Enterprise Tax Consultants

Evidence to the Committee, Finance Bill 2017:

Executive summary:

<u>About Enterprise Tax Consultants[1] ("ETC")</u>

1. ETC are a firm of tax advisers who advise across the all aspects of UK taxation for clients based in the UK and overseas. All advisers are Chartered Tax Advisers, members of STEP and / or qualified lawyers. ETC does not, and never has, advised on the creation of the types of 'disguised remuneration' devices which form the subject matter of this submission.

2. The main contributor to this submission is Andy Wood, who is a Chartered Tax Adviser and Trust & Estate Practitioner. He trained in tax at Ernst & Young and PriceWaterhouseCoopers and founded his own business six and a half years ago.

3. This note concerns the proposed *Schedule 11 of Finance Bill (HL 102) 2017*. Hereafter referred to as the April 2019 Loan Charge.

4. It is easy to sit back and let these proposals become law. There is little to be gained from supporting those who, in the eyes of the public and press, have not paid their 'fair share' of tax. There is no currency in being an apologist for tax avoidance.

5. However, Parliament should be concerned of the serious financial impact of these proposed measures which impose what itself is a retrospective tax but will also, when combined with anticipated revisions to PAYE Regulations, will also pierce the corporate veil.

6. In summary, these provisions are of serious concern as they are:

<u>Retrospective</u>:

a. By definition, these rules are retrospective. **[*Para 54 et seq*]** This is because, the April 2019 loan charge 'imposes (or increases) a tax charge on income earned, gains realised or transactions concluded at a time <u>before</u> the legislation was announced.

b. Our view is that these provisions are not 'wholly exceptional' and therefore are not consistent with the *Protocol on Unscheduled Announcement of Changes to Tax Law [**Para 70 et seq**]*

---

[1] www.enterprisetax.co.uk

Cheshire Office
3 Bridgewater Court, Barsbank Lane,
Lymm, Cheshire, WA13 0ER
+44 (0)1925 363 006

London Office
No. 1 Royal Exchange,
London, EC3V 3DG
+44 (0)20 3705 8320

Contact Details
info@enterprisetax.co.uk
www.enterprisetax.co.uk
@enterprisetax

Enterprise Tax Consultants is the trading name for Enterprise Tax Consultants Limited, a company registered in England and Wales with company number 8783235 whose registered office address is at 3 Bridgewater Court, Barsbank Lane, Cheshire, WA13 0ER. VAT registration number: 175 1528 05.

Chartered Tax Advisers
STEP ADVISING FAMILIES ACROSS GENERATIONS ANDREW WOOD SHARON COLLIER
EOA EMPLOYEE OWNERSHIP ASSOCIATION BETTER BUSINESS TOGETHER

c. The provisions are not consistent with the *European Convention of Human Rights (Article 1 of the First Protocol*) as introduced by the *Human Rights Act 1998* on the basis that they do not strike an appropriate balance between affected taxpayers and the general public. [***Para 84 et seq***]

<u>Transfer of potential liability from Employer to Employee:</u>

d. The PAYE Regulations currently, and quite rightly, provide limited circumstances in which a PAYE liability can be transferred from the Employer to the Employee. This is wholly consistent with the fundamental principle of limited liability and the corporate veil. [***Para 47 et seq***]

e. However, HMRC in consultation documents has set out its aim to be able to transfer such liabilities to the Employee if they have been involved in a disguised remuneration scheme and they Employer is not in a position to pay;

f. It is fully anticipated that, to make full use of the April 2019 provision, this will also apply to tax liabilities that have only accrued as a result of the retrospective charge.

g. This is a rather obscene proposal. What if a business used an EBT from 1999 to 2003. The proprietor stopped. He then decided to retire and close the business in 2006. Under the law at that time there was no PAYE liability. However, now, over a decade in to retirement he may have to pay tax on this due to a retrospective change in law. How can that be correct? If you agree that this does not seem right then how and where does one draw the line?

h. The PAYE Regulations are a Statutory Instrument and can therefore be amended without Parliamentary scrutiny. For a provision that will in effect pierce the corporate veil this should not be done via delegated legislation

<u>The tax position of loans up to Finance Act 2011 was settled</u>

i. The case of Dextra Accessories and the resulting legislation clarified the position regarding the corporation tax position for contributions to EBTs and similar structures. It set out that, broadly, no corporation tax (CT) deduction was available until such time as the employee received a Qualifying Benefit. [***Para 26 et seq***]

j. Interestingly, the corporation tax legislation accommodates the fact that a loan is not subject to PAYE as it is specifically excluded from being a Qualifying Benefit. IN other words, as it is recognised it will not suffer a PAYE charge it cannot get a CT deduction.

k. This position (no CT deduction but no tax charge on the principal of the loan), with one exception, is the same for an Employer making a direct loan to its Employee. A direct loan is not within Part 7A. What is the case for the treating a loan from an EBT as subject to PAYE whereas the same loan made direct from an Employer is not?

l. The one exception is where the loan is made to a Participator (i.e. shareholder in the Company). In these circumstances, a Company making a direct loan to a Participator suffers a temporary CT charge if the loan remains outstanding after the expiration of 9 months following the end of the accounting period in which it is taken out. This does not apply to EBT (and similar loans). Perhaps there is a case to bring in this 'loan to participator' charge for EBT loans instead?

m. HMRC has failed many times in Court with the argument that a loan is subject to PAYE (*Dextra, Sempra* and also in the *Rangers* decisions)

n. HMRC Manuals still recognise the position that a loan, pre FA2011, is not subject to PAYE. [***Para 25***]

<u>Part 7A of ITEPA 2003</u>

o. The law was changed in Finance Act 2011 (which had partial effect from December 2010) which explicitly rejected the tax treatment set out above in relation to loans and decided that, where a third party (eg EBT Trustee) took a relevant step (eg made a loan) then this would be subject to PAYE. [***Para 29***]

p. These were clearly a change of the law. As such, no provisions acting retrospectively beyond this time can be considered proportionate.

q. There were no attempts to introduce retrospective measures at this time. These rules only affected relevant steps such as loans after the commencement date. It seems beyond the realms of fairness for the Government to once again revisit this type of arrangement and then, at the second time, introduce retrospective measures half a decade later.

<u>The *Rangers* decision and existing legislation:</u>

r. The recent *Rangers* decision in the Supreme Court affords HMRC an opportunity to remedy historic 'disguised remuneration' cases. It does not need new powers.

s. HMRC should be compelled to use existing laws – including Follower Notices and GAAR – to collect tax rather than obtaining retrospective powers further skewing the balance of power in HMRC's favour.

Cheshire Office
3 Bridgewater Court, Barsbank Lane,
Lymm, Cheshire, WA13 0ER
+44 (0)1925 363 006

London Office
No. 1 Royal Exchange,
London, EC3V 3DG
+44 (0)20 3705 8320

Contact Details
info@enterprisetax.co.uk
www.enterprisetax.co.uk
@enterprisetax

If you have any queries then please do not hesitate to let us know.

Detailed analysis:

What is disguised remuneration?

7. Of course, where a Company pays salary or a bonus to an employee then that is subject to income tax and NICs through the PAYE system. The Company will also generally receive a corporation tax deduction for the payment on the assumption that the funds paid were wholly and exclusively for the purposes of the trade (which would usually be the case) and assuming other conditions are satisfied.

8. However, for many years, devices have been used to provide reward and incentives to employees. Clearly, tax has been a key driver, even if other factors may also be in play.

9. One such device was the Employee Benefit Trust ("EBT"), which were prolific devices through the 90's and the 00's and were used by all types of businesses.

10. It usually involved the business contributing funds to a Trustee who held the money or assets for the benefit of the employees and perhaps their relatives.

11. The Trustee would have discretion to provide certain benefits to the employee and / or his or her family. The contribution would receive a corporation tax deduction but, certainly prior to the *Rangers*[2] decision which turned received wisdom on its head, because the funds were not put unreservedly at the disposal of the individual (ie they hadn't got the use of the money) there was no income tax / NIC charge on the payment.

12. Subsequently, the Trustees may then have made a loan to the employee. A genuine loan made to an employee being capital in their hands and not subject to income tax and NICs as earnings. Where interest was not paid then there might be a benefit in kind charge payable.

13. Similarly, contractors have for many years used similar schemes where the fee paid by the end user for their services was paid to an intermediary. In turn, they usually receive a small salary or consultancy fee from the entity with the balance being paid in loans. Such a scheme might also provide additional considerations such as whether the agency, IR35 and Managed Service Company rules applied. These provisions are outside the scope of this article.

Corporation tax – *Dextra Accessories*[3] and legislative amendments

14. The old Schedule E, which in pre-*ITEPA 2003* times dealt with income from employment, changed several decades ago from an earnings basis of taxation to a receipts basis. As such, *FA 1989, s 43* was

---

[2] *RFC 2012 Plc (in liquidation) (formerly The Rangers Football Club Plc) (Appellant) v Advocate General for Scotland (Respondent) (Scotland)*

[3] *Dextra Accessories Ltd v Macdonald (Inspector of Taxes) [2002] STC (SCD) 413*

Cheshire Office
3 Bridgewater Court, Barsbank Lane,
Lymm, Cheshire, WA13 0ER
+44 (0)1925 363 006

London Office
No. 1 Royal Exchange,
London, EC3V 3DG
+44 (0)20 3705 8320

Contact Details
info@enterprisetax.co.uk
www.enterprisetax.co.uk
@enterprisetax

introduced to smooth out any timing differences between the year in which the employer could receive a deduction for payments and the employee was taxable on the receipt.

15. If, following the introduction of these provisions, the accrued remuneration (technically called 'relevant emoluments') was not paid within 9 months of the end of the accounting period in which it accrued, the new provisions meant that the associated corporation tax deduction would only arise in a year in which it was paid. This applied to 'potential emoluments' which were defined as 'amounts or benefits … *held by an intermediary [eg EBT Trustee]*, with a view to [them] becoming relevant emoluments'.

16. The implications of this legislation were discussed in the various instalments of *Dextra Accessories.* At first instance, in September 2003, it was found that contributions to an EBT were not 'potential emoluments' and therefore a corporation tax deduction was available immediately.

17. For obvious reasons, this decision set a hare racing. The law was changed mid appeal by the introduction of *Schedule 24 to the Finance Act 2003*. This provided that payments made by an employer 'to another person to use for the provision of benefits to employees' under a 'trust, scheme or other arrangement for the benefit of persons who… include… employees' are not deductible when they are made, *unless they gave rise to an employment income tax charge and a liability to pay National Insurance*.

18. However, the earlier ruling was overturned by the House of Lords (now the Supreme Court) who decided that a contribution to an EBT <u>was</u> a potential emolument if there was a realistic possibility that the sum may be used to pay emoluments.

19. That said, certain wheezes continued to operate under those new rules (*Schedule 24* which, together with *s43*, ultimately became *CTA 2009, s1288* et seq).

20. In summary, the legislation seeks to achieve a tax symmetry such that a Company making the contribution to the EBT could only receive a corporation tax relief as and when the EBT made a payment that gave rise to an income tax and NIC charge. Such a payment being termed a 'qualifying benefit' in the legislation.

21. It is interesting that the definition 'qualifying benefit' explicitly excludes loans. Why would this be the case? Could it be because the Government and HMRC believed that a loan from an EBT was not subject to tax like other 'qualifying benefits'? In other words, no income tax means no corporation tax deduction.

22. We turn to that point next.

<u>The taxation of loans</u>

23. Despite ultimate success (eventually) on the corporation tax point in *Dextra Accessories*, HMRC had a more frustrating time in trying to argue that loans from EBTs were subject to PAYE.

Cheshire Office
3 Bridgewater Court, Barsbank Lane,
Lymm, Cheshire, WA13 0ER
+44 (0)1925 363 006

London Office
No. 1 Royal Exchange,
London, EC3V 3DG
+44 (0)20 3705 8320

Contact Details
info@enterprisetax.co.uk
www.enterprisetax.co.uk
@enterprisetax

24. They were unsuccessful on this point in *Dextra Accessories* and also failed to convince a court of the same in *Sempra Metals*[4]. Indeed, even in the *Rangers* case HMRC failed to argue successfully that loans from EBTS were subject to PAYE (of course, we will deal with what the Supreme Court did rule shortly).

25. As mentioned above, it seems that this was recognised in the drafting of the corporation tax provisions discussed above. A CT deduction is not available as a loan cannot be a qualifying benefit because, it is assumed, the principal is capital and not taxable earnings (and not a qualifying benefit).

26. We say 'principal' because it is likely that the loan from the EBT would be treated as an 'employer loan'. As such, any interest unpaid, or under paid, on the loan would be a taxable benefit. Indeed, in their own Manuals,[5] HMRC seem to agree this position (as applies to pre-FA *2011* loans).

27. In other words, the principal of the loan is not subject to PAYE or any other income tax charge and the *quid pro quo* being that the Company will not obtain a corporation tax deduction.

28. The employee will pay tax on any interest underpaid.

29. However, this position is clearly, at odds with HMRC's Spotlight 5 [now withdrawn] which was published in August 2010 a few months before Part 7A was published.

Finance Act 2011 – the Government introduces the 'disguised remuneration' rules

30. As stated above, the Government and HMRC, had failed to obtain an authority in Court that a loan from such a structure was earnings and subject to PAYE.

31. It was not until December 2010 that the Government announced that it wanted to treat payments which had been made through third parties, by employers on behalf of employees, subject to PAYE. This was through the introduction of *ITEPA 2003, Part 7A*(via *Finance Act 2011*) and is often referred to as the 'disguised remuneration' rules.

32. Unsurprisingly, the rules picked up loans made by the third parties to an employee and sought to subject the amount to tax. Other payments and the use of assets would also be caught.

33. These rules applied to new arrangements and also would apply to new loans or 'relevant steps' made by existing schemes.

34. However, the rules did not attack existing loans from these schemes. As such, many schemes have essentially been locked in to a state of hibernation with substantial loans outstanding.

---

[4] *Sempra Metals Ltd v Revenue and Customs Comrs [2008] STC (SCD) 1062*

[5] https://www.gov.uk/hmrc-internal-manuals/employment-income-manual/eim26110

35. Of course, there was no suggestion that these rules should be backward facing and apply to any loans taken out since 1999.

36. For the reasons I will come to shortly perhaps this is a time to make a distinction between:

    i. Pre FA2011 scheme loans; and
    ii. Post FA2011 scheme loans

37. The latter category being designed to skirt through the gaps and deficiencies in the legislation.

<u>HMRC and the Government propose April 2019 loan charge</u>

38. Pre-FA 2011, as far as we were concerned there was a logical balance between CT deductions and loans. Despite this, and the instructions in their own Manuals, HMRC certainly were not that happy about this situation and had various attempts in the Court to get such payments in the PAYE net. They lost so, as is their prerogative, they moved to have the law changed.

39. For most in the mainstream tax planning industry, if they were or had been involved in this type of planning, *Part 7A* meant the 'game was up'.

40. If that really had been that then I do wonder whether we would be talking about these changes. However, for some, the game is never up and scheme providers produced new schemes that purported to circumnavigate *Part 7A*. For example, they might reorder the mechanics – such that the 'loan' was made first and the 'payments' to the EBT were made subsequently. Also, schemes that benefitted people in their capacities as non-employees also proliferated.

41. Indeed, in addition to the April 2019 loan charge, there are other provisions being, or already, introduced to address these successor schemes. However, these changes are outside the scope of this note.

42. Additionally, so-called contractor schemes have also proliferated, again arguing that they are outside of the *Part 7A* rules.

43. It is my view that it is these Post *FA2011* schemes that have broken the metaphorical camel's back.

44. To address these post *FA2011*, but also pre-2011, schemes they have introduced amendments to *Part 7A* which apply a PAYE charge to the full amount of any loan outstanding. It applies to all loans <u>taken out since 1999</u>.

45. For someone seeking to repay a loan going forward, only repayments in money count. As such, one cannot settle a relevant loan 'in specie'.

46. This charge will crystallise on the amount outstanding on 5 April 2019 and will be payable in respect of the 2018/19 tax year.

47. Clearly, this could potentially result in a staggering tax charge for taxpayers who have used schemes. Contractors who have used this type of arrangement might be the hardest hit of all especially where they have used arrangements for a decade or more (and many have).

Transfer of PAYE Employer liability to Employee

48. At the moment, any PAYE charge that arises as a result of these measures would fall on the employer. Other than in limited circumstances, it is unlikely that such a liability might be transferred to the individual.

49. In some cases, Companies may have come and gone over the years for various reasons – many totally unconnected with tax. In other cases, a Company might end up going out of business as a result of not being able to stump up the PAYE. In all cases, at least the taxpayer's home would not be on the line.

50. However, HMRC has set out plans in a consultation document that it wants powers to be able to transfer the liability from the employer to the individual.

51. I am deeply troubled by this. Of course, HMRC will assert that they need this power otherwise the new tax charge will be less effective, and people will just sink the Company in a cavalier fashion. Of course, this might be the case for a limited profile of private companies, and perhaps conduit entities used by providers of contractor companies. However, for most businesses this is not going to be an attractive option at all. It will be a last resort.

52. Secondly, where does one draw the line? What if a Company was wound up ten years ago because the owner of the business had retired. Will he or she be chased for the money on a liability which has only just materialised as a result of a retrospective provision?

53. This is yet a further example of HMRC getting powers to make its life easier at the expense of taxpayer's rights – even though it is well ahead in the balance of power. It is tantamount to piercing the corporate veil.

54. These powers are not set out in draft legislation however anyone involved in tax will understand that HMRC will get their own way on whatever suggestions they come up with. As the PAYE regulations are Statutory Instruments then any amendment to these provisions will not require any Parliamentary scrutiny.

Retrospective law

55. Other than in the criminal field, retrospective law is not unlawful. That said, as retrospective legislation offends the rule of law, the presumption is that new legislation should not be retrospective.

56. Indeed, this is also true of tax legislation.

57. We have discussed retrospective legislation in some detail in *Appendix 1* of this bundle.

Cheshire Office
3 Bridgewater Court, Barsbank Lane,
Lymm, Cheshire, WA13 0ER
+44 (0)1925 363 006

London Office
No. 1 Royal Exchange,
London, EC3V 3DG
+44 (0)20 3705 8320

Contact Details
info@enterprisetax.co.uk
www.enterprisetax.co.uk
@enterprisetax

58. The tax provision we see that is most analogous to the April 2019 loan charge is the Pre-Owned Assets Tax (POAT) introduced in 2005. This was a new, standalone income tax charge that was targeted at individuals who had *already* entered into 'contrived' Inheritance Tax (IHT) arrangements. These schemes essentially allowed them to remove assets from their estate for IHT purposes whilst retaining the ability to use the assets.

59. The income tax charge levied under these provisions operates in a similar way to the employee benefit in kind charges. In other words, a tax charge applies to a cash equivalent value of the benefit received.

60. By any normal definition of the term, POAT was a 'retrospective tax' as it applied to arrangements entered in to from 1986 onwards. Of course, HMRC and the Government argued that it was simply a new standalone tax being introduced and therefore was retroactive. Rather strangely, in the *HM Treasury Budget Summary for 2004*, the Treasury stated that it '*is not retrospective as it will not take effect until April 2005'* seemingly missing the fact that the tax charge applied to transactions entered in to up to almost 20 years ago. The big surprise is that, as far as I am aware, this legislation was not challenged in the Court.

61. One assumes that this was because for impacted parties who would find unwinding arrangements difficult or too expensive, it was possible for an election to be made treating the assets as being back in to the estate for IHT purposes. In other words, it would just render the planning ineffective. For these people, there would be no real cost implications of the new rules other than fees paid and the fact that, on death, the asset would be subject to IHT.

62. Others would of course review the position and take steps based on a cost / benefit analysis.

63. Indeed, the *Joint Committee on Human Rights* made the following comments:

> *'1.48 In our view, the imposition of the new tax by clause 84 and Schedule 15 cannot strictly be said to be retrospective. It* ***imposes a prospective liability, from the tax year 2005-06, in respect of the value of benefits received during those years [my first emphasis]****. It is true that this imposes, in relation to certain arrangements, a tax which was not payable at the time that those arrangements were entered into, but that does not make the change retrospective.* ***A retrospective provision would be one which levied the charge in respect of the benefit enjoyed in previous years [my second emphasis]****. Such a tax would require very careful scrutiny for compatibility with the requirement of accessibility and foreseeability.*
>
> *'Clause 84 imposes a prospective liability in respect of future benefits, and allows individuals who have already entered into arrangements whereby they have disposed of their assets to elect for them to be treated as part of their estate for inheritance tax purposes.'*

64. Can parallels be drawn between the POAT legislation and the April 2019 loan charge? Of course, both apply a tax charge to arrangements entered in to, in both cases, up to the two decades ago.

65. However, there are fundamental differences to the operation and implications of these taxes.

Cheshire Office
3 Bridgewater Court, Barsbank Lane,
Lymm, Cheshire, WA13 0ER
+44 (0)1925 363 006

London Office
No. 1 Royal Exchange,
London, EC3V 3DG
+44 (0)20 3705 8320

Contact Details
info@enterprisetax.co.uk
www.enterprisetax.co.uk
@enterprisetax

66. Firstly, POAT only sought to tax the benefit of the use of the asset going forward on an annual basis. The quantum of the tax charges being relatively small. So, on a property asset of £500k one might be paying tax on the annual rental value of, say, £25k.

67. However, the loan charge is much blunter. Regardless of the length of time a loan arrangement has been in place (whether 5, 10 or 20 years) one is taxable on the full amount at one's marginal rate of tax plus national insurance. As such, it is fairly arbitrary, converting a capital sum into income and, as such, is clearly taxing 'benefits' received or use of money provided in prior tax years.

68. This seems to be a highly relevant point as (see **My Second Underlining** above) the fact that charge only applied to future benefits seems to have persuaded the Joint Committee that the charge was not retrospective.

69. Secondly, with POAT, there was a simple way out for those economically impacted by the change. One could pay the income tax charge or one could elect for the asset to fall back in to the estate. With the latter, one being simply in the position that one would have been in had the planning not been entered in to in the first place (other than loss of fees).

70. However, with the loan charge, one has the following options:

- Repay the loan – this is likely to be very difficult for many as a bullet payment, or series of bullet payments, before April 2019 which might be financially impossible;
- Persuade the Trustees to write off the loan – this will result in income tax and NIC and potentially an IHT charge; and
- Pay the tax and leave the loan in place

71. However, this analysis has been largely superseded by the publication by the Government of their *Protocol on unscheduled announcement of changes to tax law*. As such, a comparison between the loan charge and POAT is, perhaps, of limited value.

72. This document was first published in March 2011 and set out, generally, the criteria under which tax changes would be announced other than at the Budget. However, for the purposes of this article, and in relation to retrospective tax legislation, it stated that:

> '*The Protocol will explicitly recognise that changes to tax legislation where the change is effective from a date earlier than the date of announcement will be wholly exceptional'.*

73. My previous article on retrospection provides the definitions of both 'retrospective' and 'retroactive' provisions. Although, it might seem like splitting hairs, the difference is important.

74. Ultimately, both are going to affect historic arrangements or transactions. However, retroactive rules apply to future benefits, income and gains whereas retrospective applies to benefits, income and gains enjoyed in the past.

75. One first has to get over whether a loan is a benefit, income or gains. Clearly, the traditional position is that the loan capital is not. Only the use of that money, without paying interest, would be a benefit.

76. However, let us say that the law has transmogrified the loan capital in to income. In this case, the loan (the income or benefit) has arisen in a previous year.

77. **As such, the April 2019 loan charge 'imposes (or increases) a tax charge on income earned, gains realised or transactions concluded at a time before the legislation was announced. This is, by definition, a retrospective tax law.**

78. The corollary of this is that the Government could introduce a non-retrospective measure which charged to tax the use of the money going forward. However, they already do, through the benefit in kind provisions mentioned above.

79. So, if our view is correct, and the April 2019 loan charge is retrospective then 'so what?'

80. Well, the Protocol states that legislation may be retrospective in 'wholly exceptional' circumstances. As stated in *App 2*, in cases such as *Huitson* and *St Matthews,* one can easily argue that the retrospective changes were '*wholly exceptional*'.

81. However, in our view, it is difficult to see what 'exceptional' issue the proposed April 2019 loan charge addresses other than creating an exceptionally attractive windfall for HM Treasury. Indeed, one can state that for a long period of time EBTS and similar devices were wholly unexceptional.

82. Indeed, the submission that loans are subject to PAYE has been a guaranteed loser for HMRC in the Courts. Secondly, as described above, the corporation tax rules seem to take account of this logical position.

83. Furthermore, HMRC changed the rules with effect from 2011. At this stage, they did not seek to apply *Part 7A* retrospectively. No measures were taken to clean up the old schemes. *Part 7A* was not positioned as a 're-clarification' of tax law. It was clearly the introduction of new rules.

84. My view is therefore that:

- The loan charge is retrospective; and
- It is at odds with the Governments own protocol on these matters.

European Convention on Human Rights ("ECHR")

85. Looking outside the Protocol, as the Protocol was stated as not binding on Parliament in the *St Matthews* case, one could also ask whether the charge is compatible with *ECHR*.

86. As discussed in App 2, there is no general prohibition on retrospective legislation within *ECHR* either.

87. Furthermore, as many tax scheme providers and users have found to their cost, the ECHR does not readily lend protection in matters of tax avoidance.

88. The key points, in respect of *Article 1 of the First Protocol ("A1P1")* of the *ECHR*, which entitles someone to peaceful enjoyment of their possessions, are as follows

    i. Whether there is a possession;
    ii. Whether the legislation is lawful; and
    iii. Whether the legislation is proportionate

89. Both *Huitson* and *St Matthews* (cases discussed in my earlier note) both failed to get out of the blocks as there was no possession. Merely an arguable right to tax relief or that there was no tax to pay.

90. However, in the case of the April 2019 loan charge, there is a possession. There is cold hard cash at stake, each required to pay a tax charge which, until now, did not exist.

91. Of course, one would assume, that the legislation when it comes in will be passed in accordance with the law. As such, I do not propose to discuss this here.

92. Finally, and crucially, is the legislation proportionate? Does it properly strike the balance between the taxpayers impacted by the measure and the wider public at large? In the case of both *Huitson* and *St Matthews*, the circumstances of these tax avoidance schemes meant that the Court felt such a balance was fair.

93. I find it difficult to come to the same conclusions here. Even if one accepts that even a pre-2011 EBT was a tax avoidance structure, there appears to be no doubt about the tax position of a loan under the legislation at the time. They simply were not taxable. So, unlike the aforementioned cases, this cannot be described as the emergency re-clarification of the existing rules to prevent the haemorrhaging of tax (albeit, as I said earlier, the April 2019 loan charge will be a welcome windfall to the Treasury).

94. That said, ECHR gives the Government a 'wide margin of appreciation' in framing and implementing tax policy. The question is how wide?

<u>Is there a case to discriminate?</u>

95. One could reasonably take the view that the *Part 7A* rules were a line in the sand. HMRC didn't like the old rules (and couldn't win in Court) so they changed them. As such, this should have been a warning that enough was enough.

96. This would perhaps be analogous to the *St Matthews* SDLT case where planning was defeated by retrospective changes. This planning was devised after the Chancellor had already given clear notice that he would block any such schemes with such moves.

97. So, rather than applying to loans that have been taken out since 1999, a revised April 2019 loan charge could apply to those loans taken after *Part 7A* was introduced in 2011. This would still be extremely

harsh in our view but at least would address the bigger risk takers and the more abusive arrangements.

Are these changes unnecessary?

98. Clearly, these proposals were announced prior to the decision in the *Rangers*. Why is this relevant? The decision in *Rangers* would seem to go right to the heart of this issue.

99. *Rangers* featured the use of an EBT. The beneficiaries of the EBT were players and the executives of the club. As such they were employees, albeit well paid ones.

100. In respect of the players, various side agreements and correspondence with agents had 'promised' that players coming to the club would get an amount of reward net of tax. This was made up of a salary payment (subject to PAYE in full) and also a contribution to the trust that could, and in all cases seemingly did, end up in a loan payment being made to the players by the Trustees.

101. Initially, at the First Tier Tribunal and Upper Tier Tribunal, HMRC had lost on the argument that the loans were taxable as earnings.

102. However, at the Court of Sessions, and ultimately the Supreme Court, HMRC won on a different argument. That is, that the payments to the trust were actually just a diversion of earnings that had already crystallised. In other words, if one has a right to receive the earnings, requesting that the payments are made to a third party does not matter. They are earnings.

103. However, it seems that the entire policy rationale for the April 2019 loan charge hinge on the fact that the arrangements entered in to are 'disguised remuneration'. The correct argument that HMRC should be advancing is that the funds paid in to the scheme are a 'redirection' of earnings and the PAYE results from that leg of the scheme.

104. HMRC would also have the ability to issue a Follower Notice where applicable.

105. Perhaps it is easier for HMRC to have the April 2019 loan charge. However, surely it is correct that HMRC should be expected to collect tax through the existing legislation / legal authorities rather than lobbying for retrospective legislation?

106. Finally, let's not forget, HMRC also has the GAAR at its disposal where schemes have been designed to navigate *Part 7A*. Indeed, a GAAR ruling was made recently in relation to a disguised remuneration scheme involving gold bullion.

Enterprise Tax Consultants
16 October 2017

Appendix one: Retrospective tax legislation

What is retrospective tax legislation?

According to the Chartered Institute of Taxation (CIOT), retrospective tax legislation is:

> *'legislation that is retrospective in the full sense of the term, in that the legislation imposes (or increases) a tax charge on income earned, gains realised or transactions concluded at a time before the legislation was announced'*

However, the Government and / or HMRC will often argue that a provision, which appears to be backward facing is merely retroactive. Retroactive legislation is defined, again by the CIOT as:

> *'legislation [that] imposes a tax charge on income arising or a gain realised after the date when the legislation comes in to force, but that income or gain arises from transactions entered in to (or at least commenced) before the legislation'*

Parliament is sovereign – can't it do what it likes?

Of course, Parliament is 'supreme' and can legislate retrospectively. However, it is constrained by both the *European Convention on Human Rights ("ECHR")* and also other EU provisions.

That said, even this moderation may be removed where such provisions are proportionate. In other words, they do not upset the balance between individual taxpayer and the general public at large.

Prohibition against retrospective criminal legislation

Of course, this make sense.

Fundamental to the 'rule of law' is that one should not subsequently be criminalised for conduct that was perfectly legal at the time one carried out that conduct.

This is enshrined in *Article 7 of the European Convention of Human Rights ("ECHR").*

What about tax law?

There is no general prohibition on retrospective tax law.

In 2005, the ICAEW tax faculty produced a note (TAXREP 8/05) around retrospective tax legislation largely as a result of the Dawn Primarolo statement (See below). It stated that they were opposed to retrospective tax legislation 'in principle'. This was, at that time, for three reasons:

- It failed the test of certainty;
- The legal basis for retrospective legislation was 'now questionable' under EU law; and
- It undermines the credibility of the UK tax system

In a document published on 18 July 2012 by the Library of the House of Commons entitled *Retrospective taxation: earlier debates* these concerns were countered (or at least it attempted to summarise the real objections to these points) as follows:

- The battle between scheme providers and HMRC has gone on for so long, that one should not be surprised if one uses a scheme and therefore has to pay the money back – even via a retrospective change in the law;
- Retrospective tax legislation is not, in itself, prohibited by ECHR – the key question is whether the backdating of the legislation strikes a fair balance between those affected positively and those affected negatively; and
- That, in relation to some of the esoteric remuneration tax planning entered in to around the time of the Primarolo statement, it was actually these schemes that were undermining the credibility of the UK tax system

Later, in 2010, The Chartered Institute of Taxation issued a discussion paper ("CIOT discussion paper") on Retrospective Taxation as a response to what it saw as '*the increasing use of retrospective action in the tax system*'.

The CIOT discussion paper

The CIOT stated that they '*do not say that there is never a case for retrospection…However it is something that should be used with extreme care and justified at length'*

At this time, the CIOT argued that the Government should 'develop and adopt a clear statement' on the use of retrospective legislation. As it happened, the Government did precisely this in the form of its *Protocol on unscheduled changes in tax law ("The Protocol")* published in March 2012 (see below).

Cheshire Office
3 Bridgewater Court, Barsbank Lane,
Lymm, Cheshire, WA13 0ER
+44 (0)1925 363 006

London Office
No. 1 Royal Exchange,
London, EC3V 3DG
+44 (0)20 3705 8320

Contact Details
info@enterprisetax.co.uk
www.enterprisetax.co.uk
@enterprisetax

Broadly, the CIOT was quite happy for retrospective legislation to be used to correct anomalies which would essentially assist the taxpayer.

Secondly, they were also open to changes by Ministerial Statement where an announcement is made to counter a specific arrangement (sometimes draft legislation is provided as well). This, one supposes, is not really retrospective as it draws a line in the sand from today and applies to transactions thereafter. However, this was subject to such announcements being:

- Carefully targeted;
- Precise enough regarding the timings and also the target of the new rules; and
- Provide for debate and / or consultation

However, outside of these two areas, the CIOT was of the view that there should be a 'general presumption against retrospective legislation'.

The Rees Rules

I now press the rewind button…

In April 1978, the then Chancellor Denis Healy announced two measures blocking 'highly artificial [tax avoidance] schemes.' He went on to announce that:

> *'the time has come to not only stop the particular schemes we know about but also…[those] of a similar nature that can be marketed in the future. So the provisions I shall be introducing this year to deal with artificial avoidance by certain partnerships dealing with commodity futures will go back to 6 April 1976.'*

These were controversial measures and induced a response from Peter Rees MP who stated that retrospective legislation should only be introduced in limited circumstances and that certain safeguards should be provided. He suggested the following criteria:

1. Any warning of retrospective tax legislation must be precise and identify exactly what the target is;
2. The issues should immediately be referred to a technical committee in order to devise the precise legislative provisions;
3. Once these provisions have been reached, draft clauses should immediately be published in advance of the Finance Bill;
4. <u>Without fail</u>, the clause should be included in the next available Finance Bill

In a debate over the original provisions, Geoffrey Howe stated that these rules broadly described the constitutional convention that had arisen in this area over the years.

It seems that for many years these rules were adhered to and, in reality, there were few instances of legislation being backdated to a time before the announcements. Indeed, it was accepted that this would only be done in '<u>exceptional</u> cases'.

The Dawn Primarolo statement

Although I was not born at the time of the debates which gave rise to the Rees Rules, I was in practice at the time Dawn Primarolo, then the Paymaster General, announced ("The Primarolo Statement") that she was introducing measures to counter tax schemes seeking to provide tax efficient, or tax free, remuneration.

I remember that this statement set a whole flick of hares racing in the Big 4 firm I was working in at the time.

In this statement, she described how HMRC and the Government were '*not always able to anticipate the ingenuity and inventiveness of the avoidance industry*'. In this regard, she was '*giving notice of the Government's intention to deal with arrangements that emerge in future*'.

This was seen as problematic by the tax and legal professions for the three reasons set out in the ICAEW paper discussed above.

***Huitson*[6]**

From a UK retrospective tax case law perspective, *Huitson* is seminal.

The case concerned an independent contractor. He was resident in the UK and also carried out his trade, as an electrical contractor, in the UK.

He sought to avoid UK tax on his income through a marketed tax arrangement operated through the Isle of Man that aimed to take advantage of the Double Tax Treaty ("DTA") between the UK and the Isle of Man.

Essentially, it was asserted that before the change in the legislation, the effect of the UK rules and the DTA when taken together was that the income was not subject to tax in either jurisdiction. So rather than being used to avoid double taxation, the DTA was being used to eliminate pretty much all taxation.

[6] *Huitson, R (on the application of) v Revenue and Customs [2011] EWCA Civ 893*

The taxpayer had used the scheme for seven years and had avoided income tax of almost £85k. There were approximately 2,500 other users of the scheme (or similar schemes).

As a result, the Government enacted legislation '*setting things straight'* with retrospective effect.

The taxpayer sought a judicial review of this new legislation claiming that the retrospective changes failed to achieve a balance between the interests of individual taxpayer (Ie him and his fellow scheme users) and the general public and the measures were disproportionate. On that basis, they contravened his rights under *ECHR*.

The *High Court*, subsequently supported by the *Court of Appeal*, determined the following:

1. The purpose of a DTA is to prevent double taxation and not to extinguish tax in both jurisdictions;

2. It is a legitimate aim of the UK to ensure that its DTAs do no more than relieve double taxation and should not be permitted to avoid tax completely by those both resident and conducting business in the UK;

3. The public policy enunciated in (2) is of such importance that it can be expected that Parliament will introduce legislation to stop any such abuse identified;

4. The policy in (2) is of such importance that retrospective legislation is justified.

As such, the Court had little sympathy for Mr Huitson and deemed the use of retrospective tax legislation lawful.

The Protocol

In March 2011, the Government first published a Protocol on the unscheduled announcement of changes to tax law.

This set out the criteria under which tax changes would be announced other than at the Budget.

However, for the purposes of this article it stated that:

> *'The Protocol will explicitly recognise that changes to tax legislation where the change is effective from a date earlier than the date of announcement will be <u>wholly exceptional'.</u>*

It is certainly arguable that such changes being '*wholly exceptional'* is consistent with the decision in *Huitson*. In that case, the abuse of DTAs, the artificiality of the scheme and amount of tax at stake could all be factors in saying that it was an exceptional case.

Cheshire Office
3 Bridgewater Court, Barsbank Lane,
Lymm, Cheshire, WA13 0ER
+44 (0)1925 363 006

London Office
No. 1 Royal Exchange,
London, EC3V 3DG
+44 (0)20 3705 8320

Contact Details
info@enterprisetax.co.uk
www.enterprisetax.co.uk
@enterprisetax

Barclays buybacks

In February 2012, David Gauke, then exchequer secretary to the Treasury, announced by written Ministerial Statement that the Government would introduce legislation to block arrangements created to avoid corporation tax on buy-backs of corporate debt.

The relevant legislation would apply to debt purchases that took place from the 1 December 2011, some three months prior to the announcement, meaning that it had retrospective effect. The written statement said:

> "*This is not action that the Government is taking lightly. But the potential tax loss from this scheme and the history of previous abuse in this area, means that the Government believes that this is a circumstance where action to change the legislation with full retrospective effect is justified to ensure that the system is fair for all and that those who seek to benefit from this aggressive avoidance do not get an unfair advantage.*"

Here it is clear that the Government felt that the loss of tax that might emanate from the scheme justified a breach of the presumption that tax law should not be retrospective. As part of this thought process, it was felt that the immediate threat to the Treasury (and indirectly therefore the general public) was certainly a justification to pull the rug from under the feet of aggressive tax avoiders.

The schemes were operated by Barclays and resulted in a reported £500m being paid back to the Treasury. However, despite the gloss that these were highly novel schemes that HMRC had uncovered, at least one of these schemes was widely known and both had been formally disclosed to HMRC.

In this case, no decision to challenge the lawfulness of the retrospective tax legislation change appears to have been made.

(Un)Saintly SDLT avoidance

Later that year in his budget speech delivered on 21 March 2012, the Chancellor, accompanied by a vigorous fist bashing at the despatch box, made the following comments in relation to new SDLT anti-avoidance measures:

> "*Let me make this absolutely clear to people. If you buy a property in Britain that is used for residential purposes, then we will expect stamp duty to be paid. That is the clear intention of Parliament. I will not hesitate to move swiftly, without notice and retrospectively if inappropriate ways around these new rules are found. People have been warned.*"

Cheshire Office
3 Bridgewater Court, Barsbank Lane,
Lymm, Cheshire, WA13 0ER
+44 (0)1925 363 006

London Office
No. 1 Royal Exchange,
London, EC3V 3DG
+44 (0)20 3705 8320

Contact Details
info@enterprisetax.co.uk
www.enterprisetax.co.uk
@enterprisetax

So, it was clear that changes would be made without notice and retrospectively. However, this did not stop a slew of scheme providers tweaking the mechanics of the target of the original legislation and coming up with a 'new' scheme.

As was made clear by the above legislation, legislation was introduced in June of the following year to counter those new schemes, with retrospective effect to the March 2012. Of course, this rendered those new schemes ineffective.

There was a challenge to this use of retrospective tax legislation in the High Court in the *St Mathews*[7] case. These challenges were both based on the changes being a breach of the taxpayer's human rights and can be summarised as follows:

- Under *Article 1, Protocol 1* ('right to peaceful enjoyment of property') of the ECHR they were deprived of the money they would have had if they would not have had to have paid it to HMRC; and

- Article 6 of the ECHR that the use of retrospective tax legislation deprived them of a hearing (a fair trial) as to the merits of the SDLT scheme

Both arguments were rejected by the High Court. *Huitson* was the reference point and was considered quite carefully in this case.

In respect of the first argument, the Court found that the thing they were deprived of was not money, nor any form of possession. Instead, all they had was a legal argument and this, regardless of the merits of the argument, was not a 'possession'.

Furthermore, under *Article 1, Protocol 1* domestic legislation is compatible where it is lawful and proportionate. The court considered that the changes were lawful and were not arbitrary. Whilst the amendments were retrospective in application it was clear that the Government had put taxpayers on notice that this might happen as part of Budget 2012. It was therefore foreseeable.

In respect of the second argument the Judge found:

> *'little difficulty in reaching the conclusion that the legislation easily satisfies the higher test of compelling grounds in the public interest. The interference with the Claimants rights to air their arguments as to the effectiveness of this artificial tax avoidance scheme was proportionate and justified for… the reasons… already given for reaching the conclusion in respect of Article 1, Protocol 1…'*

Going on to say that:

---

[7] *St Mathews (West) Ltd and others) v HMRC [2014] EWHC 1848 (Admin)*

'It was equally compelling justification for retrospective tax legislation that it would have the desirable effect that the relevant provisions of the FA2003 would operate in the manner Parliament intended.'

On this basis, the High Court refused permission for the taxpayer to seek Judicial Review of the legislation.

This case was slightly different to the Barclays scenario. Here, a very clear announcement was made by Mr Osbourne that can be paraphrased as 'we have stopped your existing schemes – if you come up with something similar then we will also make sure that those changes are rendered ineffective from the same date'.

This should have been clear to those entering schemes, and certainly to those marketing the schemes, after the Budget.

April 2019 loan charge

There has been a lot of disquiet about the introduction of a simple PAYE charge on the users of so-called disguised remuneration schemes. This PAYE charge will apply to loans outstanding from third parties (eg EBT Trustees) as at 5 April 2019 and will apply to any loan taken out and not repaid since 1999.

Is the 2019 loan charge retrospective? At first glance, it certainly is. One is being subjected to a tax charge that one could not have known about when the loan was taken out many years, or maybe decades, ago.

Alternatively, can it be claimed that the charge is 'retroactive'? This is likely to be the defence offered by HMRC and the Government. My view is that it is retrospective and not retroactive. If I am right, does it strike the right balance? Is it proportionate?