can manage the repayments. We might sometimes*

> *put a charge on somebody's property. However, we will not make people sell their homes to pay their disguised remuneration tax bills.*
>
> *...*
>
> *insolvency is very much a last resort. There are only two circumstances where we would pursue that as a route for taxpayers such as the ones you have described. The first one is that we would consider insolvency where people already have a tax debt that they cannot manage and are carrying out some sort of activity that means that the problem is only going to get bigger and bigger and therefore worse for them and worse for us ... That is not likely to apply to this group of customers, and the reason for that is because settling your disguised remuneration, or indeed paying a loan charge, is a one-off tax bill ...The other reason why we would ever consider insolvency is that, in any group of customers, the vast majority are wanting to sort things out and they are talking to us because they want to pay. There may well be a tiny, small minority who are determined not to. In those circumstances, we feel it is right that we retain the right to consider insolvency out of fairness to the people who are trying to settle."*

This may offer some comfort.

7. Judicial Review Proceedings against HMRC

Robert Venables QC and I have been instructed in two sets of judicial review proceedings which were filed in December – one for the Employee Loan Charge and one for the Self-Employed Loan Charge.

They are funded by the Loan Charge Action Group – a body of persons set up as awareness of the loan charges grew to take political action in response. They are not, however, class actions.

They face a major hurdle: the Loan Charges are primary legislation, and Parliament is sovereign. The Court's cannot strike down primary legislation in the UK.

So instead, the judicial reviews seek two things:

- A declaration that the Charges are incompatible with the Human Rights Act. This will be of purely political importance under article 4 HRA.
- A declaration that the Revenue cannot enforce the Loan Charges, because they are incompatible with the Human Rights Act, under article 6 HRA. This is a more powerful legal remedy.

Current status of the reviews

The applications for judicial review are currently in the permission stage.
HMRC are predictably fighting permission to bring the proceedings on every technical point they can, despite the obvious public importance of the case. They are also, as ever, dragging their heals whilst the taxpayers sweat.

Timetable

It is hoped that a result will be obtained from the High Court before the filing deadline for loan charge information on 1 October 2019. However this is far from certain.

A result is expected, however, before 31 January 2020, when the payments of tax are due.

8. Effect of addition of Section 95 to Finance Act 2018

On 8 January a non-government amendment was passed in respect of the Loan Charge.

One report excitedly exclaimed

> *"Victory for LCAG! Supportive MPs force Government to concede review on Loan Charge!*
>
> *In our first News Release of 2019, we were able to announce the effective unenforceability of the 2019 Loan Charge.*
>
> *Now the 2019 Loan Charge is about to be consigned to the HMRC rubbish bin."*

This is nonsense.

The amendment, which added what is now section 95 of the Finance Act 2019 to the Bill, actually merely required the government to conduct a review of time limits in regard to offshore matters, and to consider the Loan Charges whilst doing so:

> "***95***
>
> ***Review of changes made by sections 80 and 81***
>
> *(1) The Chancellor of the Exchequer must review the effects of the changes made by sections 80 and 81 to TMA 1970 and IHTA 1984, and lay a report on that review before the House of Commons not later than 30 March 2019.*
>
> *(2) The review under this section must include a comparison of the time limit on proceedings for the recovery of lost tax that involves an*

offshore matter with other time limits on proceedings for the recovery of lost tax, including, but not limited to, those provided for by Schedules 11 and 12 to the F(No. 2)A 2017.

(3) The review under this section must also consider the extent to which provisions equivalent to section 36A(7)(b) of TMA 1970 (relating to reasonable expectations) apply to the application of other time limits.

Sections 80 and 81 deal with the insertion of s36A into TMA 1970 — which adds the 12 year time limit for offshore matters — and a similar 240B into IHTA 1984.

So although it is notable that almost all the discussion of this new clause in the Commons was focussed around the unfairness of the Loan Charge, the amendment was a long way away from repealing, or even proposing a repeal of, the Charges.

9. Further action by Parliament.

MP Sir Edward Davey's All Party Parliamentary Loan Charge group continues to press the issue on behalf of those affected by the charge. In April they published a report which dammed it and recommended amongst other things

(i) An urgent 6-month delay and suspension of the Loan Charge

(ii) That the loan charge be removed for years that would otherwise be closed to HMRC

On the 4 April the House of Commons debated a motion moved by Conservative MP Ross Thomson which among other things called for an immediate suspension of the loan charge for a period of six months, for all related settlements to be put on hold and for an independent inquiry into the Loan Charge to be conducted by a party that is not connected with either the Government or HMRC.

The motion was carried, and included a statement that the House "*believes that the Loan Charge is fundamentally unfair and undermines the principle of the rule of law"* but the government can ignore it and appear to have chosen to do so.

10. What should taxpayers do?

With the 5 April deadline now passed, taxpayers who have been caught by it have few options:

- Pay the tax

This is the simplest option, if it is possible.

- Settle with the Revenue

  Although there was initially a deadline for settlement, HMRC are now saying they will continue to accept people who come forward for settlement.

  With continued parliamentary pressure in relation to the charge, it is likely that they will continue to offer decent terms to those who are struggling to pay.

  Settlement seems also to be sometimes done on the basis of the payments being emoluments when paid, and taxed as such, which can result in significant CT rebates as part of the settlement calculations. This can mitigate the charge significantly if the company is employee owned (although interest will also be payable).

  As with paying the charge, one of the problems with this is that the loan remains in the EBT. And if you try to wind up the Trust as part of the settlement HMRC do not seem amenable to ignoring any IHT that they think is also chargeable!