

# The wait is over

Employment Tax

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Personal tax



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Jon Claypole and Charlotte Thorpe ask what the Independent Review of the disguised remuneration loan charge will mean in practice

## Key Points

### What's the issue?

On 20 December 2019, the eagerly anticipated report from Sir Amyas Morse in respect of the independent loan charge review was published, along with the government's responses to the recommendations in the review.

### What can I take away?

The government has accepted substantial changes to the loan charge following the recommendations made by Sir Amyas Morse. Crucially, the loan charge will now only

apply to loans made on or after 9 December 2010.

### **What does it mean to me?**

Taxpayers who have not yet settled their disguised remuneration arrangements with HMRC, and who are still subject to the loan charge, may either provide an estimate of their tax liability on their 2018/19 Self Assessment Tax Return by 31 January 2020 or may delay filing until 30 September 2020.

HMRC introduced a charge on disguised remuneration (DR) loans in Finance (No. 2) Act 2017. This is commonly referred to as the 'loan charge'. The legislation imposes an income tax liability on any loans received on or after 6 April 1999 which are still outstanding at 5 April 2019. HMRC refers to these loans as disguised remuneration on the basis that they were in lieu of salary or bonuses and were never designed to be repaid.

The participants in these DR arrangements should have filed an information return disclosing the balance of the loan with HMRC by 30 September 2019. This was required if individuals or their employers had not settled their use of a DR tax planning arrangement with HMRC and loans were outstanding as at 5 April 2019. If clients have failed to report details of their outstanding DR loans, or if the information they have provided to HMRC is not complete and/or correct, then they may be subject to the following penalties:

1. an initial penalty of £300;
2. further daily penalties of up to £60 a day up to a maximum of 90 days; and
3. a penalty not exceeding £3,000 for each inaccuracy deliberately or carelessly included within the information provided, or discovered after the information has been submitted to HMRC and the user does not tell HMRC.

### **The Independent Review**

The loan charge has been controversial from the outset, with lobbying as it progressed through the legislative process, with representative bodies gaining support from a number of MPs and raising awareness in the media.

On 4 September 2019, Boris Johnson announced during prime minister's questions a review into the loan charge. On 11 September 2019, a review was commissioned by the chancellor of the exchequer, Sajid Javid.

The Treasury announced that the independent review would be undertaken by Sir Amyas Morse, former CEO of the National Audit Office.

The Treasury issued 'Terms of Reference' in respect of the independent review into the loan charge. The Terms of Reference defined the scope and objectives for the review and stated that 'the review is focused on the impact of the loan charge on individuals who have directly entered into disguised remuneration schemes'.

To the authors, the terms appeared to invite the review to only consider the impact on individuals such as freelance contractors rather than employers using arrangements such as employee benefit trusts.

The Terms of Reference also stated that:

'In considering its recommendations, the review must also take account of:

- the impact on wider taxpayer fairness;
- HMRC's ability to tackle tax avoidance effectively in the future.'

The second bullet point was particularly interesting, as there has been a view in the tax profession that HMRC have failed to use their powers in a timely manner to recover the historical taxes due as a result of these arrangements. The loan charge is often described as 'retroactive' in that the tax effect of previous events is changed; that is, effectively historic tax years which are out of time to be assessed are being brought into charge.

## **Outcome**

On 20 December 2019, the eagerly anticipated report from Sir Amyas Morse in respect of the independent loan charge review was published, along with the government's responses to the recommendations in the review. The government has accepted substantial changes to the loan charge following the recommendations made by Sir Amyas Morse, as summarised below:

Firstly, and crucially, the loan charge will now only apply to loans made on or after 9 December 2010. This is 11 years later than originally set out in Finance (No.2) Act 2017. The reason this date has been decided upon is that it coincides with the date on which targeted anti avoidance legislation was announced to tackle the use of DR arrangements. It does not differentiate between the nature of the participant as the terms of reference appear to have requested.

In addition, the loan charge will not apply to loans made between 9 December 2010 and 5 April 2016 in cases where the taxpayer's participation in DR planning was fully disclosed to HMRC, and HMRC did not open an enquiry. The meaning of what constitutes 'fully disclosed' is unclear and we discuss this further below.

Taxpayers who have not yet settled their DR arrangements with HMRC, and who are still subject to the loan charge, may either provide an estimate of their tax liability on their 2018/ 19 Self Assessment Tax Return by 31 January 2020 (the normal filing deadline) or may delay filing until 30 September 2020. If a taxpayer chooses to delay filing their tax return until 30 September 2020, they will not incur any late filing penalties or interest on payment of the tax from the normal due date of 31 January 2020. HMRC have updated their guidance to note that these changes apply both to any liability arising under the loan charge and to any other Self Assessment tax liabilities.

This limiting of the scope of the loan charge is significant and will impact a large number of taxpayers. The government estimates that the changes will impact around 15,000 individuals, with up to 10,000 individuals being taken out of the scope of the loan charge altogether.

### **Payment options**

The review made some welcome changes for those who would have difficulty in paying the liabilities arising at once.

Where payment of the loan charge is still due, it can be spread evenly across three tax years, rather than being due in one lump sum. This is to prevent taxpayers inadvertently falling into higher rate tax brackets because of the loan charge. Before the loan charge review, HMRC had issued guidance which still applies for taxpayers looking for a Time to Pay arrangement:

- a) For individuals earning less than £50,000 per annum, a five year Time to Pay will be provided.
- b) For individuals earning less than £30,000 per annum, a seven year Time to Pay will be provided.

In addition, the loan charge review recommended that individuals subject to the loan charge should only be asked to pay up a maximum of half of their disposable income each year, and only a 'reasonable proportion' of their liquid assets.

HMRC have also accepted the recommendations that:

- a) individuals will not have to sell their primary residence to settle their liabilities; and
- b) individuals will not be asked to utilise funds from their existing pension pot to settle their liabilities.

HMRC has, however, restated what it has said since the introduction of the loan charge, which is that the loan charge itself does not bring the investigations into the underlying DR tax planning to a conclusion. Instead, anything paid under the loan charge merely franks the final tax liability.

In its response to the review, HMRC has indicated it will set up dedicated teams to investigate the DR planning to litigation if necessary, but a fresh settlement opportunity, applying the November 2017 terms, will be announced shortly.

### **What if a taxpayer has already settled with HMRC?**

Many taxpayers, both companies and individuals, have over the last few years been working with HMRC to settle their historic tax affairs regarding their participation in DR arrangements.

For those taxpayers who remain in the scope of the loan charge as set out above, but who have settled with HMRC, no action is required; i.e. they are not impacted by the outcome of the loan charge review.

Where taxpayers have settled their affairs with HMRC under voluntary restitution, the taxpayer will be due a refund from HMRC if:

- the loans were made before 9 December 2010; and/or
- the loans were made between 9 December 2010 and 5 April 2016 and the taxpayer 'fully disclosed' the use of the arrangement to HMRC.

The government will introduce legislation in Finance Bill 2020 to implement the changes to the loan charge. With the Budget announced for 11 March 2020, the typical timeframe for Royal Assent is July 2020 which it is assumed will have effect from 20 December 2019. HMRC's guidance states that they will not be able to process any refunds until changes to the loan charge legislation have been enacted in Parliament.

It is expected that HMRC will write to taxpayers who have settled the tax due on a DR arrangement, or have not settled and could be subject to the loan charge, to set out what the changes mean to them.

## **Other things to consider**

### Information Return

As set out in the recap section above, the users of DR arrangements should have filed an information return online with HMRC by 30 September 2019, or potentially be subject to various penalties.

For those no longer caught by the loan charge and who did not provide the information return discussed above, it should be an academic issue; however, the review was silent on this matter.

### Inheritance tax

There are a number of taxpayers who have settled with HMRC and included an inheritance tax (IHT) liability on the write-off of their loans as part of settlement. It is important to note that the loan charge review did not cover the IHT implications of DR arrangements and that IHT is a completely different tax charge.

Whilst the loan charge and/or a settlement may not apply or be required, taxpayers must still consider the ten year and exit charge implications in respect of the DR arrangements they have participated in, under the IHT legislation.

It is important to note that taxpayers who have settled under voluntary restitution and have included IHT on the write-off of their loans will need to consider with their advisors whether the IHT liability is now recoverable.

### ITEPA 2003 Part 7A

For taxpayers who settled with HMRC under voluntary restitution, in many instances the loan itself was written-off. Upon the write-off of the loan, a charge would have been created under ITEPA 2003 Part 7A. However, under settlement, HMRC did not tax the same income twice and therefore the write-off of the loan did not trigger the Part 7A income tax charge.

Where HMRC will be refunding taxpayers who settled under voluntary restitution, it is unknown whether HMRC will now pursue the tax on the write-off of the loan that would have been due under Part 7A. This is given the settlement of the income tax

liability under DR will now not have occurred.

### Meaning of 'fully disclosed'

For loans made between 9 December 2010 and 5 April 2016, taxpayers will not be subject to the loan charge if they 'fully disclosed' their participation in a DR arrangement and HMRC did not open an enquiry. The government and HMRC have not yet provided a definition of what constitutes 'fully disclosed'. This is a crucial term and the interpretation of it could affect a number of taxpayers.

The majority of taxpayers in our experience did not include information regarding loans from a DR arrangement on their Self Assessment tax returns. Is this the test for what constitutes 'fully disclosed' or could it be something different? For example, could the inclusion of loans in the financial statements of the trusts, or the existence of an employee benefit trust in company financial statements, constitute a 'fully disclosed' DR arrangement for these purposes? Would a DOTAS number be sufficient? Or would disclosure by promoters be sufficient?

Unfortunately, there is no straightforward answer as of yet. This is very much a 'watch this space' in respect of how the interpretation of this wording develops and the practical outcomes.

### **Conclusion**

The world of DR arrangements, settling with HMRC and the introduction of the loan charge was already complicated, producing different tax and commercial outcomes for every client.

With the loan charge review, whilst its conclusions are to be welcomed, the DR world has just got even more complicated and convoluted. Taking specialist and bespoke advice is highly recommended!