Paradise lost; paradise regained

Employment Tax | Management of taxes

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Keith Gordon takes a second look at a case concerning schemes where contractors were paid in loans

Key Points

What is the issue?

Hoey v HMRC is a lead case considering the effectiveness of HMRC's challenge to the many thousands of contractors whose work arrangements were channelled into

schemes that ended up paying them the majority of their earnings in loans.

What does it mean for me?

It was Mr Hoey's case that the PAYE regulations confer on employees a credit for any tax that should have been deducted under PAYE, reflecting the fact that HMRC's principal remedy in cases of PAYE non-compliance is pursuing the non-compliant employer and not the employee.

What can I take away?

According to the findings of the Upper Tribunal, the taxpayer has a tax liability which will be cancelled (or at least substantially ameliorated) by the PAYE credit – meaning that HMRC will end up with no or little tax.

In the October 2019 issue of Tax Adviser, I considered the decision of the First-tier Tribunal in the case of Hoey. This has become a lead case considering the effectiveness of HMRC's challenge to the many thousands of contractors whose work arrangements were channelled into schemes that ended up paying them the majority of their earnings in loans. Readers will be aware that HMRC had hoped to avoid this litigation by introducing the loan charge, the principal purpose of which was to encourage taxpayers to abandon their appeals.

However, leaving aside the issue of the loan charge, in my view HMRC did not recognise that many contractors did not significantly benefit financially from the loan arrangements – a slice of the supposed tax savings was pocketed by the promoters in the form of ongoing arrangement fees. As a result, some contractors were not in a position to settle on the terms put forward by HMRC, leaving them with no choice but to continue fighting through the courts.

The facts of the case

The facts of Hoey are typical of such cases. At the previous hearing, the First-tier Tribunal expressly found that Mr Hoey's motivation for entering into the arrangements was not to save tax but to avoid the complexities of running his own company. Indeed, he did not understand the underlying tax structure.

Although many contractors were subject to enquiries (which were not actively pursued for many years, in many cases for over a decade), Mr Hoey's case concerns discovery assessments. As well as saying that the schemes were ineffective on ordinary principles, HMRC advanced an alternative argument by reference to the transfer of assets abroad legislation (discussed in another context in my article 'Terms of procurement' in the March issue of Tax Adviser).

In the light of the Supreme Court's decision in the earlier Rangers case [2017] UKSC 45, Mr Hoey accepted that the arrangements were ineffective and that tax should have been paid. However, as was made clear in Rangers, the taxable payment was not the advance of the loan (as previously argued by HMRC), but the earlier diversion of Mr Hoey's earnings into the trust that later made the loan to him. Accordingly, again as held in Rangers, it was that payment into the trust that attracted a liability to deduct tax under PAYE.

It was Mr Hoey's case that the PAYE regulations confer on employees a credit for any tax that should have been deducted under PAYE, reflecting the fact that HMRC's principal remedy in cases of PAYE non-compliance is pursuing the non-compliant employer and not the employee. HMRC did not dispute the fact that this credit usually arises. However, in the present case, it advanced the following two arguments:

1. The existence (or otherwise) of the credit PAYE is not a matter that the First-tier Tribunal can decide. Instead, if the appeal is not successful and the assessments are therefore upheld and Mr Hoey does not pay the tax demanded, it will be up to Mr Hoey to assert the existence of the PAYE credit as part of his defence in any subsequent enforcement proceedings (in the County Court).
2. In any event, HMRC had effectively withdrawn the credit by exercising its power under the Income Tax (Earnings and Pensions) Act 2003 s 684(7A)(b).

In the First-tier Tribunal, Mr Hoey's appeal failed for the following two reasons. First, the procedural challenges to the discovery assessment were dismissed. Secondly, the First-tier Tribunal considered that there was nothing in the legislation that prevented HMRC from removing the credit under s 684(7A)(b), even many years after the date on which the credit first arose.

The one consolation for Mr Hoey was that the First-tier Tribunal held that the transfer of assets abroad legislation was of little benefit to HMRC because the

additional income assessable under those rules was nil (given that the income was already taxed as employment income).

Mr Hoey appealed to the Upper Tribunal.

The Upper Tribunal's decision

The case of Hoey v HMRC [2021] UKUT 82 (TCC) came before Mr Justice Adam Johnson and Judge Swami Raghavan. The Upper Tribunal distinguished between, on the one hand, the amount of an HMRC assessment (which would be justiciable in the First-tier Tribunal) and, on the other, the amount of tax payable as a result of the assessment (which is a matter for consideration in collection proceedings only, typically in the County Court).

In the present case, the Upper Tribunal held that the wording of the PAYE regulations conferring the credit put the case into the latter category. Accordingly, the question as to the availability of the credit was not something that the First-tier Tribunal could consider and would become live only if HMRC chased Mr Hoey for payment. Accordingly, the effectiveness or otherwise of HMRC's decision to remove the credit retrospectively was not something that the Upper Tribunal had to consider.

The Upper Tribunal also dismissed the taxpayer's appeal in relation to the validity of the discovery assessment. HMRC also clawed back some ground in relation to the legal points arising in respect of the transfer of assets abroad legislation. However, the Upper Tribunal upheld the First-tier Tribunal's decision on the more fundamental point, being that the taxable income arising under the transfer of assets abroad code is nil. Nevertheless, as a result of the earlier parts of the tribunal's decision, the Upper Tribunal upheld the assessments as made by HMRC.

Commentary

Taking a strict approach to the case, it is without doubt that the taxpayer lost and HMRC will technically be entitled to treat this as another HMRC victory in avoidance-related litigation. However, it is very likely to be a result which will have given far more pleasure to Mr Hoey (and the many other contractors who were eagerly awaiting the decision) than to HMRC.

As I have said, the Upper Tribunal did not have to consider the validity of HMRC's purported attempt to remove the PAYE credit under s 684(7A)(b). However, that did not stop the Upper Tribunal from considering it in some detail.

This is a very helpful step because, in my experience, County Court judges are usually very reluctant to get bogged down with difficult questions arising from the tax code (there is, after all, a specialist tribunal which is meant to deal with tax disputes). Of course, in the present case, the Upper Tribunal has decided that this is a question that must be addressed in the County Court and, therefore, it is likely that County Court judges will be grateful for the Upper Tribunal's analysis on the point, which considered earlier decisions on the point.
In the First-tier Tribunal, the Judge had said: 'I cannot escape the fact that the wording of s 684(7A) seems to give a very wide discretion to HMRC and effectively renders [the provisions that allow the credit to be removed but with greater protection given to taxpayers] otiose.'

In another similar case (Higgs v HMRC [2020] UKFTT 117 (TC)), the First-tier Tribunal held:

> 'In my view, the aims and applications of s 684(7A)(b) overlap with those of [those other provisions that expressly remove the PAYE credit]. It follows that they are not mutually exclusive … I cannot agree … that giving s 684(7A)(b) a wide – including retrospective – interpretation
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> "undermines the careful balance within the PAYE regulations": I consider that it was intended that HMRC should have both the discretion conferred by s 684(7A)(b) and the powers contained [elsewhere].
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> 'I reject [the taxpayers'] primary submission that s 684(7A)(b) must operate prospectively only. On the contrary, I agree with [HMRC] that the converse is true: there is nothing in the statutory wording that cuts down the exercise of the discretion to a prospective application. In my view, so long as the discretion is properly exercised in accordance with the statutory requirement (that an officer of HMRC "is satisfied that it is unnecessary or not appropriate" that a person comply with the PAYE Regulations), then I see no difficulty with the decision having prospective and/or retrospective effect.'

On the other hand, in yet another case (Lancashire v HMRC [2020] UKFTT 407 (TC)), the First-tier Tribunal took a different view on the same point:

‘In my view, it does not necessarily follow, as HMRC seemed to suggest, that the legislature must be taken to have intended that the retrospective disapplication of the payer’s compliance obligation, where relevant, is to be read into regulations which determine the tax position of the relevant worker. It is one thing to disapply the PAYE regulations retrospectively to relieve the payer/employer from its own obligations under them for a tax year and another, in effect, to re-write the rules under which the employee/worker is required to calculate his tax liability for that tax year.’

In the present case, the Upper Tribunal took a similar view to that in Lancashire. As the tribunal held:

‘[T]he plain reading of the language is that it has prospective effect … If 7A were to have this retrospective effect one would expect clear words. In fact, the statutory language is consistent with prospective effect.’

In my view, the Upper Tribunal’s decision on the question of retrospection cannot be faulted and that the first two decisions in the First-tier Tribunal (in Hoey and Higgs) were wrong – I should add for completeness that I represented Mr Higgs in the First-tier Tribunal.

Subject to any appeal (as to which see below), the result of the case is that:

1. The taxpayer has a tax liability which
– in the non-binding view of the Upper Tribunal – will be cancelled (or at least substantially ameliorated) by the PAYE credit – meaning that HMRC will end up with no or little tax.
2. HMRC cannot engage the Transfer of Assets Abroad (TOAA) code in an attempt to get around the PAYE credit point. To be fair, I am not sure that, even if the TOAA code could be engaged by HMRC, it would cancel out the PAYE credit. However, that point was decided against the taxpayers in Lancashire (but might well be revisited on further appeal).

As I have said, this is a defeat that is likely to have caused the taxpayer little disappointment.

What to do next

Ordinarily, I use this section to suggest what advisers in other related cases might wish to consider doing. However, in the present case, the more pertinent question is what should Mr Hoey and HMRC do next?

Of course, the obvious answer (in my view) is that HMRC should recognise the fallacy of its arguments about s 684(7A)(b) being used retrospectively. The provision was never designed for such purposes and HMRC's own manuals disavowed any such power. Indeed, when HMRC's officer in the First-tier Tribunal responded to this point by suggesting that the guidance must have been wrong, when he was not even a PAYE expert, he undermined credibility in HMRC's ability or willingness to deal with taxpayers in a professional manner.

I fear, however, that that obvious way forward for HMRC is unlikely to be attractive to it and it might therefore now try to pursue the tax from Mr Hoey, who will then have to deploy the points articulated by the Upper Tribunal when asserting the existence of the PAYE credit. As I have said, the Upper Tribunal's analysis is likely to be readily followed in the County Court (or, even in the High Court, if the case is transferred there) and the matter might then have to be considered again at the Court of Appeal.

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Of course, Mr Hoey could appeal against the Upper Tribunal's decision (remembering that he lost the appeal) to the Court of Appeal. Although he might persuade the tribunal to find that the discovery assessment is invalid or even knock out the TOAA line of attack, the real purpose of any further appeal would be to get the court's determination that the PAYE credit point can indeed be raised in the First-tier Tribunal. Whilst that would undoubtedly be a nice result to achieve, there is very little point in Mr Hoey pursuing the point to the Court of Appeal. This is because, absent such an appeal, the current state of the law is that the argument must be raised in the County Court.

Furthermore, HMRC could not turn round in Mr Hoey's case and argue that, actually, it was wrong after all and try to persuade a County Court that it does not have

jurisdiction to hear the argument. That would amount to an abuse of process and possibly also fall foul of the res judicata principle. Therefore, even if (in another case) the courts were to decide that the Upper Tribunal was wrong on this point, Mr Hoey should still be fully entitled to run the PAYE credit argument in the County Court.

There is a theoretical possibility of HMRC itself pursuing some of these arguments to the Court of Appeal, even though it won in the Upper Tribunal. However, that is not something that it usually does and I do not expect it to do so in this case.

The Upper Tribunal decision refers to a stayed judicial review application made by Mr Hoey and that might be revisited in the light of the tribunal's decision. However, without any details as to what that claim entails, I cannot tell whether it is likely to be resurrected now. But for that possibility, the most likely course of action is that the case will now be transferred to the County Court, with HMRC fighting the PAYE credit point on the back foot.

However, this then leaves the question as to what other taxpayers in a similar position should do. One obviously attractive (and cheap) option is to abandon any appeals and simply await enforcement proceedings in the County Court and then deploy the PAYE credit point. However, there is a real risk that HMRC would seek to argue that, by abandoning any appeal, the taxpayer has effectively accepted that the tax is due in full.

Accordingly, I think consideration should be given to pursuing the appeal on the basis of the PAYE credit and await HMRC's arguments in response. Only if HMRC then asserts that the argument should be deployed in the County Court might it be safe to abandon the appeal.

Of course, HMRC could make a public statement to the effect that (notwithstanding its views about the availability of the credit) it considers it to be a matter for the County Court and that it will not seek to argue that it should be raised in the course of tribunal proceedings. The advantage would be that unnecessary proceedings in the First-tier Tribunal could be averted to the advantage of taxpayers, HMRC and the tribunals.

However, it should also be noted that to the extent that a taxpayer wishes to challenge the validity of any discovery assessment (or closure notice), that is a matter that will have to be argued in the First-tier Tribunal. Therefore, appeals

should not be abandoned if such arguments are still to be advanced.

Finally, this complexity lends support to the idea that a judicial review might prove to be the most effective way forward (even though that is not usually for the faint-hearted). If that course of action is to be pursued, I would recommend that legal advice be sought promptly.