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HM Treasury

Name: [x]  
Team: [x]  
Date: [13 December 2019]

To: Chancellor of the Exchequer

cc: Financial Secretary to the Treasury

Response to the Independent Loan Charge Review

Summary

[To draft after the main body of the submission]

Background

1. [DN – I think we need to remind the Chx what DR is before we describe the LC. The Loan Charge is due to be paid by affected taxpayers on 31 January 2020. Following significant opposition from the Loan Charge Action Group (LCAG) and from the Loan Charge APPG, which had more than 200 members. You commissioned an independent review of the policy and whether it was an appropriate response to disguised remuneration (DR) tax avoidance in September. The Review has been led by Sir Amyas Morse (former CEO of the National Audit Office), who has now submitted his report for your consideration.
2. This submission focuses on the response to the Review. You need to decide how to respond to the recommendations, when to publish his report and the Government's response.

Summary of Review's recommendations

3. The Review makes several recommendations about the Loan Charge and the wider approach to tackling ongoing DR tax avoidance. Overall, Sir Amyas recognises that those using these schemes were engaged in tax avoidance and the Government has been correct to tackle it. He recommends retaining the Loan Charge, but making some important changes to the scope in order to mitigate some of its effects on individuals and employers. He has focused on the overall fairness of the policy, the distress and hardship it could cause, and HMRC's accountability we will need to come back to this and check this is right – I am not sure we were expecting the review to focus significantly on HMRC accountability. His recommendations have significant costs to the Exchequer of around [£1 billion] over the coming years. [DQ – can we flag – that the reviewer appears to have based his recommendations largely on the uncorroborated personal testimony of those affected by or campaigning against the LC rather than the extremely detailed evidence from HMRC/HMT. It is disappointing if the reviewer has not balanced his conclusions and base this more on evidence]
4. Sir Amyas has also roamed beyond the terms of reference and made several recommendations that have wider application, such as an internal review I think the recommendation is a review of the interest rate used rather than how HMRC applies it of

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how HMRC applies interest in the future and even questioning whether tax advisers should be regulated in order to provide more effective oversight of the tax advice market.

5. The full list of [XX] recommendations are in Annex A, but the most significant are below.

*Design of Loan Charge*

- It should only apply to loans taken out after 9 December 2010 (rather than 6 April 1999), when specific anti-avoidance legislation to tackle DR was announced and came into effect. Sir Amyas judges that it was clear that individuals and employers should not have been using these schemes from this date, but it is plausible that there was some ambiguity before then. Need to revisit when we see the report and I understand this is referring to the reviewer but I think we need to be careful not to imply that we accept that people could have thought it was OK to be paid in loans via offshore trusts at any time. Can we rephrase this to focus more on the fact that before this date there was less clear communication about these schemes and HMRC activity and bigger bills for individuals?
- Loans taken out after 9 December 2010 should remain within the scope of the Loan Charge unless the individual who used of the scheme can prove they disclosed details and HMRC failed to take action to protect its position by, for example, opening an enquiry. Sir Amyas judges that the Loan Charge should not give HMRC a “second bite of the cherry” where individuals disclosed that they were using a scheme and HMRC did not take action. Can we add in our analysis of the 96-99% here
- Repaying tax to those who have settled their underlying liabilities with HMRC for loans that would no longer be subject to the Loan Charge if the Government accepted the Review’s recommendations, i.e. where “voluntary restitution” had been paid by individuals and employers since the Loan Charge was announced in March 2016. We need to explain this more fully
- If they wish, users should be able to choose to spread the remaining outstanding loan balance on 5 April 2019 evenly over 3 tax years (2018-19, 2019-20 and 2020-21) rather than one tax year (2018-19), i.e. a third of the loan balance is allocated to each year to reduce the marginal tax rates in some cases. Sir Amyas judges that the taxing all the loans in one year unfairly increases the tax due by causing some people to pay a higher marginal rate. Flag that individuals had the opportunity to pay tax in the relevant years

**Commented [WJ(K1):** Does the recommendation relate to individuals only as described here, and not employers? Our costing covers both groups.

*Individual impact of the Loan Charge*

6. Sir Amyas also recommends providing special payment arrangements on more generous terms than those HMRC currently offer to anyone else, including tax credit claimants, struggling to pay their debts:
- Anyone with income of less than £30,000 should be able to enter into a special time-to-pay arrangement that will include allowing any remaining Loan Charge liability to be

written off if it hasn't been repaid after 10 years. Sir Amyas thinks it is unfair that individuals have debts hanging over them for a long period of time.

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#### HMRC implementation

7. Sir Amyas also recommends improvements to the customer experience:

- HMRC should update taxpayers directly about open tax enquiries at least annually. Sir Amyas thinks it is unreasonable that, in the past, taxpayers have found themselves subject to open enquiries for many years without HMRC keeping in touch with them directly.
- HMRC should increase funding to external bodies, such as tax charities, to provide independent advice to those entering into time to pay or other debt collection arrangements with HMRC

#### Next steps and future

8. Sir Amyas also recommends further action to tackle the ongoing use of disguised remuneration schemes, noting that around 8,000 individuals have used them since April 2019, 3,000 of whom are using them for the first time, despite the challenges that the Loan Charge was draconian publicity and clear public statements from HMRC maintaining that these new schemes do not work:

- The Government should explain how it will tackle ongoing use of DR schemes given the continuing scale of use post the Loan Charge period. The reviewer does not offer recommendations as to how the government might seek to stop this form of tax avoidance in the future
- The Government should seek to improve the market for tax advice and tackle those who continue to promote use of DR schemes, including publishing a strategy within 6 months and considering more effective oversight of the market (which could include more formal regulation of tax advice)

#### Impact of these recommendations

9. The recommendations will affect individuals and employers in different ways depending on their own circumstances, and the information available about the detailed characteristics of all DR scheme users is limited, so it is difficult to make generalisations and there will be extreme cases. All estimates are subject to change following ongoing analysis and scrutiny by the OBR. A fuller appraisal of the impacts is available in Annex B, but in summary:

- The total cost to the Exchequer is estimated to be around £1 billion if all recommendations are accepted. This is broadly around 60% of the yield forecast from the Loan Charge and settlements that was scored.
- We estimate that Around [10,000] individuals and [1,000] employers who have not settled will be taken out of the Loan Charge entirely because all their loans were before 9 December 2010.

Commented [WJ(K2)]: I need to check and confirm this statement – the comparison with what had previously been scored is not straightforward.

Commented [H3]: DN: Could we in a sentence or two remind CHX of the overall size of the population here (50,000) and explain the interaction between individuals and employers (e.g. are the 50,000 individuals employed by the 10,000 companies, if not what is it, etc)

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- Of the remaining [32,000] individuals who have not settled, around [xxxx] will receive some benefit from the recommendations.
- Of the [5,000] individuals and [4,000] employers who have settled, around [1,000] of each will receive a repayment and/or not have to pay further voluntary restitution.
- Around [10,000 individuals] will not benefit from any of the recommendations.

**Commented [H4]:** KAI: Is it possible to produce an aggregate figure for number of individuals who benefit from the recommendations in their totality?

10. While we cannot provide full estimate of how the impacts differ across the population, the analysis suggests that the recommendations impact different taxpayers very unequally. A small group who have settled and benefit from the recommendations (around [1,000] individuals and [1,000] employers) make up the majority of the revenue lost (£700 million), while other taxpayers may only marginally benefit from the other recommendations.

**Commented [WJ(K5):** I need to check this with the KAI team

11. Some of the recommendations (e.g. spreading the Loan Charge balance across three tax years) add a level of complexity for taxpayers which will make it difficult for taxpayers to make a decision without professional tax advice.

12. These recommendations are all deliverable, but the changes are complex for HMRC to implement and for taxpayers to navigate in time for 31 January 2020. The operational impact is severe and for those impacted, there will be a very disrupted and difficult customer journey, e.g. customers will receive automatic penalty notices even if HMRC allows people more time to submit or amend returns following 31 January 2020. The operational delivery and taxpayer experience will therefore be sub-optimal given the time pressure, but HMRC will do everything possible to mitigate this.

13. In addition to the fiscal and operational impacts there are broader concerns about future efforts to check this form of tax avoidance which continues to grow.

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#### Options on responding to the report

14. You have a choice about how to respond to the review. In essence, you can either:

- Choose not to accept the substance of the recommendations and hold firm on defending the policy; or
- Accept the substance of the recommendations and amend the policy.

15. This is a finely balanced decision due to, on the one hand, the ongoing resistance to the policy by the campaign group and MPs, and on the other hand the fiscal costs and severe risks for HMRC's future approach to tackling tax avoidance, including the presentational risk of being seen to be soft on tax avoidance. And a focus on the action that needs to be taken by engagers, promoters and HMRC rather than the responsibility of individual users. In your decision, you will need to take into account:

- **the parliamentary and political context**  
The review was commissioned in response to considerable parliamentary resistance and lobbying under a minority Government, so addressing these concerns would be your key objective if you accept the recommendations. However, this remains a niche

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issue affecting a small group, and you should therefore consider the current parliamentary arithmetic and emerging parliamentary mood since the general election. If you consider damaging resistance to the policy remains, there is a risk that anything short of accepting all the recommendations will not satisfy MPs. Further, while some MPs who have opposed the policy may be won over by accepting these changes, officials anticipate the outcome of the Review will not satisfy the majority of campaigners, who will settle for nothing less than repeal of the Loan Charge; it is possible some MPs will continue to be influenced by this and they may continue to resist and even seek to amend the Finance Bill when you bring forward legislation to implement the recommendations.

- the reputational impact for the Government

On the one hand, a choice to reject the recommendations of a respected independent reviewer who you commissioned would be challenging to defend and you would face continued criticism from MPs and campaigners. On the other, accepting the recommendations could be seen as a U-turn by the Government considering your predecessors' position, and it would appear soft on tax avoidance, which is challenging particularly given your wider manifesto commitment to tackling tax avoidance. Finally, even if external stakeholders welcome the Government accepting the recommendations, the inevitably sub-optimal customer experience for affected taxpayers would be heavily criticised.

- HMRC's ability to collect tax from tax avoidance in future



- the fiscal impacts

As noted above, accepting the recommendations would cost around [£1 billion] if all recommendations are accepted, with longer term ramifications for the tax gap. You should consider these fiscal impacts in particular in the context of your wider strategy on tax and spending, and your fiscal strategy. Accepting the recommendations will involve taking a major measure decision outside the Budget cycle and this will constrain your spending choices later on.

#### Option 1: Responding positively to the review

~~45.16.~~ If you would like to respond positively to the review, officials recommend you accept all the review's recommendations with one exception. We recommend you reject the recommendation individuals should be able to write-off any remaining Loan Charge liability after 10 years.

~~16:17.~~ This change would set a significant precedent by giving HMRC much wider discretionary powers. Currently HMRC don't have any discretion in calculating tax liabilities which are due and set through parliamentary legislation. If you were to introduce this change, this would give HMRC much wider discretion over what tax liabilities to collect for this group. This is dangerous precedent because if this were applied more generally, it would have considerable fiscal and operational costs.

~~17:18.~~ The fairness implications are severe and would likely lead to calls to apply this change more widely, as you would be treating DR tax avoiders more favourably than other individuals with tax debts (including tax credit claimants with very low disposable incomes). This may have significant knock-on effects to taxpayer incentives and behaviour, deteriorating tax compliance both now and in the future. It is also likely to be perceived as rewarding tax avoidance.

~~18:19.~~ Finally, this change is not the best way to achieve Sir Amyas' stated objective, which we understand is to provide relief for individuals in severe hardship. HMRC already has a strong payment affordability offer for individuals who are not experiencing problem debt, and HMRC's time to pay arrangements have been successful at scale (with approximately 700,000 in place across HMRC charges), with over 90% of those completed successfully. For those with problem debt there are insolvency solutions such as Individual Voluntary Arrangements. In many cases these will be a better solution than an extended time to pay arrangement with HMRC that covers tax debt only, so Sir Amyas' proposal may push more vulnerable individuals in problem debt to make the wrong choice for their circumstances. Can we make include the point about settlers' ability to pay by way of context – ie 60% paid without the need for instalments and the balance I think was in a 3 or 4 year TTP arrangement.

~~19:20.~~ If you were to take this approach, we think the narrative for your response should include these key points:

- Welcome Sir Amyas' recognition that disguised remuneration schemes don't work and that the Government was right to take action;
- Recognise that the Loan Charge had significant effects on some users of tax avoidance particularly pre 2011 went too far and that the Government will make changes to correct this and to build trust in HMRC's approach to affordability flexible payment options;
- Commit to tackling promoters of schemes and taking future action to tackle tax avoidance.
- Reaffirm the government's commitment to tackling tax avoidance and DR in particular. Commit investment in HMRC and the courts to progress cases where the LC is removed as the means to tackle DR and future work on DR.

[PLACEHOLDER, TO BE COMPLETED FULLY WHEN HAVE AGREED POLICY POSITION: Option 2:  
Responding negatively to the review

~~20:21.~~ If you want to hold firm on the Government's principled approach to tax avoidance etc, we would recommend... Narrative would be...]

Other policy choices [NB: initial views on location of this section welcome, we will consider fully as part of process for agreeing the policy position above]

21-22. You have the option of significantly narrowing the scope of the recommendations in order to reduce the cost to the Exchequer by around [~~£x million~~ (to around ~~£x million~~ to ~~£xmillion~~)]. You expressed a strong interest in this approach during discussions about the terms of reference.

22-23. The terms of reference asked Sir Amyas to consider the impact of the Loan Charge on individuals who have “directly entered” into disguised remuneration schemes. The rationale was based on pragmatic concerns about reducing the exposure to the Exchequer from the Review by focusing on this group and that MPs’ concerns have focused on the effect of the Loan Charge on individuals. Sir Amyas has considered this and has recommended everyone, including individuals and employers, should benefit from his recommendations.

23-24. The Loan Charge creates an income tax and NICs charge on the individual based on their loan balance at 5 April 2019. However, where there is an employer, it is responsible under PAYE regulations for collecting and paying the income tax and NICs to HMRC in the first instance and then may recover recovering it from the employee.

24-25. The definition of individuals who have directly entered into DR schemes is complex, but broadly means certain contractors, typically self-employed freelancers or agency workers, whose income was diverted and received as third-party loans. However, this is only a subset of the individuals who are affected by the Loan Charge and does not include others. While it is possible to design concessions to target contractors or other groups, it is difficult to legislate this without creating hard cases at the boundaries. This is set out in more detail in Annex B. I think we are confident we can target this population more effectively than this paragraph suggests.

25-26. Despite the additional fiscal cost, we would recommend following Sir Amyas’ advice and applying the recommendations to everyone, rather than seeking to make distinctions. We believe that attempting to restrict the recommendations to individuals who “directly entered” into the schemes is deliverable, but it is imperfect, difficult to explain and defend, and will result in significant ongoing lobbying[DN So far employers have been largely silent as predicted. Do we really think leaving employers in scope will change that? Or are we suggesting the contractor lobby will change tack?. Bearing in mind the very big difference in fiscal cost I am not persuaded this recommendation feels sufficiently supported.]

#### Timing and handling

26-27. In addition to determining your preferred principled approach, you also need to make a decision about the timing of your response. You can:

- Announce your position now

This would look decisive and it has the advantage that it would be unexpected, and there won’t have been an opportunity for pressure to mount on the Government and MPs in advance of the announcement. Due to operational constraints relating to

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customers contacting HMRC over Christmas, you would need to publish on [17 or 18] December at the latest.

- Delay announcement until January

If you want time to revisit your decision in light of emerging Parliamentary mood, you could delay announcing the Government's position slightly. You would need to announce the Government's view by the first week in January at the latest to avoid the risk of being timed out from accepting the recommendations and the likely associated criticism of the Government's approach. This would mean affected taxpayers continue to face uncertainty about their position and anxiety over the Christmas period. We would expect this to receive significant negative media attention, and aggressive lobbying could seek to exploit this anxiety to intensify a push to delay or cancel the Loan Charge. Therefore, to mitigate this we would strongly recommend publicly setting out an update on the 31 January 2020 deadline before the Christmas holidays and determining the approach you want to take in early January now.

27-28. Officials will need to engage with No10 urgently on this issue to seek agreement to the updated public position you prefer in advance of Christmas, so we would welcome an indicative steer on which approach you would like to take publicly urgently to inform these discussions.

28-29. When you have determined your preferred approach to announcing the Government's position, we will ensure that a full stakeholder handling strategy is in place to deal with the media and MPs when the report is released.

Decision points

- What is your preferred principled approach:
  - a. To hold firm in defending the policy and not accept the substance; or
  - b. To accept the substance of the review.
- On the approach to the substance of the recommendations:
  - a. If a) (defend), do you agree to accept all recommendations except the 10 year write off?
  - b. If b) (accept substance), do you agree to XXX
- On timing, do you prefer to:
  - a. Announce your response now; or
  - b. Delay announcement until January, and providing a public update on the 31 January 2020 deadline in the interim?

29-30. If you are content, we will agree the detailed implementation of the recommendations with the Financial Secretary to ensure the detailed policy design has approval.

Annex A: Full list of recommendations

	Recommendation
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## Annex B: Impacts

All estimates are subject to change following ongoing analysis and scrutiny by the OBR

- The total cost to the Exchequer is estimated to be around [£1 billion] if all recommendations are accepted. This is broadly around 60% of the yield forecast from the Loan Charge and settlements that was scored.
  - [£750 million]\* is the result of it now only applying to loans after 9 December 2010,
  - [£150 million]\* is a result of removing years after 9 December from the Loan Charge if they were disclosed and HMRC took no action
    - \*Of which [£700 million] is a result of the repayment and forgoing of voluntary restitution for settlements (with [£600 million] relating to employers)
  - [£50 million] is a result of allowing users to spread the loan balance over 3 years
  - [£30 million] is a result of allowing individuals to write off any remaining liability after 10 years if they earn less than £30,000

\* A large share of the revenue impact [£700m] relates to Of which [£700 million] is a result of the repayment and forgoing of voluntary restitution for settlements (with [£600 million] relating to employers)

○

- Around [10,000] individuals and [1,000] employers who have not settled will be taken out of the Loan Charge entirely because all their loans were before 9 December 2010
- Of the remaining [32,000] individuals who have not settled, around 2,000 will receive some benefit because some of their loans were before 9 December 2010 and [22,000] will be able to reduce their Loan Charge liability by some amount (around [20%] on average) if they elect to spread their loan balance over 3 years. The amount saved will depend on personal circumstances and some could actually pay more in certain situations due to the tapering of the personal allowance at £100,000. This is why it is important for users to be able to choose to spread their loan balance rather than it applying automatically.
- Around [10,000 individuals] will not benefit from any of the recommendations
- Of the [5,000] individuals and [4,000] employers who have settled, around [1,000] of each will receive a repayment and/or not have to pay further voluntary restitution
- Around [x,000] individuals are expected to have some of their Loan Charge liability written off after 10 years.

Commented [WJ(K6)]: As above, I want to check this statement.

Commented [WJ(K7)]: This is likely to change (reduce)

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Commented [H8]: DN: Could we in a sentence or two remind CHX of the overall size of the population here (50,000) and explain the interaction between individuals and employers (e.g. are the 50,000 individuals employed by the 10,000 companies, if not what is it, etc)

Annex C: Individuals and employers

The Loan Charge creates an income tax and NICs charge on the individual based on their loan balance at 5 April 2019. However, HMRC will seek to recover the amounts due from an employer in the first instance where possible. The individual may then be asked by their employer to repay any amounts paid on their behalf.

The definition of individuals who have directly entered into DR schemes is complex, but broadly means certain contractors, typically self-employed freelancers or agency workers, whose income was diverted and received as third-party loans. However, this is only a subset of the individuals who are affected by the Loan Charge and does not include others including:

- individuals in a similar position who are contractors operating through owner-managed companies who are rewarded in the form of a loan received from a trust (although we think the number of individuals in this category is likely to be small)
- individuals who are employees and whose employer requires them repay after the employer has paid the tax to HMRC