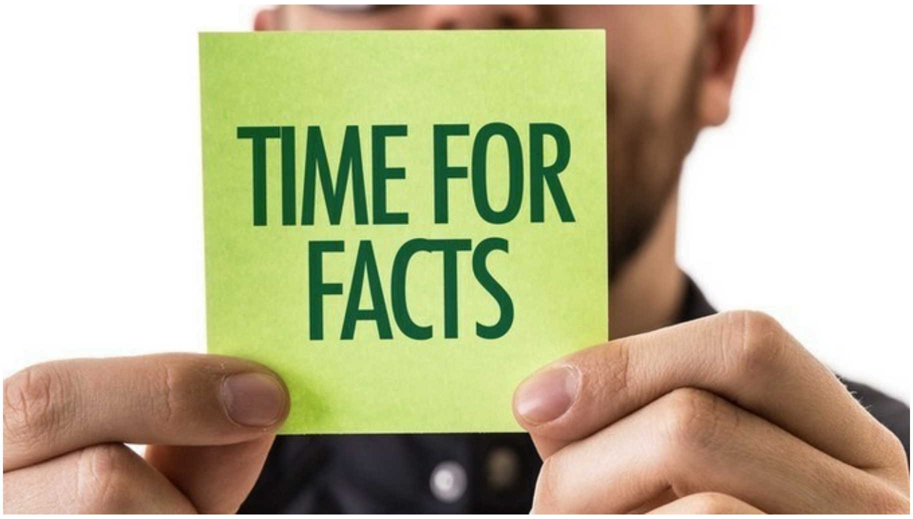
The April 2019 Loan Charge - Ultimate contractor guide



Contractors who have engaged in disguised remuneration schemes over the past two decades have little time left to avoid potentially huge tax penalties, as the April deadline for the 2019 Loan Charge approaches.

Billed by HMRC as 'a charge on outstanding loan balances', the retrospective tax charge looks set to have disastrous consequences for contractors, many of whom engaged in tax avoidance schemes to avoid perceived excessive taxation at the hands of IR35.

The Loan Charge grants HMRC license to punish contractors retrospectively for loan agreements dating back to 1999. As such, it has been heavily criticised by experts, who have described it as a disproportionate response to an issue which is partly HMRC's own making.

Though legal and parliamentary action against the Loan Charge is underway, affected contractors are advised to act fast to mitigate their impact. To assist them, Philip Manley, former HMRC inspector and current tax partner at Dow Schofield Watts, shares everything that you need to know about the 2019 Loan Charge.

What is the 2019 Loan Charge?

In the Finance Act (No 2) 2017, Government introduced aggressive measures to tackle the use of disguised remuneration loan schemes, known as the 2019 Loan Charge.

The charge targets remuneration by way of a third-party loan, the most common being the Employee Benefit Trust (EBT). Here, an employer would pay into an EBT and receive a tax deduction, with funds paid out to employees as non-taxable loans which were to be left outstanding indefinitely.

"Rules had already been introduced within the Finance Act 2011 to ensure that EBT loans were taxed as employment income," explains Manley. "This tax charge didn't apply to loans made before the 2011 Finance Act, meaning those loans were safe for the time being.

However, when the Loan Charge was introduced in 2017, it granted HMRC power to look back almost 20 years over the tax affairs of those involved. This is far more than the four-year enquiry window that HMRC is granted to raise a standard discovery assessment, and predictably has had a devastating impact.

"Such retrospection stomps all over the absolute necessity of certainty within taxation that enquiry windows provide," explains Manley. "Considering the emphasis that the Organisation for Economic Co-operation and Development (OECD) places on such certainty, it will be interesting to hear its response on the matter of the Loan Charge."

The Loan Charge is not limited to EBTs. HMRC can investigate and apply a charge to any third-party loan which is found to have been set up with the intention of benefitting an employee, and which was entered into on or after 6 April 1999.

“Whatever portion of the loan is still outstanding by the 5 April 2019 deadline will be subject to the charge,” notes Manley. “Taxpayers have until then to make repayments to reduce or negate their Loan Charge, which must be paid in cash only.

“The legislation was obviously geared towards motivating those in receipt of these loans to repay them before the Loan Charge takes effect, to mitigate their impact and show that their loans were not disguised remuneration.”

Who and what is to blame for the 2019 Loan Charge?

The Loan Charge is a means of tackling loan schemes. For many, initial involvement seems to have been driven by IR35. The Loan Charge encompasses disguised remuneration loans entered into throughout the existence of IR35, which Manley notes sparked an uptick in scheme usage:

“IR35 was the beginning of the situation that we find ourselves in today. Many limited company contractors joined these schemes to avoid breaking IR35 rules, and the majority of contractors caught in this charade were sold these structures as protection against IR35 by advisors.

“HMRC has been quick to condemn those involved as large-scale tax avoiders,” Manley continues. “But what it has failed to acknowledge is that, due to the fees paid to promoters, contractors often received a very similar amount in net pay to what they were previously receiving through their limited company prior to IR35.”

Manley adds that, for the majority, tax avoidance wasn’t the main motivation, as the relatively modest savings made would suggest. Instead, the key driver for most was escaping punitive taxation at the hands of IR35, which imposed both employment taxes and employer’s National Insurance (NI) upon affected contractors. This results in an effective tax rate far more than that paid by an employee.

HMRC’s failure to tackle loan schemes and close loopholes has also inevitably contributed to the introduction of the Loan Charge. Remarkably, despite schemes being displayed on individual tax returns and Disclosure of Tax Avoidance Schemes (DOTAS) numbers declared, HMRC failed to open an enquiry into many cases.

“The enquiries that the taxman had opened yielded nothing, as HMRC spent so much time unsuccessfully trying to convince the courts that loans were taxable,” comments Manley. “HMRC simply had no way of lawfully collecting tax where it had issued a closure notice. To get around this inconvenience, it did nothing until eventually conceiving the Loan Charge as a means of cleaning up its mess.”

Are schemes targeted by the Loan Charge illegal?

Though the loan schemes targeted by the Loan Charge are dubious, they aren’t technically illegal. Partly because those involved provided full and accurate disclosures of their tax affairs, the use of the schemes falls into the category of tax avoidance and not tax evasion.

Since the Loan Charge was introduced, HMRC has rather ambiguously claimed that the targeted schemes ‘did not work’, which Manley translates as meaning HMRC simply doesn’t like the use of such schemes:

“Ultimately, this is HMRC’s opinion, and whether right or wrong, opinion should not override the law. Though the adoption among some was unethical, these schemes were, and are legal, and there is no suggestion from HMRC that they constitute evasion.”

This view is contrary to the claims of financial secretary to the Treasury Mel Stride who, in July 2018 before the House of Commons, told MPs: “The activities and arrangements entered into by those who are in scope of this measure were not legal when they were entered into, even though they may have been entered into in the past.”

“This is extremely worrying,” notes Manley. “It either means that the financial secretary was mistaken, which is of grave concern given his position, or it means he purposely branded in excess of 60,000 individuals criminals despite knowing this not to be the case.”

How have people been impacted by the Loan Charge?

HMRC’s portrayal of the Loan Charge has added fuel to the fire, with many experts arguing that the public and Parliament have been misled. HMRC has stated before Parliament that the charge is not retrospective, insisting that loan recipients were always liable.

“If we were to believe this, it means that throughout the years, HMRC has failed to say a single word to the thousands of individuals who were steadily incurring huge costs,” comments Manley. “Given that they were disclosing their use of such schemes and were not being reprimanded or warned, these individuals had every right to assume that all was OK. Whichever way you look at it, it doesn’t portray HMRC in a positive light.”

As an advisor for thousands of individuals who are facing a Loan Charge bill, Manley also takes issue with HMRC’s impact assessment of the

2019 Loan Charge, which states: ‘this measure [the Loan Charge] is not expected to have a material impact on family formation, stability or breakdown.’

“I would estimate that three-quarters of my clients will be facing bankruptcy as a result of the Loan Charge,” notes Manley. “Two have attempted suicide. In short, the damage is devastating beyond belief.”

While HMRC anticipates that the Loan Charge will affect between 40,000-50,000 individuals, Manley believes the figure to be closer to 60,000, adding: “This figure obviously does not include family members, who of course are deeply involved when the topics are that of bankruptcy, mental health and potential suicide.”

HMRC has claimed that scheme users typically earn twice as much as the average UK taxpayer, though this isn’t consistent with Manley’s experience with his own clients – among them nurses, social workers and supply teachers: “The vast majority of those affected, who I’ve seen, fall into the average salary bracket. These are just normal people with normal jobs and normal families.”

Although it has published its impact assessment, the taxman has so far failed to prove that any real analysis was conducted. Manley highlights that HMRC has also since attempted to justify its claim that the impact of the Loan Charge will be ‘minimal’ by clarifying that it meant within the context of the entire UK population:

“To state that a measure has a minimal impact on a selection of people who clearly aren’t affected by it is the most pointless exercise possible,” he comments. “It would be laughable if it wasn’t so tragic.”

Are there any formal challenges to the Loan Charge?

Fortunately for contractors, legal challenges against the Loan Charge are being made. The Loan Charge Action Group (LCAG) has been formed to raise awareness of the tax charge and to support and inform those affected. In September 2018, LCAG launched a Judicial Review to challenge the lawfulness of the Loan Charge, for which it is inviting contributions.

A High Court judgment is expected before September 2019, though appeals through the Court of Appeal and the Supreme Court are to be expected, meaning it could take several years before a conclusive judgment is reached.

There is also strong opposition from within Parliament, where an early day motion (EDM) opposing the Loan Charge has gathered 86 signatures at the time of writing. The EDM calls on Government to revise the legislation so that it only applies to loans taken out after the Finance Act 2017 received Royal Assent, citing a number of concerns, including:

> - Retrospectively taxing something that was technically allowed at the time is unfair
> - Many individuals were required to work through these arrangements by their clients
> - HMRC should pursue these organisations, rather than individuals who acted in good faith
> - The charge is likely to cause financial distress and bankruptcies and devastate lives.

If the EDM is successful, these concerns about the Loan Charge will be debated in the House of Commons.

What will happen if the Loan Charge is overturned?

Should a challenge prove successful and the Loan Charge is overturned, HMRC would be unable to impose charges on individuals for years where no enquiry has been opened. This is especially significant, given how few enquiries were opened into the use of these schemes.

The removal of the Loan Charge wouldn’t in itself close any open enquiries. However, HMRC would be required to complete each enquiry individually and issue a closure notice if it wanted to charge tax, an action which is appealable by the individual under investigation.

Manley adds that, if the rules are changed, it seems far more likely that the charge will simply be restricted to loans entered into after the Finance Act 2017, rather than a wholesale removal of the Loan Charge:

“I believe removing the retrospective nature of the Loan Charge would eliminate 95% of the problem anyway,” he notes. “Nobody should take issue with HMRC clamping down on what it believes to be tax avoidance. Its powers to do so just need to be applied in a fair and reasonable manner, which retrospective taxation can’t be described as.”

I am concerned about the 2019 Loan Charge – what should I do?

If you are a contractor who has in the past been involved in schemes targeted by the Loan Charge, you may already be aware of an enquiry that is open against you. Alternatively, you may be yet to hear from HMRC. Either way, according to Manley, it is essential that you take professional advice as soon as possible.

“If you are concerned about the Loan Charge, the best means of mitigating your impact is circumstantial,” explains Manley. “For example, if faced with an open enquiry, settlement may be the right option for one person, but not for another.”

Manley notes that agreeing on a settlement before the deadline tends to be the cheapest option, though typically not by a significant amount, reinforcing that numerous variables need to be considered, depending on the individual’s position.

“Ultimately, this is a decision for the individual to make, as it will have such a significant impact on their lives. But what a professional will do is explain the ramifications and likely outcomes of each option in detail, to ensure that the decision is fully informed.”

If you are concerned about the 2019 Loan Charge and you’re seeking professional advice, ContractorCalculator recommends you speak to Dow Schofield Watts.

Published: Monday, October 22, 2018