Loans, legislation and liabilities

David Graham and **Dave Jennings** explain the application of the 2019 loan charge legislation

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There has been much coverage of the Supreme Court's decision in *RFC 2012 plc (in liquidation)* – formerly *The Rangers Football Club PLC* (2017) UKSC 45. Generally, the views of advisers and HMRC towards employee benefit trusts (EBTs) – and for EBTs also read employer-financed retirement benefits schemes (EFRBS) and various other titled trusts or third party vehicles – have changed considerably over the years and this includes changes as a result of the disguised remuneration (employment income provided through third parties) rules introduced in 2011 and now in ITEPA 2003, Pt 7A. However, the government has decided to produce yet more legislation to counter transactions that may already be subject to these prior rules. This legislation is contained in F(No 2)A 2017, Sch 11 (with supplementary changes in FA 2018, Sch 1) and is referred to here as the 'loan charge rules'.

In short, the legislation requires an individual (or related party) who borrowed from an EBT (or similar) to repay funds before 5 April 2019. Failure to do so will trigger income tax and National Insurance liabilities. The loan charge rules now form part of the disguised remuneration rules but, if the latter is referred to in this article, it is as a reference before the loan charge rules were brought into effect.

While the disguised remuneration rules seek to apply to an action, the loan charge rules focus on a failure to take action, such as a failure to repay. In this sense, companies, individuals, trustees and advisers should be aware that a lack of action or pretending not to notice cannot provide a means of escape from the income tax and National Insurance charge.

Key points

- The 5 April 2019 loan charge will apply to third-party employment loans made since 6 April 1999.
- Details may have to be reported to HMRC even if the loans have been repaid.
- There are other options: settle with HMRC before 5 April 2019 or repay the loans.
- HMRC must be approached with information before 30 September 2018 if settlement is sought before the loan charge applies.

Who is affected?

Although the disguised remuneration rules were largely effective against transactions undertaken from December 2010, the loan charge rules behave entirely differently and have a far greater reach. This new legislation requires almost every loan from EBTs since 6 April 1999 to be repaid. Several commentators have already expressed reservations about this legislation amounting to retrospective law and, therefore, potentially subject to challenge. However, and although these rules may be contentious, the focus of this article is largely on the impending deadline and the implications of the rules themselves rather than their fairness.

The rules are not straightforward and, because they have been widely drafted, they have the capacity to apply to many types of arrangements that have sprung up over the past 20 years. These rules also overlap with other legislation previously introduced in this area, particularly over the past five years or so, not least accelerated payment notices (APNs) and follower notices (FNs). Further, there are the practical issues that arise inevitably over any 20-year period. These will include:

- changes to HMRC's procedural approach during this time;
- the fact that many promoters, advisers and employers are no longer around to help clients; and
- trustees being reluctant to assist or respond, especially given the raft of rules introduced in this area in recent years.

To complicate matters, many advisers have not had uninterrupted relationships with their clients for the past 20 years, so knowing their full history to the extent this law might require can be extremely difficult. Nevertheless, these new rules place a potential requirement on all parties to the transaction (employer, employee and trustees) to assist, so it is to be assumed any agents of these parties need to be aware of these deadlines.

The deadline to repay stated by the legislation cannot be delayed by a lack of knowledge and it remains to be seen how HMRC expects these rules to be policed and supervised. This is particularly the case when advisers and their clients are simply unaware that the tax will be triggered if the company or individual fails to act. However, in recent years there has been a lack of sympathy from some quarters for people involved in such arrangements. But it does seem questionable to introduce rules in November 2017 without much publicity which require positive action within 18 months where they seek to tax arrangements that were entered into almost 20 years ago

Can the loan charge rules be avoided?

Broadly, these rules do not apply to those who have already repaid the loans before March 2016 or have settled matters with HMRC. Those who had believed they would be unaffected by these rules if HMRC did not raise an enquiry or assessment on the original transaction, will be affected. Either the stakeholders need to enter into a written contract with HMRC on their stated settlement terms or a payment to the trust must be made before 5 April 2019.

This date may be postponed in some circumstances, including if an accelerated payment notice has been paid and a dispute on liability continues or if the arrangement is an approved fixed-term loan.

Insolvency and offshore entities

It is entirely foreseeable that many of the employers that have funded these arrangements over the past 20 years will be either offshore or no longer solvent (or both) and will not be able to pay the tax arising from the loan charge rules. However, the charge can apply to the individual, not just the employer.

Last year, a consultation reviewed the ability of HMRC to recover debts from individuals that may otherwise fall due on the employer. The department has confirmed that, in the right circumstances, it may seek to rely on related rules to move the tax arising on the loan charge from the onshore or offshore company on to the individual.

An individual may have been an unwitting borrower arising from a transaction almost 20 years ago and may reasonably have expected the employer to deal with the tax risk. But, generally, it is not possible for an individual to simply assume that the defunct employer will shoulder the tax under the loan charge rules. It is HMRC's view that an individual who has an outstanding loan at 5 April 2019 must include the loan charge on their self-assessment return.

> “Broadly, these rules do not apply to those who have already repaid the loans before March 2016 or have settled matters with HMRC.”

Application

The legislation will apply if a third party has made a loan (defined further below because it extends beyond just loans) to a relevant person, including sometimes connected and unconnected parties, since 6 April 1999 and it remains outstanding as at 5 April 2019. Any loans repaid before March 2016 are excluded from these rules and will not require disclosure to HMRC under this legislation. However, any loans repayments after March 2016 must have been made in a specific manner as outlined below in order to fall outside the disclosure requirements

Persons

Some of the definitions are newly created in Sch 11 and some apply the definitions previously provided in the original disguised remuneration provisions in ITEPA 2003, Pt 7A

- Third party (ITEPA 2003, s 554A(7)). The third party, normally but not exclusively the trustee of the EBT or EFRBS, is defined as 'person P' in the loan charge as simply a person. In that sense, it is just about as wide as can be. Therefore, it would include the various forms of EBT, EFRBS, and remuneration trusts that would also, on occasion, have different names or titles given to them. The trust may be in the UK or offshore. Because the legislation defines the person so widely it may capture many other entities beyond trusts and could also include companies, including those owned by a trust, whether in the UK or offshore.

- Relevant person (ITEPA 2003, s 554A(1)). This would usually be the original employee who benefited from the loan, but not always. As tax planning evolved, the borrower sometimes became a member of the family, a favoured company, or an investment vehicle owned by the individual or family. Interestingly, the definition also catches someone entirely unconnected to the individual if the loan they received has been made by the third party at the direction or request of the individual (or even a connected person of the individual). (ITEPA 2003, s 554C(2). Again, this is a wide definition and takes account of many variations to the mainstream approach when an EBT would lend to an individual. Equally, it does not matter whether the individual was excluded from benefit under the terms of the trust or serviced the loan with annual interest payments.

Loan

Although funds were often borrowed by the individual from the trust before the introduction of the disguised remuneration rules in 2011, the 2017 legislation takes a much wider definition by including any form of credit. It also extends the definition to include something referred to as a 'quasi-loan (F(no 2)A 2017, Sch 11 para 2(2)). The latter term will capture many of the arrangements that were advised upon since the disguised remuneration rules were introduced. In many cases after 2011, rather than the trust lending to the individual, another third party – typically the employer – would pass funds or assets to the individual and they would in turn undertake to pay the trust in the future.

> “Paragraph 4 also confirms that no overlap relief can be claimed if any earlier event has not led to the tax being paid, rather than simply being payable.”

Anti-avoidance

Schedule 11 para 4 contains an anti-avoidance test that will disregard a repayment if there is 'any connection (direct or indirect) between the payment and a tax avoidance arrangement (other than the arrangement under which the loan was made)'. The definition is again widely drafted and ensures the tax charge will apply if the payment is linked to tax avoidance, albeit making sensible allowance for the original transaction that led to the loan being granted.

Double tax

Paragraph 4 also confirms that no overlap relief can be claimed if any earlier event has not led to the tax being paid, rather than simply being payable. This removes any argument that could apply under the older definition of overlap relief in ITEPA 2003, s 554Z5 which allowed relief if tax was payable. Relief can be claimed only if tax has been paid in full.

Legislation was also introduced (new s 554A5B introduced by FA 2018, Sch 1 para 1) at the same time to put beyond doubt that any earlier part of the transaction (such as the employer contributing to a trust) that might be said to have been a 'redirection of earnings' per the *Rangers* judgment, will not prevent tax being due under the loan charge rules unless it has already been paid in full on the redirection of earnings. This is important because the redirection argument was brought up only recently in litigation and HMRC had not always raised the requisite enquiry or assessment in time to backdate this approach to older cases. This amendment, therefore, now ensures the department is not shut out from applying the loan charge rules if a taxpayer may have tried to argue they should not be taxed twice.

Amounts

Schedule 11 para 3 confirms that the amount owed to the trust will consist of both the initial principal lent as well as any sums that have become principal under the loan, other than by capitalisation of interest.

Any sums owed to the trust that have not been repaid before 17 March 2016 can only be paid in money if the loan charge is to be avoided. Before then it may have been possible to pass the assets to the trust in settlement of any debt, but this approach will not be acceptable for the purposes of the loan charge if it is made after that date and before 5 April 2019. This requirement to pay in money seems unnecessary, particularly since the trust is permitted to hold assets and indeed may wish to do so should it receive payment in money towards the loan charge.

Care should be taken by the individual that they do not source funds from a third-party lender to make the loan repayment in a way that may offend the wider disguised remuneration legislation, including the various categories within s 554C (for example, borrowing money from another EBT to repay the original loan would itself crystalise a Pt 7A charge) but which the various subsequent exemptions may not save, such as those in s 554F (ordinary commercial transactions).

Fixed-term loans

Approved fixed-term loans may not require repayment before 5 April 2019 if:

- an application has been made to HMRC and was then approved by an officer;
- it was made before 9 December 2010;
- the term was ten years or less; and
- it has not been replaced by a previous loan, altered to a ten-year term or postponed.

It is unlikely that this provision will be of practical assistance in most EBT cases

Accelerated payment notices

FA 2017, Sch 11 para 23 confirms that if an APN (or Partner Payment Notice) has already been raised by HMRC on the original transaction, then postponement of the loan charge may be possible. HMRC will only consider postponement in the situation where the outstanding loan amount is less than, or equal to, the APN payments made. It should be noted that, as with the fixed term loan approval requirement, an application needs to be made to HMRC for this offset to be approved.

The legislation is silent for a situation where an APN only becomes due after the loan charge deadline has expired or is subject to a loan charge payment plan which continues after 5 April 2019. It may be possible to agree with HMRC a bespoke agreement or to consider wider possibilities that better deploy the funds held within the trust. It is stated in the legislation that the application to HMRC to reduce the amount due must be made in 2018 unless HMRC consider a later application to be acceptable.

Should the APN be repaid in the future, para 24 confirms that the loan charge will apply to the balance owed to the trust that had been postponed and become due within 30 days of the APN being repaid, assuming this takes place after 5 April 2019.

Exclusions

The legislation within F(no 2) A 2017, Sch 11 Pt 3 (para 25 to para 35) lists several exclusions to the loan charge rules. Unsurprisingly, commercial transactions with third parties with no related avoidance motive are unaffected. Transactions under employee benefit packages and employment related loans likewise retain the avoidance motive test, which seems particularly relevant given many older EBT loans were deemed employment related loans.

It is also confirmed that the ITEPA 2003, s 180 threshold (de minimis for beneficial loans) cannot be exceeded for this exclusion to apply, which would exempt the larger EBT loans. Most of the exclusions retain an avoidance test, although para 35, which concerns loans used solely to acquire unlisted employer shares, does not. It does, however, confirm that it applies only to loans made before 9 December 2010 and the acquisition of the shares must have occurred within one year of the loan being made.

Duty to notify HMRC

Presumably one of HMRC's biggest challenges will be to ensure advisers and clients are aware of these rules given the implications of failing to act. Doubtless, there will be similar challenges to the flow of information that HMRC requires ahead of this deadline and in the months afterwards. Schedule 11 Pt 3A deals specifically with this aspect.

If the loan charge applies or amounts have been repaid to the trust after 16 March 2016, this information needs to be disclosed to HMRC (unless full and final settlement of all liabilities relating to the loan charge has been agreed with the department before I October 2019).

Paragraph 35B places a statutory duty on the third party (in other words, the trustee) to provide the related loan information to the individual or their personal representatives. If the trustee cannot assist, they must nevertheless provide a statement confirming that this information is not available to them. Paragraph 35C confirms that the individual must provide this loan information to HMRC. Such information must be provided after 5 April 2019, but before 1 October 2019. The rules do not specify the manner other than to say it must be 'in such form and manner as they [HMRC] may specify'. In this respect, it is disappointing that the legislation has not kept pace with the requirements it is placing on taxpayers. Likewise, para 36 confirms this information must be provided to the company by the individual and the trustee for good measure within ten days of the loan charge date.

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Finally, paras 35F to 35K specify the penalties for failure to comply with the loan charge rules and para 35H confirms that reasonable excuse may be a defence to the failure to provide information, but not to the charge itself.

Options

Despite the rules themselves having several overlapping elements and interactions with the other rules, the options are straightforward. Given the variety of arrangements affected by this legislation, the individual will need to either repay in money before 5 April 2019 or incur tax through the loan charge rules.

Those who may think the latter is inevitable for their circumstances may therefore wish to register for settlement with HMRC in advance of the deadline. The original 31 May 2018 registration time limit has passed, but HMRC has announced that information received before 30 September 2018 should be sufficient to settle before the loan charge applies. However, it should be emphasised that in some cases there may be significant differences between the tax due under the settlement terms offered by HMRC and the tax arising from the 2019 loan charge rules. ●

Planning point

Schedule 11 para 4 contains an anti-avoidance test that will disregard a repayment if there is 'any connection, direct or indirect, between the payment and a tax avoidance arrangement.

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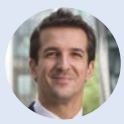

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