



Loan Charge Briefing (March 2020)

What is the Loan Charge?

- The Loan Charge was introduced in the Finance (No. 2) Act 2017 and came into effect on 5th April 2019 as a **20-year retrospective charge** applying to all remuneration received in the form of loans since 1999.
- The Loan Charge is calculated by adding up all loans received and taxing them in one go in a single tax year, 2018-19, which results in an increased likelihood of being taxed in a higher tax band.
- Taxpayers can agree a so-called 'voluntary settlement' with HMRC to avoid paying the Loan Charge and to achieve closure, however, the settlement terms are punitive, non-negotiable and often include additional interest and inheritance tax charges (relating to a trust structure rather than any death) on top of the income tax being demanded. Individuals are also forced to admit to wrongdoing and waive their right to a resolve the dispute via the tribunals or courts.
- The Loan Charge does not apply to any loans after 5 April 2019, so does nothing to clarify the position of any similar arrangements going forward, which are still being sold.

Who is affected by the Loan Charge and how have they been impacted?

- The Loan Charge impacts tens of thousands of people. HMRC estimate it is 50,000, but it's more; HMRC don't even know all who are affected. Some estimates are as high as 100,000 people.
- Those impacted include contractors, freelancers and agency workers from diverse sectors (including IT, oil and gas, financial services, public sector, social workers, supply teachers, nurses and locum doctors).
- In addition, many small and medium sized company owners and directors are impacted having followed professional tax advice, and their staff are now facing the prospect of redundancy.
- Those affected face huge and wholly unaffordable tax demands. For many, the sums run into hundreds of thousands of pounds and will lead to bankruptcies, family breakdown and mental health problems. **There have been seven known suicides of people facing the Loan Charge.**
- The only source of direct support is the helpline set up by the Loan Charge Action Group ("LCAG") which has received over 400 potentially life-saving calls. HMRC refused to set one up.

How did this happen?

- The **introduction of IR35 in 1999** was devised to stop 'disguised employment' but led to genuine contractors facing the risk of pursuit by HMRC if operating through a limited company/personal service company (PSC) if HMRC deemed them an employee of their end clients.
- Driven by fear of HMRC and tax uncertainty, contractors and freelancers sought professional tax advice and were advised to use umbrella schemes rather than to operate a limited company/PSC.
- Tax professionals, including chartered accountants, recommended loan schemes as 'tax law and HMRC compliant', QC approved and the safest option, in light of the IR35 legislation.
- Many self-employed public sector workers, who were recommended to use these umbrella companies, *were not even aware that they were being paid through loans.*

Lack of a proper impact assessment for the Loan Charge

- **The whole policy was based on a flawed impact assessment.** A Freedom of Information (FOI) response revealed that *they actually considered the impact against the whole population rather than on individuals.* **This gave the false impression that the measure would not have the catastrophic effect on people and families that it has had and is still having.**
- The impact assessment states, "This package is not expected to have a material impact on family formation, stability or breakdown". ***This is demonstrably false: people have already experienced relationship and marriage breakdown, reports of miscarriages and there have been seven suicides.***
- Further FOI requests have shown that **no estimate was done of the number of bankruptcies or family breakdowns (and suicides) that the Loan Charge would cause.**

Why is the Loan Charge so unfair?

- **HMRC is only pursuing individuals who acted in good faith**, rather than the client organisations, agencies and umbrella companies who all benefited significantly from the arrangements whilst the workers received none of the usual employment benefits such as sick pay or holiday pay.
- It is the most compliant taxpayers, those who disclosed information on their tax returns, who have been hit hardest by HMRC's aggressive pursuit, which includes Accelerated Payment Notices (APNs), which are demands to pay an amount on account of tax or national insurance contributions within 90 days of receipt.
- If a taxpayer agrees to pay HMRC the disputed tax, they are forced to make a confession of their wrongdoing whilst also waiving their rights to any protection from the tax tribunals and courts.
- Paying the Loan Charge does not conclude open enquiries (i.e. open years where HMRC opened an enquiry, also known as "protected years"); they still need to be resolved. **This also means that even paying the Loan Charge doesn't represent full and final settlement**, HMRC could decide they want more. ***Taxpayers settled what they were led to believe was full and final payment under a previous settlement opportunity, but then HMRC have decided to reopen using the Loan Charge.***

The legislation is clearly retrospective which undermines the Rule of Law

- The 2019 Loan Charge is clearly retrospective as it **changes the tax position of the law at the time**. ***Initially this was 20 years, back to 1999, however this will now be 2010, but this is still 10 years' retrospective taxation.***
- **It demands disputed tax that has not been legal proven to be due.**
- The legislation ignores and **removes basic statutory taxpayer protections**:
 - **It reopens 'closed years'** (*legislation specifies that once HMRC have closed an enquiry into a tax year, it cannot be reopened*).
 - It **ignores statutory time limits** which only allow for tax returns to be open for 12 months before raising an enquiry, or reopened within 4 years for simple errors, 6 years for carelessness or 20 years for evasion/fraud.
 - It goes back beyond the 7-year statutory requirement to keep financial records. *This means people who have no longer got records are unable to prove that HMRC are incorrect.*
- An investigation by **House of Lords Economic Affairs Committee** concluded that, ***"The charge is retrospective in its effect, claiming tax from years which should be closed to enquiry"***.

HMRC's failed to act at the time, which is why they pushed for the Loan Charge

- The Loan Charge allows HMRC to go back and demand tax (with no right of appeal) despite HMRC failing to pursue this at the appropriate time, which is why they pushed for it.
- HMRC could have opened enquiries, alerting individuals to HMRC's concerns. They did not act until many years later, by which time settlement on HMRC's terms was not possible for people.
- HMRC also failed to open enquiries on many of the umbrella companies which the courts have declared to be liable for the tax under the law at the time. This has allowed them to walk away leaving only one possible target remaining for HMRC to pursue – the individuals.
- This delay from HMRC in acting also causes difficulties for any potential recovery by the individuals against the advisers or their professional indemnity insurance due to time-barring rules.

Legal reality – legal cases do not justify the introduction of the Loan Charge

- HMRC and the Treasury frequently cite the Supreme Court ruling in the Rangers case as justification for the Loan Charge. The reality of the Rangers case is as follows:
 - 2012 HMRC lose in First Tier Tribunal (FTT), arguing that loans are taxable as income.
 - 2014 HMRC lose again in the Upper Tier Tribunal, arguing that loans are taxable as income.
 - 2015 HMRC change argument on the advice of their QC, so no longer argue that loans are taxable and they achieve a surprise success in the Court of Sessions in Scotland, that Rangers are liable for tax from the use of EBTs to pay players (*not that the players avoided tax*).
 - 2017 the Supreme Court upholds the decision of the Court of Sessions.
- **The Supreme Court never found that loans were taxable.** *It found that the tax liability from the use of an Employee Benefit Trust (EBT) fell unequivocally upon the Employer, not the employee.* Yet HMRC has made no serious attempt to chase these employers. ***Instead they have used the Loan Charge to go after the softest target, the individual.***

- HMRC and the Treasury have declared that the schemes are tax avoidance and ‘never worked’, and that the loans were always income. However, the law says otherwise:
 - McDonald v Dextra Accessories and Others (2003) judgement held that loans achieved the, “outcome promised when they were being marketed”.
 - The case of Sempra Metals Ltd v HMRC (2008) confirmed the loans were NOT taxable.
- The only other case that HMRC have won with any relevance to this situation was P Boyle v HMRC TC03103 at FTT (and thus cannot be used as precedent for other cases). This was decided based on the specifics of the case and mainly on the basis that those loans never actually existed.

HMRC and HMT record of misinformation to parliament

- HMRC claim to be pursuing prosecutions of promoters of such tax arrangements, but there is no evidence that this is occurring. HMRC have previously pointed toward past prosecutions, which on closer inspection turn out to be unrelated cases of outright fraud against taxpayers.
- HMRC have misled MPs that the amounts most people are facing are much lower than the reality, for the “typical” size of a settlement by giving the median average, which is much lower than the mean.
- HMRC have refused to answer the question if contractors working on HMRC projects used such arrangements, when it is known they have been and HMRC refuse to provide any figures.
- HMRC have repeatedly reassured parliamentarians that they will not force anyone to sell their home and “do not wish to make anyone bankrupt”. There is evidence of both taxpayers having sold their homes and cases of HMRC issuing County Court judgment and control of goods orders. The sums demanded will inevitably lead to many bankruptcies whether or not HMRC want them to happen.

HMRC treatment of people facing the Loan Charge

- HMRC are well-known for giving the impression that they are very sympathetic and helpful when in reality they are ruthlessly pursuing people demanding unaffordable sums.
- The Loan Charge APPG published a report into HMRC’s conduct highlighting unaffordable Time to Pay (TTP) offers, aggressive communication, threats of bankruptcy, unreasonable delays, Inconsistencies, punitive rates of interest and unreasonable settlement terms.ⁱ

Promoters and tax advisers are facing no action nor demands

- HMRC (and HM Treasury) are keen to give the impression that they are pursuing, indeed seeking to prosecute, promoters and arrangers of such schemes but this is not the case.
- **HMRC have continually refused to answer FOI requests about the number of prosecutions that have taken place. There is no record of any prosecutions.**
- HMRC have merely referred some schemes (that still openly advertise) to the Advertising Standards Authority over the wording of adverts. The promoters simply change the wording.

House of Commons opposition to the Loan Charge

- There has been considerable opposition and concern expressed by MPs.
- 152 cross-party MPs signed an Early Day Motion in the 2017-19 parliament calling on the Government to revise the legislation - <https://edm.parliament.uk/early-day-motion/51710>
- 189 MPs signed a letter calling for a suspension of the Loan Charge and an independent reviewⁱⁱ
- The Loan Charge APPG now has 226 members (as of 20th February 2020) including 216 MPs.

The House of Lords Economic Affairs Committee Report (December 2018)

- The Loan Charge was strongly criticised in a report by the House of Lords Economic Affairs Committee which said there is disturbing evidence of “HMRC threatening individuals with arrangements that could result in bankruptcy” and “reports of increasingly aggressive behaviour towards taxpayers” by HMRC.
- The Committee stated, “*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*”.
- The report exposes HMRC’s approach of pursuing taxpayers but not scheme promoters and also criticises HMRC for failing to make its position on the schemes clear, for its unreasonable delays in legislating and for

failing to progress enquiries into individuals' tax affairs. **The report calls on the Government to reform the Loan Charge, which the Lords Committee declared is "clearly retrospective" and "undermines basic principles of tax fairness and certainty."**

- The Committee called for immediate amendments to the Loan Charge legislation to exclude loans made in years where taxpayers disclosed their participation in the schemes to HMRC or which would otherwise have been considered "closed". They also called for HMRC to urgently review all cases where the only remaining consideration is the individual's ability to pay.

The Morse Review

- Following campaigning from MPs and LCAG, Boris Johnson committed to an independent review of the Loan Charge during a hustings for the Conservative Party leadership.
- The Treasury announced a review which was formally commissioned on 11th September 2019 to be led by the former Auditor General, Sir Amyas Morse.
- Publication of the report and Government's response was delayed due to the 2019 General Election. Most recommendations were accepted, but some were changed or rejected.ⁱⁱⁱ

The key conclusion of the Morse Review

- The review concluded that the Loan Charge was not a proportionate or a fair response to the use of payroll loan arrangements, *"...the design of the Loan Charge is highly unusual. While unusual policy design is not inherently wrong, it creates an obligation to ensure that all elements of the policy are justified and proportionate. That was not the case for the Loan Charge."*
- The report recommended scrapping the Loan Charge prior to 9th December 2010 but leaving it in place for loans after this date. The reason given is that the review believes "the law was clear" from December 2010. This is simply not the case because:
 - The 2011 legislation only applied to 'employees' who received third party loans, not to self-employed loans. **The law for the latter was introduced in 2016, passed 2017.**
 - People were advised by professionals, including reputable/chartered tax professionals, 'big four' firms, and top law firms that the arrangements were compliant and not subject to the legislation. They would not have done so if the law clearly stated they were not compliant
- **The Loan Charge would not be required if the law had been clear from 2011.** HMRC did NOT effectively communicate to taxpayers or tax professionals that all such arrangements were considered unacceptable until Spotlight 33 was published on HMRC's website in July 2016^{iv}.

Current status of the issue

- The Government announced that the Loan Charge legislation will be amended in the Finance Bill.
- Even with these changes, tens of thousands of people still face the Loan Charge.
- Without further changes there will be further bankruptcies, forced house sales and continuing mental health impact and suicide risk.
- Campaigners report that nearly four years after the legislation was announced, HMRC are contacting people for the first time telling them that they may be liable for the Loan Charge
- There is still considerable concern amongst MPs and backbenchers. Many do not agree with the conclusions of the Morse Review and oppose all retrospective application of the Loan Charge.
- The obvious solution is to **remove retrospective and to apply the Loan Charge prospectively from the date of royal assent** of the Finance Bill^v, granted on 16th Nov 2017.

i The Loan Charge APPG Inquiry report into the fairness of tax legislation and HMRC's conduct in enforcing it - <http://www.loanchargeappg.co.uk/wp-content/uploads/2019/05/Loan-Charge-Inquiry-Report-April-2019-FINAL.pdf>

ii Letter to former Chancellor requesting suspension and review of the Loan Charge - <http://www.loanchargeappg.co.uk/wp-content/uploads/2019/11/Open-letter-to-Chancellor-re-Loan-Charge-Suspension-25-September-2019.pdf>

iii <https://www.gov.uk/government/publications/disguised-remuneration-independent-loan-charge-review>

iv Spotlight 33, 7th July 2016 - <https://www.gov.uk/guidance/contractor-tax-loan-schemes-can-cost-you-more>

v <https://services.parliament.uk/bills/2017-19/finance.html>