



HM Revenue
& Customs

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The Rt Hon. Lord Forsyth of Drumlean
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Dear Lord Forsyth

Loan Charge follow up inquiry

At House of Lords Economic Affairs Committee session on 15 July, Mary Aiston and I committed to provide supplementary information on HMRC's work.

Do you have a legal opinion that provides the basis for the extrapolation from Rangers through to the actions that you feel it has been appropriate to take against individual contractors? If the answer is yes, please may we have a copy of it? (Q3)

In complex cases involving income tax avoidance, HMRC considers the whole range of legal arguments relevant to the facts of each particular case, and there is not a single legal opinion covering all scenarios. A UK-based employer using a loan scheme should have deducted tax from the payments under PAYE but, as with other payments of employment income, the longstanding basis of the UK income tax system is that the income tax liability is that of the employee and HMRC may collect the tax from the employee in some circumstances.

HMRC recovers tax from the employee in some circumstances because these tax avoidance arrangements are set up to try and ensure no-one pays tax. Typically, the employer is set up as part of the scheme in such a way as to ensure that tax cannot be recovered from them, such as the employer not owning assets or being based offshore.

Where the employer is offshore, PAYE regulations do not apply to them. In certain circumstances a PAYE obligation can arise on the UK end user of the employee's services, rather than his or her offshore employer. However, HMRC has found in most cases that the end user was not aware that the employee was employed by an

offshore entity and was participating in an avoidance scheme. This is despite the end user making reasonable efforts to comply with their obligations.

The Rangers decision is wide-ranging and will apply in many contractor cases. The judgment sets out the principle that income paid from an employer to a third party is still taxable as employment income. The judgment also confirmed that the Pay As You Earn (PAYE) system could operate without obstruction.

In the majority of Disguised Remuneration cases the employees initially argued that the amounts they received were not taxable as employment income. Following the decision in Rangers, employees have tended to concede that the amounts they were paid were earnings and should have been taxed. However, some contend that the end users or providers of their services should have deducted PAYE and they are entitled to a tax credit to cover the amount which should have been deducted. This is despite the fact that employees have not been able to show that they gave the full facts surrounding their engagement to the end user or provider of their services to enable them to comply with any obligations under the PAYE regulations.

Where a PAYE obligation arises on an employer or end user in respect of a payment to an employee, HMRC expects the employer or end user to comply with the requirements placed on it by ITEPA 2003 and the PAYE regulations. In general, HMRC will look to the employer to pay the amount due as the employer has an obligation to operate PAYE correctly, but HMRC will consider other options to recover the unpaid tax where the employer or end user doesn't pay or has good reason not to have complied with their obligations. Liability for the tax is always that of the employee and Parliament has given HMRC a range of powers where it can, in certain circumstances, either transfer the obligation to pay from the employer to the employee or relieve the employer of the obligations placed on it by the PAYE regulations and collect the amount due from the employee. These transfer provisions are designed to ensure fairness to both employee and employer and to ensure that the right amount of tax is paid.

There are different legal references for the ability for HMRC to transfer liability depending on the circumstances. These are mostly longstanding provisions which apply to any situation where the PAYE system has not been operated correctly, but the application to tax avoidance schemes is:

Legal reference	When these provisions may be applied to tax avoidance schemes
s.684(7A) (ITEPA 2003) This section allows HMRC to disapply the PAYE regulations so the liability falls with the individual rather than the employer.	The PAYE regulations were not intended to ensure that the employer, or any other person treated as making a relevant payment of PAYE income, should bear the cost of unwittingly becoming party to an individual's arrangements to avoid their tax liability.

	HMRC will disapply the PAYE regulations where an officer considers it “unnecessary or not appropriate” for the employer/end user to account for the tax if they are not operating a tax avoidance scheme, but where the employee is part of a tax avoidance scheme and should therefore bear responsibility for the tax due. This would apply, for example, to an end user who was unaware of a tax avoidance arrangement set up to insert an intermediary ‘employer’ below them in the chain to operate the tax avoidance scheme. This section was introduced to prevent the end client being liable for tax when they were not party to the avoidance scheme.
Section 689(4A) (ITEPA 2003) Section 689 enables HMRC to require someone who is not the employer of an employee, but for whom the employee works, to account for PAYE on that employee’s earnings.	This provision will be used to remove any PAYE obligation that a UK end user or agency may have had in respect of the Loan Charge if the employee who had used the avoidance scheme was employed by a person abroad. It ensures that no UK entity ever becomes liable for PAYE in these circumstances, so the liability for tax due on Loan Charges arises directly on the employee who received the loan. As above, this ensures the UK end user is not liable for tax when there is a contrived offshore employer/employee relationship and there is lack of knowledge about scheme usage by the end user.
Regulation 72(5) (Income Tax (Pay As You Earn) Regulations 2003) Where there has been a failure to operate PAYE, Regulation 72 permits HMRC to: • direct that the employer is not required to pay the unpaid tax, and	These provisions allow for tax to be collected direct from an individual where the employer has not accounted for the tax under the PAYE system. There are stringent conditions to protect the employee from being liable for tax the employer should have paid but, in tax avoidance scheme use, Condition B is deployed when the failure to operate

• issue a PAYE Direction under Reg 72(5) to an employee, where there has been a failure to deduct tax under PAYE and either Condition A <u>or</u> Condition B is met. ○ Condition A is that the employer satisfies HMRC – (a) that the employer took reasonable care to comply with the PAYE Regulations, and (b) that the failure to deduct the tax was due to an error made in good faith. ○ Condition B is that HMRC is of the opinion that the employee has received relevant payments (earnings), knowing that the employer wilfully failed to deduct the amount of tax which should have been deducted from those payments.	PAYE is a deliberate act by the employer and the employee is aware of this action. As described above, this regulation is often used where the ‘employer’ is routinely set up as part of the tax avoidance scheme and set up in such a way as to ensure that tax cannot be recovered from them.
Regulation 81(4) (Income Tax (Pay As You Earn) Regulations 2003) Regulation 80 allows HMRC to assess the employer for an amount of unpaid tax. Where this has not been paid by the employer, Regulation 81 permits HMRC to: • direct that the employer is not liable to pay the tax in question, and • issue a PAYE Direction under Reg 81(4) in circumstances where the outstanding Reg 80 tax has not been paid within 30 days of the Reg 80 becoming final and conclusive, and either Condition A <u>or</u> Condition B is met.	These provisions will be used in similar circumstances to when Condition B within Regulation 72(5) is deployed where the employee is aware that PAYE has not been accounted for correctly. The difference is that Condition B within Regulation 81 is used in relation to tax avoidance schemes when HMRC has issued an assessment for tax under Regulation 80 and it is not paid within 30 days, as opposed to Regulation 72(5) which applies to a ‘historical’ inaccuracy. It is also used since most avoidance schemes use third parties to make payments to employees which are notional payments for the purposes of PAYE. These are specifically covered by Regulation 81.

○ Condition A is that HMRC is of the opinion that the employee has received relevant payments (earnings), knowing that the employer has wilfully failed to deduct the amount of tax which should have been deducted from those payments. ○ Condition B is that the unpaid tax represents an amount for which the employer was required to account under Reg 62(5) (notional payments) in relation to a notional payment to the employee.	As described above, this regulation is often used where the 'employer' is routinely set up as part of the tax avoidance scheme and set up in such a way as to ensure that tax cannot be recovered from them.
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How many agencies are included in the category of employers from which HMRC has recovered tax related to loan schemes (Q4)

As we explained at the hearing, we first of all consider whether we can recover tax from the employer. This includes agencies who, in certain circumstances, are treated as the employer for the purposes of PAYE. In cases where we have settled, around 30% of settlements are with employers, including agencies who have been treated as employers. We do not have data available about the business sectors that those who have settled operate in so we cannot say how many of them were agencies. We prioritise recovering tax from agencies in the same way as we do for employers.

What is the mean and median averages of tax under consideration in disguised remuneration schemes, and the standard deviation (Q8)

It is not possible to reliably estimate tax under consideration at individual level before full compliance enquiries have been carried out because while HMRC may know a taxpayer has used a Disguised Remuneration scheme we will not always know the amount of the loans received. Therefore, HMRC does not have full data on the tax under consideration for the whole population of Disguised Remuneration scheme users.

HMRC shared data on disguised remuneration settlements with Lord Morse for his Independent Loan Charge Review. The table below sets out the mean and median settlement amounts for individuals over time, from Budget 2016 up to 30 June 2019.

	Median	Mean
End of December 2018	£13,000	£45,000

	Median	Mean
End of March 2019	£18,000	£58,000
End of June 2019	£18,000	£59,000

The averages have changed as more individuals have settled, and we expect they will continue to change as more individuals settle. We plan to publish updated settlement numbers in the autumn. They are currently being assured, and we will share these with the Committee at that time.

Please note that the group of customers who have settled may not be representative of the whole Disguised Remuneration population, as only a subset has settled so far. Settlement amounts also include any interest, penalties and surcharges and as such are not a direct reflection of the original tax at risk.

The Loan Charge was legislated in Finance (No.2) Act 2017 and is part of a package which was estimated by the Office for Budget Responsibility to yield £3.2 billion over five years.

Progress on processing refunds in respect of voluntary settlements (Q6)

The Independent Loan Charge review led by Lord Morse recommended that HMRC should refund voluntary restitution elements of settlements made since 2016 that were paid to settle unprotected years when the relevant loans were entered into: a) prior to 9 December 2010; or b) between 9 December 2010 and the start of the 2016-17 tax year, where the customer made reasonable disclosure of their scheme usage in their tax return. Lord Morse also recommended that HMRC should ensure that repaying the voluntary restitution does not lead to any unintended tax advantages for those using loan schemes.

We need to work through what was included in a settlement, what reliefs and benefits have been offset in the settlement and then work out whether any adjustment is required to ensure that repaying the voluntary restitution does not lead to any unintended tax advantages, as recommended by the Independent Loan Charge review.

We are working through cases as quickly as possible and will update the Committee on our progress by the end of the year.

I hope the Committee finds this information helpful.

Yours sincerely

J Harra

**JIM HARRA
CHIEF EXECUTIVE AND FIRST PERMANENT SECRETARY**

