Loan Charge All-Party Parliamentary Group

Fair and final Settlement Opportunity Proposal for people facing the Loan Charge

August 2020

This Report was researched and written by the Loan Charge APPG. The Loan Charge APPG Secretariat is staffed and funded by the Loan Charge Action Group.

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Introduction

This is a proposal for a fair, proportionate and reasonable settlement opportunity with HMRC for all those who used payroll loan schemes from 1999 onwards many of whom, on the current settlement terms, face unfair and unaffordable demands, bankruptcy and long-term family detriment.

Terms of Settlement Opportunity – Key Points

1) An Income Tax rate of 10% will apply to:

    a. All loans received via a contractor loan arrangement from 6th April 1999 to 8th December 2010 (inclusive) where HMRC has protected the tax year in question, and;
    b. All loans received via a contractor loan arrangement on or after 9th December 2010 to the effective date of settlement, for both protected and unprotected years, that are subject to the Loan Charge.

2) All amounts will be subject to interest from the date that the tax is deemed due, to the date that the taxpayer registered their initial interest in settling with HMRC.

3) No forward rate interest will apply to Time to Pay arrangements required to facilitate the settlement and a minimum Time to Pay term of 5 years is available to all taxpayers.

4) No Inheritance Tax is deemed due on any loans applicable to the settlement terms.

5) All outstanding enquiries and assessments relating to loan arrangements will be closed, and all unprotected years will be included in the contract as settled and incapable of further adjustment by HMRC in respect of the use of loan arrangements.

6) A relevant step noted under Schedule 11 & 12 of the Finance Act (No.2) 2017 is deemed not to have been taken where the settlement is reached before 5th April 2021.

7) Loans which are included in the settlement for both protected and unprotected years will not be subject to a further tax charge under the provisions of s.554C ITEPA 2003.

Justification of terms

The terms detailed above are fair and equitable in all the circumstances and are considered by Lord Diplock in *R v Inland Revenue Commissioners, Ex p National Federation of Self-Employed and Small Businesses Ltd*[1], as within HMRC's powers to offer:

> *"a wide managerial discretion as to the best means of obtaining for the national exchequer from the taxes committed to their charge, <u>the highest net return that is practicable</u> having regard to the staff available to them and the <u>cost of collection</u>."*

We have detailed below why, having consideration to the highest practical return, the staff currently available to HMRC and the cost of collection, the settlement terms available satisfy HMRC's requirement to act within their care and management powers.

It is important to note that the terms offered above are not new. They have been presented to HMRC as an opportunity to resolve the present situation for many years.

During the House of Lords Economic Affairs Committee Finance Bill Sub-Committee evidence session on 17 October 2018[2] tax experts present noted:

> "*There are four parties and the tax due is around 40% in most cases, as that is the band it is taken it into. We propose that each of those parties should pay 10%".*

Similarly, the Loan Charge APPG Loan Charge Inquiry report[3] reached the same conclusion with the following recommendation:

> *"For Treasury Ministers to change policy and instruct HMRC to offer the option of a 10% full and final settlement rate, or an alternative settlement offer that is fairer and less punitive than the current terms, on any open/protected years for any taxpayers who wish to simply draw a line under the past and move on with their lives".*

We believe that the following terms achieve this finality for both HMRC and their customers.

1) 10% Flat rate of Income Tax

The House of Lords Economic Affairs Committee Report 'Treating Taxpayers Fairly'[4] states:

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[1] R v Inland Revenue Commissioners, Ex p National Federation of Self-Employed and Small Businesses Ltd [1982] AC 617, 636

[2] Economic Affairs Committee Finance Bill Sub-Committee Uncorrected oral evidence: Finance Bill 2018 Wednesday 17 October 2018- https://www.parliament.uk/documents/lords-committees/economic-affairs-finance-bill/draft-finance-bill-2018/Uncorrected%20Oral%20Evidence%20-%2017%20October.pdf

[3] Loan Charge APPG Report; Loan Charge All-Party Parliamentary Group Report on the Morse Review into the Loan Charge March 2020

[4] House of Lords Economic Affairs Committee 4th Report of Session 2017–19 HL Paper 242 The Powers of HMRC: Treating Taxpayers Fairly

> *"The judgment in the Rangers case found that the loans advanced constituted earnings for tax purposes. Not only was the amount taxable on the employee, but the employer should have applied PAYE".*

This finding evidently indicates that HMRC should be pursuing employers in the first instance for recovery, not the employees themselves.

Despite this the same report also concluded that:

> *"Disguised remuneration schemes are an example of unacceptable tax avoidance that HMRC is right to pursue. All individuals using these schemes must accept some degree of culpability for placing an unfair burden on other taxpayers".*

Most taxpayers affected are prepared to accept some culpability to bring about a swift and final conclusion to the long running trauma of enquiry. They were convinced by comprehensive assurances of compliance by salespeople and as The Lords Report notes "*In many circumstances, individuals were being directed to use these schemes by their employer".* Despite this, for many, the years of pursuit by HMRC has taken its toll and put simply, a conclusion is needed. The current terms are not manageable for most, but a 10% rate would be possible, where a Time to Pay can also be implemented and certainty achieved.

The 10% rate acknowledges four key parties in the transaction: the employee (taxpayer), the employer (promoter/scheme operator), the end-client and HMRC.

Assuming a loan of £50,000 the calculations could be represented as follows:

(a) The employee (tax payer) benefited to the tune of c.5% saving on their annual tax bill: **c.£2,500**
(b) The employer (scheme operator) typically realised a 15% fee, characterised as "tax and fees" to the employee: **£7,500**.
(c) The end-client was afforded the opportunity to save employers national insurance contributions, typically between 12-14% over the period: **£6,000-£7,000**.
(d) HMRC of course did not benefit from the arrangement, however, The Lords Report found that "*There were unreasonable delays in legislating and in failing to progress those enquiries which were opened into individuals' tax affairs, depriving them of certainty even in situations where they were actively seeking to engage with HMRC to finalise matters*". It is therefore equitable that HMRC should accept apportionment of culpability.

By taking the highest tax rate to which these arrangements typically apply (40%) and sharing it between those culpable parties, a 10% rate is considered just and equitable.

The tax years affected by the settlement are representative of those, where HMRC can recover, in current legislation by both The Taxes Management Act 1970 and The Finance (No.2) Act 2017.

The use of special tax rates is an accepted care and management process and is not novel. Clearly, however, the resulting change in tax rate will require HMRC to refund those who have previously settled their liability, a portion of the amounts paid. However, following the Morse review, HMRC are already committed to refunding voluntary restitution years now excluded from settlement, a measure which has now been legislated for, so an additional step is merely an incremental in this pre-existing process.

Put simply, a rate of 10% supports a manageable, fair and equitable rate of tax, upon which to conclude matters for all parties.

2) Interest

As above, the Economic Affairs Committee Report found that there were "*unreasonable delays in legislating and in failing to progress those enquiries which were opened into individuals' tax affairs*"[5] by HMRC. The latest of such delays has been caused by HMRC's lack of resourcing to conclude settlements which have been outstanding, in many cases, since March 2017. We therefore conclude that taxpayers should not be unduly penalised by HMRC's delay, especially where they have indicated an interest in settling. Whilst it is accepted that interest is a statutory instrument, it is within HMRC's gift to waive it in cases of excessive delay by HMRC. In this case, all that is being sought is for interest to stop at the point the taxpayer signalled their intent to settle. Interest should therefore be stopped from that date if settlement is consequently reached.

3) Time to Pay Arrangements

In almost all instances the taxpayer is unable to repay the tax at stake. There are often multiple years of involvement due to HMRC's failure to raise concern and on-going assurances of compliance by the promoters. Similarly, the employer noted that all tax was being paid on their behalf, so no provision has been made accordingly.

As a result, a Time to Pay is required for almost all taxpayers. HMRC's policy is to charge future interest at a punitive rate of 1% above the late payment interest rate (which is currently 3.6%) on Time to Pay arrangements. This appears entirely contrary to equity, where those who are most unable to pay are penalised to the point of being blocked from settlement.

As a result, certainty in the availability of Time to Pay and a removal of punitive interest charges as a result of Time to Pay must be part of the settlement.

4) Inheritance Tax

Inheritance Tax is perhaps one of the main reasons that taxpayers choose not to settle. The uncertainty and perceived impression of double taxation is often one step too far. It also does not acknowledge the true steps that took place. Whilst the payment was often documented to include payment into a trust, often in reality it was distributed directly to the taxpayer. The resulting direct payment from employer to employee should, therefore, not attract Inheritance Tax in this calculation.

5) All years involving use of loans schemes should be within scope

It is incumbent upon any settlement that enquiries will be closed. However, recently, as a result of the Morse Review's exclusion of tax years prior to 2010/11 from the Loan Charge, HMRC have newly suggested to taxpayers that they may use their enhanced enquiry powers to attempt to open previously unprotected years. Most tax experts doubt that HMRC have such powers (noting that HMRC could otherwise have exercised them far sooner). However, the mere threat creates further pressure on taxpayers. As a result, and to offer the Taxpayer absolute certainty, all years of involvement in a

[5] House of Lords Economic Affairs Committee 4th Report of Session 2017–19 HL Paper 242 The Powers of HMRC: Treating Taxpayers Fairly

loan arrangement must be noted as resolved in the contract, regardless of their applicability for tax. As an example, and to be explicit on this point, where an individual has a combination of open and closed tax years, for a loan received in the 2008/09 tax year which is not subject to an enquiry or assessment (and is therefore closed), the contract must state that the 2008/09 is settled for £0 tax liability.

6) Finance Act (No.2) 2017 Relevant Step

This legislation indicates that a liability to tax under the Loan Charge arose on 5th April 2019. It is therefore considered that where settlement is reached after this point, express provision to the dis-application of the Loan Charge will need to be noted in the contract terms to protect the taxpayer from the risk of double taxation.

7) s.554C ITEPA 2003- Resolving Loans

S.554C ITEPA 2003, inserted in Finance Act 2017, raises a charge to Income Tax on a loan which is written off, even where the year is unprotected and not subject to the Loan Charge. This cannot have been the intention of Parliament or the amendments brought about by the Morse review. Point 6 above will go some way to finalising the matter, but the settlement must also make provision for no further charge to income tax where an outstanding loan is subsequently written off.

Financial Justification for a settlement

As above, according to Lord Diplock in *R v Inland Revenue Commissioners, Ex p National Federation of Self-Employed and Small Businesses Ltd*, HMRC are able to exercise their discretion on settlement where the highest net return that is practicable having regard to the staff available to them and the cost of collection.

It is evident that HMRC do not have the required resource to litigate the loan arrangements. Enquiries span a period of 15 years or more. It would, therefore, be sensible for HMRC to offer settlement terms based on what allows them to achieve the "highest net return which is practicable".

Best estimates assume that there are around 200 different contractor arrangements for HMRC to litigate. Assuming follower notices can be used, this may reduce to 10 substantive cases. Costs of the exercise vary considerably between cases and so a reasonable assessment of average costs is often unrealistic. For illustrative purposes we can assume £1,000,000 for HMRC to take a court case through the four tiers of court. Ten cases is therefore, £10,000,000 cost.

In a survey of its members conducted in January 2019, the Loan Charge Action Group found that for 71% of its members, bankruptcy would be required if HMRC pursued what they considered due[6]. HMRC consider that 50,000 persons are affected by its provisions; therefore it is reasonable to assume that HMRC's policy could result in 35,500 bankruptcies. Many of these individuals work in positions where liquidity is a pre-requisite for the role. As a result, the consequent loss of earnings and tax revenue will be stark.

[6] Loan Charge Action Group press release, 29th January 2019 https://www.hmrcloancharge.info/lcag-press-release-29th-january-2019/

This is illustrated as follows:

Assuming the average person was in an arrangement for three years from 2011-2014 and was earning £50,000 per annum. Under HMRC's current policy the tax due equals:

2011/12	£10,800 + interest
2012/13	£ 9,882 + interest
2013/14	£ 9,818 + interest

Taking the tax at stake and leaving aside any national insurance and interest for now, this represents £30,500 outstanding.

Multiplied by HMRC's estimation of 50,000 impacted persons affected the tax at stake is £1,525,000,000.

Of those 50,000, 35,500 may be made bankrupt resulting in a potential recovery of £442,250,000 and litigation costs of £10,000,000= £432,250,000, leaving £1,082,750,000 uncollected.

As a result of the bankruptcies, future loss of earnings and consequent tax take will be suffered by HMRC. Assuming the same £50,000 salary this equals:

2018/19-	£8,356
2019/20-	£7,498
2020/21	£7,498
Total	**£23,352**

Multiplied by 35,500 potential bankruptees equals £817,320,000 of lost tax revenue.

To summarise, HMRC therefore risk tax of £817,320,000 (future tax) + £1,082,750,000 (loss of historic tax due to bankruptcy) + £10,000,000 (litigation)= £1,910,070,000 to potentially recover £442,250,000

Instead HMRC could settle on the terms offered above.

This realises the following:

50,000 people with total loans over three years of £150,000 would be taxed £15,000. This offers a recovery of £750,000,000 through settlement (more than litigation), no bankruptcy, and thereby securing future revenue of £817,320,000.

It therefore stands to reason that the "*highest net return that is practicable having regard to the staff available to them and the cost of collection"* must be this settlement.

Conclusion

Despite the significant changes made to the Loan Charge by the Government as a result of implementing most of the recommendations of the Morse Review, many thousands of people, some of whom have were involved in the same schemes as people no longer facing the Loan Charge, still face financial consequences that are out of all proportion to any benefit they realised.

The changes also leave many people facing simply unaffordable, punitive demands and still leave the fundamental injustice of the Loan Charge in place: That those facing it are being denied the basic right to dispute HMRC's demands in the normal tax tribunal system.

As well as being chilling in the way it denies basic rights and undermines the rule of law, we also believe that this is clear discrimination to one set of taxpayers compared to others, that HMRC also believes may not have paid the correct amount of tax.

This singling out of those who used loan schemes is in reality justified only by the fact it saves HMRC the bother of litigating, but considering that much of the reason for the proliferation of these schemes was due to inaction and inadequate communication from HMRC, this justification does not override more fundamental concerns or give a valid excuse to deny basic rights to any group of individuals.

Whilst the Loan Charge APPG Officers remain of the opinion that the Loan Charge should not be retrospective and that all taxpayers should be afforded the right to the normal legal processes, we do believe that the only way to bring finality to this whole issue and scandal - one that has taken huge amounts of Parliamentary time and cost lives - is to offer a genuine, fair and affordable settlement opportunity to all who used loan schemes and wish to agree to a proportion of the disputed tax as full and final settlement, allowing them to get on with their lives and to allow HMRC to collect considerably more revenue, in a shorter timescale and without the otherwise inevitable bankruptcies and disastrous impact on mental health and family life for many.

Many people facing the Loan Charge – and indeed many public sectors workers who were mis-sold loan schemes post 2017 but do not actually face the Loan Charge - have indicated that they would be willing to agree a genuinely affordable settlement, based on a reasonable and not a punitive overall sum and with genuinely affordable monthly payments. They should be allowed to do so and those that do not wish to, or still cannot afford to do so, should be allowed to continue to challenge the injustice of the Loan Charge and the way it discriminates against one group of taxpayers versus others.

The Economic Affairs Committee summarised in their report that "*Many witnesses were willing to settle outstanding liabilities in so far as they could*"[7], they now have an opportunity to help Taxpayers achieve this. As Keith Gordon said at an Economic Affairs Committee evidence session, "*the problem is the legislation goes for the person least able to defend him or herself*"[8].

It is now incumbent on the Government/Treasury and HMRC to allow people the opportunity reach a fair and equitable conclusion to years of painful enquiry and personal damage, along with ensuring the best net return for the Treasury and far fewer negative and damaging consequences, noting the cost to the Exchequer of every bankruptcy, plus the cost to the economy of all who are no longer able to work as a result of bankruptcy or due to the mental stress of the whole matter.

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[7] House of Lords Economic Affairs Committee 4th Report of Session 2017–19 HL Paper 242 The Powers of HMRC: Treating Taxpayers Fairly

[8] House of Lords Economic Affairs 4th Report of Session 2017–19 HL Paper 242 The Powers of HMRC: Treating Taxpayers Fairly

We have been advised by a tax lawyer that legislation is not needed for this to come about, that HMRC have the discretion to implement it, and that you have the power to instruct them to use it, in this way, to offer such a settlement to all those who have used loan schemes.

The Loan Charge Scandal is not going to go away as a political issue or as a serious mental health crisis for thousands of individuals and without such a settlement opportunity it is clear that many people simply will not pay the Loan Charge and many cannot do so. Doing nothing will mean individuals are at risk of bankruptcy, homelessness, breakdown and suicide.

We urge the Government to agree to delay the Loan Charge deadline date of 30 September 2020 and to properly consider and then instruct HMRC as to a genuine, fair and affordable settlement opportunity along the lines of that outlined in this proposal to allow many people to settle and move on with their lives and to bring a fair and just conclusion to the whole matter for many people and their MPs.

As well as having the support of the Loan Charge APPG, this proposal for a genuine, fair and affordable settlement and a six-month delay to allow settlements to be concluded is supported by the Loan Charge Action Group and by tax advisers and lawyers who have been advising the APPG.

Loan Charge APPG
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