Written evidence submitted by the Tax Faculty of the Institute of Chartered Accountants in England and Wales (ICAEW) (FB 02)

Finance Bill 2017-19 cl 34-35 & Schs 11-12: Employment income and trading income provided through third parties, alias disguised remuneration loan charge

Submission by ICAEW on 20 September 2017 to House of Commons Public Bill Committee in response to invitation dated 14 September 2017 to "have your say"

WHO WE ARE

1. Please see Appendix 1.

SUMMARY OF THE MEASURE

2. Clauses 34 & 35 and Schedules 11 & 12 in Finance Bill 2017-19 published on 8 September 2017 at http://services.parliament.uk/bills/2017-19/finance.html introduce new charges on outstanding loans from disguised remuneration (DR) schemes. The charges apply to the total amount of DR loans made to employees and traders after 5 April 1999 that are outstanding on 5 April 2019. Affected employees and traders will be chargeable at their marginal tax rates in 2018/19 on the value of all outstanding loans.

3. The policy was outlined in the Government's 5 December 2016 policy papers, for employees at https://www.gov.uk/government/publications/tackling-disguised-remuneration-update/tackling-disguised-remuneration-update and for traders at https://www.gov.uk/government/publications/disguised-remuneration-self-employed-schemes/disguised-remuneration-self-employed-schemes.

4. (Additional draft legislation relating to the loan charge comprising information requirements for employees was published on 13 September 2017 at https://www.gov.uk/government/publications/draft-legislation-tackling-disguised-remuneration-avoidance-schemes.)

FAIRNESS AND PROPORTIONALITY

Our concerns

5. We support the underlying policy of countering tax avoidance but we are concerned about the potential hardship that this measure will cause in certain cases, including some who were misled into using these schemes.

6. The exchequer need to recover tax lost needs to be balanced with legitimate expectations, and introducing a charge on transactions entered into up to 20 years ago which potentially could result in taxpayers becoming insolvent (as described in the policy papers referred to above) may not only leave the Government vulnerable to challenge under human rights law but actually reduce the tax yield.

7. Some people using DR schemes knew exactly what they were doing and were deliberately avoiding tax: they deserve little or no sympathy. In fact HMRC should have acted far sooner against these schemes. However, not all taxpayers are in this position. Unfortunately, many others were misled about the arrangements and would not have appreciated what they were doing: in their case, while their position needs to be regularised and tax paid, we think that they should not be so heavily penalised. Between these two extremes were employees and traders who were presented with the schemes by employers and agencies as a fait accompli and who, if they understood the explanations that they were given, if any, were, in practical terms, not given a choice if they wanted the work.

8. Workers such as nurses, teachers, IT workers, cleaners, etc, were often paid earnings at around national minimum wage with the balance via loan arrangements. Such users may even have been uneasy about receiving loans rather than pay in return for their services but, in a similar manner to the victims of earlier pensions and payment protection insurance miss-selling, assumed that their employers or agencies who were putting them into the arrangements were acting within the law and accepted the advice that they were given. Those who had doubts may well have assumed that HMRC (or the former Inland Revenue) would step in to regularise the position before too long.

9. Following the judgment in the *Rangers* Supreme Court case (RFC 2012 plc (in liquidation) formerly The Rangers Football Club plc) v AG for Scotland), it is now beyond doubt that employees and contractors in DR loan schemes were avoiding tax. We welcome this certainty. What is disappointing is that it has taken nearly twenty years to take decisive action to counter these schemes and those who perpetrated them.

10. Our members report HMRC using unreasonable estimates to quantify loan balances subject to tax – multiples of 6-8 times salary have been cited even when evidence suggests lower figures. We would have thought that relying on estimates should be unnecessary for employees given that loan balances would have been reported to HMRC on forms P11D.

11. The size of the potential tax liabilities facing loan scheme users may well make those subject to the new charge bankrupt. For some this may be a necessary outcome but not for everyone. Making DR scheme users bankrupt will mean that little or no tax will be collected from these individuals, and bankruptcies have social impacts that draw on social security and NHS resources. We believe that HMRC is likely to collect more tax if it adopts, in appropriate cases, a sympathetic and flexible approach to resolving the taxpayers' affairs, and allows time-to-pay arrangements that are substantially longer than normal.

Recommendations

Bunching of loans into a single year

12. We consider that it would be equitable if the tax collected under the loan charge broadly reflects the tax that would have been paid had the loans been treated as earnings at the time. We also recognise that, on the basis that the loans were earnings, the exchequer has been out of pocket.

13. If one considers a trader in receipt of these loan arrangements who would have been subject to basic rate tax across a number of years, it appears inequitable to seek tax at the higher or additional rates as a result of deeming all of the earnings to arise in a single year.

14. One way of making the tax charge proportionate would be to cap the tax recovered under the loan charge at the amount of tax that would have been due had the loan constituted earnings for the tax year in which it was made, plus any interest that would have been charged on late paid tax on those earnings.

15. As an alternative, we suggest that, as a simple albeit rough and ready mechanism to achieve fairness, in calculating the tax charge the loans should be top-sliced over the number of years over which they were granted and the tax charge be limited to tax chargeable on these sums plus an amount representing interest on late paid tax that would have been due had the top-sliced loans been treated as earnings at the time. (For example, loans granted over four years, add the loans together, divide by four, calculate the tax at marginal rates on the one fourth figure and multiply the outcome by four. To calculate the additional amount representing interest on late paid tax, allocate the one fourth figure to the four tax years in which the loans were granted and calculate notional interest from 5 April in those years to 5 April 2019 or when the tax is settled if earlier.)

Ability to pay

16. We recommend that, where those on whom a charge is imposed do not have the means to pay, HMRC should agree with those liable to the loan charge a reasonable amount of time in which to pay rather than being subject to bankruptcy. We believe this would increase the yield for the exchequer.

17. We should welcome a ministerial assurance to this effect.

Suggested legislative amendments to achieve the above

Bunching of loans into a single year

18. Either – if loan charge is to be capped by reference to tax that would have been payable had loans been taxed as earnings when loans made:

Page 534: add new sub-paragraph at the end of paragraph 1 of Schedule 11:

> "Income tax levied as a consequence of this schedule applying shall not exceed the amount that would have been payable had the loan or quasi-loan constituted earnings under section 62, plus interest as if section 101 of the Finance Act 2009 had applied to late payment of tax on those earnings."

Page 553: add new sub-paragraph at the end of paragraph 1 of Schedule 12:

> "Income tax levied as a consequence of this schedule applying shall not exceed the amount that would have been payable had the loan or quasi-loan constituted earnings under

section 5, plus interest as if section 101 of the Finance Act 2009 had applied to late payment of tax on those earnings."

19. Or – if loan charge is to be top sliced: (*based on s.536 ITTOIA*)

Page 534: add new sub-paragraph at the end of paragraph 1 of Schedules 11:

"Income tax levied as a consequence of this schedule applying shall be calculated as follows:

Step 1
Find the annual equivalent of the amount of the loan charge by dividing the total amount of loans or quasi-loans by the number of tax years in which they were granted ("N").
Step 2
Find the relieved liability on the annual equivalent by calculating the individual's liability to income tax on the annual equivalent on the basis that –

(a) The loan is limited to the annual equivalent
and
(b) The highest part assumptions in section 535(4) ITTOIA 2005 apply.

Step 3
Multiply the annual equivalent by N.
Step 4
Add interest as if the relieved liability on the annual equivalent had constituted earnings under section 62 for the years in which the loans or quasi loans were granted as if section 101 of the Finance Act 2009 had applied to late payment of tax on those annual equivalents

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APPENDIX 1

ICAEW TAX FACULTY – WHO WE ARE

ICAEW Tax Faculty is internationally recognised as a source of expertise and is a leading authority on taxation. It is responsible for making submissions to tax authorities on behalf of ICAEW and does this with support from over 130 volunteers, many of whom are well-known names in the tax world.

ICAEW is a world-leading professional accountancy body. We operate under a Royal Charter, working in the public interest. ICAEW's regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the UK Financial Reporting Council. We provide leadership and practical support to over 147,000 member chartered accountants in more than 160 countries, working with governments, regulators and industry in order to ensure that the highest standards are maintained.

ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value ICAEW is a world-leading professional accountancy body. We operate under a Royal Charter, working in the public interest. ICAEW's regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the UK Financial Reporting Council. We provide leadership and practical support to over 147,000 member chartered accountants in more than 160 countries, working with governments, regulators and industry in order to ensure that the highest standards are maintained.

September 2017