House of Commons Public Bill Committee
Scrutiny Unit
House of Commons
London
SW1A OAA

8 June 2020

By Email: scrutiny@parliament.uk

Dear Sir or Madam,

Finance Bill 2019 – 21 Evidence: *2019 Loan Charge*

Please find below, our evidence for your consideration in relation to the Finance Bill 2019-21, submitted by ETC Tax, a firm of Chartered Tax Advisers.

You might note our original submission to the Finance Bill Committee 2017[1]. The issues seem to be largely the same.

This submission covers the following:

i. Abolition of the loan charge;
ii. Enhanced settlement opportunities;
iii. A presumption that disguised remuneration loans were illusory – and therefore cannot be exploited by unscrupulous 'third party' companies;
iv. Counteracting continuing / new schemes;
v. Litigation

[1] https://publications.parliament.uk/pa/cm201719/cmpublic/Finance/memo/FB16.pdf

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Abolition of the Loan Charge

1. Despite there being some debate as to whether *Schedule 11 and 12 to Finance (No.2) Act 2017* ('the Loan Charge') creates a *retrospective* or *retroactive* charge to tax, recipients of loans from 10 December 2010 onwards, had no knowledge, at the point of receipt, that these payments would be taxable on 5 April 2019, until at least 2016, when this was first consulted upon.

2. There is, of course, the contention that these payments were always taxable, as was confirmed by the Supreme Court in *RFC 2012 Plc (in liquidation) (formerly The Rangers Football Club PLC) (Appellant) v Advocate General for Scotland (Respondent) (Scotland) [2017] UKSC 45*. However, the Loan Charge creates a new charge to tax, in addition to any additional historic tax liability and therefore, it is difficult to interpret this distinct charge to tax as anything other than retrospection. Notably, this is further emphasised by the fact that any taxpayer who pays the respective tax on the Loan Charge does not resolve any earlier years where loans were made and HMRC has protected its position.

3. HMRC has a broad range of investigatory powers, as provided for in the *Taxes Management Act 1970*, alongside other legislation. This includes the power to open an enquiry into a taxpayers' return for up to 12-months following the submission a return and 4-years to issue a discovery assessment, where it is believed that there is an underpayment of tax. Further, the 4-year period may be extended in the circumstances of carelessness and deliberate conduct. Where an enquiry or assessment has been issued to a taxpayer legitimately, HMRC is deemed to have 'protected its position'. Our understanding is that there is an overwhelming majority of taxpayers whereby HMRC has protected its position, in relation to loans received. Therefore, the Loan Charge is being implemented without any significant need, as HMRC had an existing mechanism to tax recipients of relevant loans and had used those powers in many cases, or at least in part. **To be clear, we have no issue with HMRC pursuing their existing powers in relation to these taxpayers, albeit it might make sense for more attractive terms to be offered for those affected to encourage early settlement allowing a line to be drawn under these issues.**

4. In a strict sense, the Loan Charge only affects taxpayers who have received disguised remuneration loans and HMRC has failed to protect its position. For those taxpayers who have received disguised remuneration schemes and HMRC have legitimately protected its position, the Loan Charge acts as an irrelevant distraction and only a means of luring taxpayers into settlement. Where HMRC has failed to protect its position, the Loan Charge offers an additional opportunity for HMRC to seek to recover tax on disguised remuneration, whilst overriding the specific mechanisms for tax recovery and taxpayer protections as provided for in the *Taxes Management Act 1970*. There is nothing to suggest that loan schemes are substantively worse than other marketed tax avoidance schemes, where methods of retrospection have not been used to date. Therefore, arguably such a response is unprecedented and unjustifiable. Overall, we believe that this sets a dangerous precedent for the future counteraction of avoidance, alongside erosion of taxpayer rights. In light of the above, we believe that the Loan Charge should be abolished in relation to loans received before the date of consultation in 2016, removing any element of retrospection.

Settlement Opportunities

5. Alongside our contention that the Loan Charge should be abolished, we seek to argue that the settlement terms should be significantly improved for those where HMRC has protected its position and the taxpayers are ultimately taxable.

6. In some cases, HMRC has protected its position in relation to loans received 20-years ago. Many of recipients' lives have significantly changed from the time of receiving the loans (i.e. some have retired) and by default, with HMRC having protected its position, it could and should have acted within a reasonable time to recover these amounts owed. As a means of balancing taxpayer behaviour with HMRC inaction we make the following propositions in relation to settlement:

    a. In relation to the post-December 2010 schemes, we propose that a flat rate charge of 40% of all loans; and,

b. In relation to pre-December 2010 schemes, we propose a flat rate of 25% should apply to all loans received.

c. In any case where a detailed calculation shows a lower tax liability for the taxpayer then they should be allowed to settle for that amount

7. In seeking to tax taxpayers on the entirety of their loans, which may be up to 20-years after receiving these payments, this fails to acknowledge the inaction by HMRC in failing to deal with this in a timely manner.

8. **All settlements should also be full and final**, whereby all payments already made towards repayment of tax, such as the payment of APN's, should be credited and HMRC should be prevented from having further opportunity to recover tax at a later date.

9. Inheritance Tax ('IHT') should not be payable on any settlement. Principally, seeking to tax taxpayers on the basis that these loans are income, i.e. recharacterizing these loans as income and then also seeking to recover IHT on the same amount, if the loan is written off, is contradictory and unfair. This charge to IHT is based upon the 'exit charge', whereby IHT is charged upon dispositions from certain settlements. However, *Section 65 (5) (b) Inheritance Tax Act 1984* expressly excludes an exit charge where a payment is made for the purposes of income tax. Therefore, an IHT charge, where income tax is also payable is unjustifiable and unfair.

10. Further to the above amendments, we would also suggest that every person seeking settlement with HMRC should get a 5-year payment plan as an absolute minimum, where required. Beyond that, we believe that taxpayers should be offered flexible repayment terms on the basis of demonstrating affordability.

There should be a presumption that these loans were illusory

11. We have first hand experience that trustees have 'sold' on debts to third parties (who are generally no such thing) and these parties are enforcing the debts with the view to 'offer' to write the loans off for a bullet payment of 5%.

12. These entities, operated by former promoters of the types of scheme that generated them, are heaping further misery on taxpayers.

13. There should be a clear statement that this is not acceptable and could take the form of a general presumption in the court that such disguised remuneration loans, where they have been taxed as earned income, are illusory. As such, a Claimant needs to demonstrate that they acquired the debt without the knowledge that they were disguised remuneration loans.

Counteracting New Schemes in the Future

14. One inherent weakness of the Loan Charge is that it is completely ineffective in addressing contemporary loan schemes.

15. Notably, many recent loan schemes involve direct loan payments from umbrella schemes, which do not fall within *Part 7A, Income Tax (Earnings and Pensions) Act 2003*[2]. Therefore, these schemes are not caught by the loan charge, even where the Loan Charge was re-enacted for a later date. We believe that there is a danger in seeking to make further amendments to the existing Part 7A provisions and instead, we propose an alternative solution.

16. We propose that the Managed Service Company ('MSC') legislation should be used to curtail such schemes. The MSC legislation was introduced to plug perceived gaps in the IR35 'intermediaries' legislation in relation to mass market promoters of intermediary companies.

[2] It should be noted that, although Part 7A does not apply, we do not necessarily agree that these schemes achieve the advertised tax benefits

Where the rules bite, they ensure that any payments received by the individual from the MSC are treated as employment income and PAYE is due accordingly.

17. The MSC rules establish that payments received from the entity will be treated as employment income. Clearly, if all payments have already borne PAYE then there is no insufficiency and the rules are irrelevant. However, where there has been an insufficiency this will fall, in the first instance, on the entity as the employer. One of the unfair elements of the loan charge is that the jeopardy for any asserted insufficiency to tax ultimately falls on the individual worker rather than the employer or promoter. However, the MSC rules provide for a 'transfer of debt' from the MSC to 'others'. These 'others' include:

    - The director, or other office holder or associate of the MSC;
    - The MSC Provider, or the director, or office holder or associate of the MSC Provider; Or,
    - Any other person who directly or indirectly has encouraged or been actively involved in the provision by the MSC of the services of the individual, or a director, or other office holder or associate of such a person.

A person here means a company, partnership or individual. There are, of course, some exceptions.

18. The MSC rules are complex. However, there is no reason why an equivalent set of rules applying more generally to umbrella companies require complexity. For instance, an umbrella (as properly defined) could potentially be within the scope of the rules automatically. If the umbrella subjects all its payments to PAYE then there is no problem at all. However, if that umbrella did not pay over PAYE on the full value of payments made to its workers then a counteraction for this insufficiency would be triggered. One could allow a margin for error such that 'innocent' mistakes (e.g. expense errors) could not be transferred. In the first instance, the entity would have to pay the outstanding tax. However, if it could not (or would not) then this liability would be transferred to the directors of the entity or associates. The ability to transfer to associates, in our mind, is important as we are led to believe that a number of these promoters will operate behind umbrellas where the director is essentially a

'straw man'. This moves the jeopardy from the individual to the Promoter. Our view is that this would immediately stop the vast majority of all scheme promotion in this area.

Litigation

19. As is provided for in Article 6 of the European Convention of Human Rights, in the determination of rights and obligations, everyone is entitled to a fair and public hearing within a reasonable time by an independent and impartial tribunal established by law. We submit that the Loan Charge provides for a subversion of this right and prevents taxpayers from litigating the merits of their arrangements.

20. Instead, we believe as an alternative to settling or suffering the Loan Charge, a litigation route should be offered, whereby taxpayers are offered the opportunity to litigate their arrangements. We believe that certain measures may be put in place to prevent taxpayers using this as a delay tactic, such as the taxpayer offering up security to the court for their potential debt. This would seem appropriate where the more preferential settlement terms are offered as described abov. However, we believe that this option must be open to all, where a taxpayer would like to exercise this fundamental right.

If you have any questions, please do not hesitate to contact us.

Yours faithfully,

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