HM Revenue
& Customs

Tackling disguised remuneration

Technical note and summary of responses

5 December 2016

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1. Introduction

1. At Budget 2016 the government announced a package of changes to tackle existing disguised remuneration (DR) avoidance schemes and prevent their future use. These changes will ensure scheme users pay their fair share of income tax and National Insurance contributions (NICs).

2. The first part of the package was introduced in Finance Act 2016, including one change with effect from 16 March 2016. The main part of the package will be introduced in Finance Bill 2017.

3. The government wants to ensure that the changes are targeted at only DR schemes and don't impact on commercial non-DR arrangements. The government also wants to ensure that the changes are effective in tackling DR schemes. Therefore, a technical consultation setting out the changes in detail, including draft legislation where possible, was published on 10 August 2016. The consultation asked specific questions about some of the changes, but also asked more generally if the changes would affect arrangements that weren't connected with DR schemes.

4. This document provides a technical overview of the changes announced at Budget 2016, highlighting amendments and additions, as well as a summary of the responses to the consultation.

5. The consultation also included outline proposals to tackle schemes used by the self-employed, and deny employer deductions where DR schemes are used. These proposals were announced at Autumn Statement 2016 and this document provides further detail.

6. There are some parts of the package of changes that won't be included in Finance Bill 2017, such as the transfer of liability proposals. These are highlighted in this document and, where possible, the next steps are set out.

7. This document focuses on the tax legislation that will give effect to the proposals and its implications. It is the government's intention that these changes will also apply for NICs purposes. Many of the changes will not require any specific changes as existing provisions will already ensure NICs applies as intended. However, some changes will be needed, such as the double taxation relief proposals set out in Chapter 7. Draft regulations will be published in early 2017 in order to allow stakeholders to provide feedback.

8. HM Revenue and Customs (HMRC) will discuss potential settlement, including setting out the terms, with all users of DR schemes who are interested.

9. If you would like to discuss settlement and you are already speaking to someone at HMRC about your involvement in a DR scheme you should contact them in the first instance.

10. If you don’t have a contact, and you are an individual or contractor, you should email cl.resolution@hmrc.gov.uk. If you’re an employer, you should email ca.admin@hmrc.gov.uk.

11. All statutory references in this document are to the Income Tax (Earnings and Pensions) Act 2003 (ITEPA 2003) unless otherwise stated.

12. In addition, references to ‘employee’ include directors, and also include any individual ‘contractors’ who were working under a contract of employment, even where those individuals might normally think of themselves as self-employed.

2. Summary of responses

1. The government received 338 written responses, and HMRC met with a small number of respondents who requested a meeting. The responses were received from individuals, employers, accountants, lawyers, tax advisors and representative bodies. A list of those who responded, other than individuals, is included at Annex A.

2. The vast majority of respondents, over 90%, disagreed with the fundamental policy objective of the measures to tackle DR. They did not comment on whether the proposals were sufficiently targeted at DR schemes or effective in tackling them. These responses were mostly from individuals who had used a DR scheme and were concerned about their ability to meet their liabilities arising from these changes, in particular the loan charges in 2019. Similarly, many were concerned about the transfer of liability proposals and how these would affect them. All of these responses were reviewed and considered as part of the consultation process.

3. The remaining responses, around 10%, broadly supported the aims of the consultation. These technical responses were mostly from accountants, tax advisors and representative bodies.

4. These responses focused on the details of the changes and whether they are targeted and effective. They provided valuable insight, and analysis, that has resulted in improvements to the draft legislation.

5. Across both types of response there was broad support for the government's aims to tackle tax avoidance. However, there were concerns about the perceived retrospective nature of the loan charges.

6. The following chapters detail the changes to the legislation that have been made as a result of the consultation process and a summary of the responses received.

3. Strengthening Part 7A

1. As set out in Chapter 2 of the consultation, in order to prevent the future use of DR schemes the government is making changes to Part 7A.

2. These changes will put beyond doubt that Part 7A applies to all forms of DR schemes, as was always intended, and they will apply from 6 April 2017.

Loan transfers

3. As set out in the consultation, some schemes do not involve the third party making a loan directly to an employee. Instead, the loan is made by someone else, such as the employer, and the loan subsequently transferred to a third party, a 'loan transfer'. Therefore, Part 7A is being amended to make clear that loan transfers are treated in the same way as if the third party made the loan directly.

4. The consultation asked if the proposed loan transfer changes would impact on any non-DR arrangements.

Question 2.1 - Are there any other transactions or arrangements which the government should consider excluding from the new loan transfer rules?

5. Respondents didn't identify any new transactions or exclusions.

6. The loan transfer changes have been revised to make clearer when they are intended to apply.

7. The previous draft legislation required consideration of what the employee and third party had received at the same time. The revised draft legislation now starts with whether the third party has acquired a right to a payment, or an asset. Then there must be a connection with that acquisition and a payment, or asset transfer, to the employee.

8. One respondent queried whether the loan transfers rules would apply to transfers within a single group of companies. The existing provision at section 554A(8) will continue to apply to treat a group of companies as a single employer. This means that the DR rules won't apply to a transfer between two companies in the same group as neither will be considered a third party.

9. There were no comments on the proposed exclusion at section 554OA for the transfer of employment-related loans. This ensures that Part 7A doesn't apply to a transfer between two employers not in the same group of companies.

10. A targeted anti-avoidance rule (TAAR) has been added to the exclusion to prevent it being abused. This means that the exclusion will not apply where it is used in connection with a tax avoidance arrangement. This is an approach taken in many of the existing exclusions in Part 7A.

Loan transfers are provided for by draft amendments to section 554C, introduced by paragraph 5 of Schedule 10 of the draft Finance Bill 2017.

The exclusions for the transfer of employment related loans are provided for by the draft addition of the new section 554OA introduced by paragraph 7 of Schedule 10 of the draft Finance Bill 2017.

Release of a DR loan

11. There were no substantive comments on the changes to bring within Part 7A the release, or write-off, of a DR loan. Therefore, there have been no changes to the draft amendments to section 554C.

12. A few stakeholders queried whether releasing, or writing-off, a DR loan would be considered earmarking within section 554B. HMRC doesn't consider that the conditions in section 554B would be met by releasing, or writing-off, a DR loan.

Release of a DR loan is also provided for by draft amendments to section 554C, introduced by paragraph 5 of Schedule 10 of the draft Finance Bill 2017.

Close companies' gateway

13. As set out in the consultation, some DR schemes attempt to avoid the 'gateway' conditions of Part 7A by claiming the remuneration isn't in connection with an employment.

14. These schemes are used by directors, and employees of, close companies who also have substantial shareholdings. A scheme is often used instead of, or in conjunction with, dividends, or distributions, from the close company employer. The schemes seek to create a payment from a third party that is neither remuneration nor a distribution. Scheme users claim these payments aren't taxable under any tax legislation.

15. The 'close companies' gateway' is intended to put beyond doubt that these schemes don't work by removing any potential ambiguity about when Part 7A applies. The consultation proposed the following conditions:

    - there is a close company, as defined by section 439 of the Corporation Tax Act 2010;
    - an individual has a qualifying connection with that close company;
    - there is an arrangement to which the individual is party, or which relates to the individual;
    - the close company is also party to the same arrangement, or facilitates it in some way;
    - the outcome of the arrangement is that payments, or benefits, are provided to the individual; and
    - a relevant step is taken by a third party.

16. The consultation asked if the proposed close companies' gateway was appropriately targeted and if the proposed conditions should consider any other criteria.

Question 2.2 - Are there any other transactions or arrangements which the government should consider excluding from the close companies' gateway?

Question 2.3 - Are there any additional criteria or conditions the government should consider to ensure that the close companies' gateway is targeted at DR schemes?

17. Respondents were unanimous in their view that the proposed conditions were too broad and would tax transactions as employment income that had no connection with any employment. Many respondents were concerned about capital payments being brought within Part 7A. For example, the sale of shares in the employer company or payments that derive from distributions by the employer.

18. The government has listened to these concerns and accepts that the close companies' gateway wasn't sufficiently targeted. Amendments have been made to attempt to target it more squarely at DR schemes without changing the policy objective.

19. Instead of the employer merely facilitating the arrangement, the employer must directly finance it through a relevant transaction. This is defined in a similar way to a payment within the meaning of the existing section 554C. This means there must be a 'double relevant step' where both the employer and the third party are required to make a payment.

20. Certain transactions are excluded from this to ensure the commercial transactions entered into by the employer do not trigger the close companies' gateway. A TAAR is also included to ensure that this only applies to arrangements not connected with tax avoidance.

21. One type of excluded transaction is where the employer makes a distribution to the third party, for example a cash dividend.

Example 3.1:

A family trust 'P' wholly owns a company 'B'. Family member 'A' is a director of the company. B pays P an annual dividend of £10,000. The dividend is treated as a distribution by B.

P distributes the £10,000 to family members at the end of each year.

Any payments from P to A that are connected to the distribution will not be caught by the close companies' gateway.

22. Another type of excluded transaction is where the employer undertakes it in the ordinary course of their business on terms that would have been entered into by two unconnected parties.

Example 3.2:

'B' is a close company which specialises in decorating. 'P' is a company that manufactures and sells paint. B buys paint from P regularly for use in its business, and the transaction isn't part of an avoidance scheme.

An individual 'A' is a director of B, and also a shareholder in P. Any payments from P to A that are related to the commercial transaction will not be caught by the close companies' gateway.

23. The final excluded transaction is where shares in the employer are disposed of on arm's length terms.

Example 3.3:

An individual 'A' wholly owns a close company, 'B', and is also a director of B. A wants to sell B to a competitor, 'P'.

In order to encourage P to purchase B, B provides some samples of its products and a tour of its premises to the owners of P.

P decides to purchase B by acquiring all the shares held by A.

The sale proceeds are excluded from the close companies' gateway.

A may still be liable to Stamp Duty and Capital Gains tax on the disposal of the shares.

24. The government looks forward to working with stakeholders to refine the close companies' gateway further and will actively seek views on the draft legislation published on 5 December 2016.

25. Other stakeholders raised technical queries about the application of the close companies' gateway beyond the initial conditions. One of these was how the close companies' gateway would apply to arrangements where a Limited Liability Partnership (LLP) wholly owns one or more subsidiaries.

26. The existing gateway prevents the LLP being treated as a third party by section 554A(8). This approach has also been replicated in the close companies' gateway so any companies ultimately wholly owned by an LLP are not considered a third party.

This will ensure that any transactions within the group are not within the scope of the close companies' gateway.

27. Some responses raised concerns about the application of the close companies' gateway to arrangements outside the UK. As with other Part 7A charges, it will only apply to non-UK residents where there are UK duties of employment. The existing section 554Z4 removes any remuneration provided for non-UK duties.

Example 3.4:

'A' is an employee of a close company 'B' which is registered in the UK.

In 2017, A lives in France and has no UK tax liability and no UK duties.

Later in 2017, B pays £20,000 into a trust 'P', which then provides a loan of £10,000 to A.

Part 7A doesn't apply as all of the loan relates to non-UK duties.

Example 3.5: (follows example 3.4)

In 2018, A moves to the UK and performs his duties for B in the UK.

P pays him a second loan of £5,000. This loan is caught under Part 7A because his duties are in the UK.

28. As the close companies' gateway requires the individual to have a material interest, or shareholding, it is possible that loans could be caught by both Part 7A and the loans to participators rules in Chapters 3, or 3A, of Part 10 Corporation Tax Act 2010 (CTA 2010). However, a combination of existing, and new, provisions will make clear which rules take priority in any given situation. This will ensure that a loan must fall into one regime or the other.

29. Chapter 3 of Part 10 CTA 2010 normally applies to loans made directly by a company to a participator. In such circumstances, Part 7A cannot apply as there is no third party involved in the arrangement. However, section 459 CTA 2010 can give rise to a charge to tax for loans to a participator from a third party. Where that is the case Chapter 3 of Part 10 CTA 2010 will take priority due to the proposed amendments to section 554Z2.

Example 3.6:

‘A’ is a director of company ‘B’. B makes a loan to a company ‘P’ of £10,000. The purpose of this loan is to make a further loan from P to A of £10,000.The loan to A is treated as a loan to a participator under section 459 CTA 2010 and a tax charge is due.

The conditions of the close companies’ gateway are also met and a charge arises under Part 7A. Section 459 CTA 2010 takes priority so only that tax charge stands to avoid double taxation.

30. The amendments to section 554Z2 also ensure that where that loan is released it is charged to income tax under the existing provisions at section 415 Income Tax (Trading and Other Income) Act 2005 (ITTOIA 2005).

Example 3.7: (follows example 3.6)

P writes off £5,000 of the £10,000 loan and a charge arises under the distribution rules on A (section 415 ITTOIA 2005).

The conditions of the close companies’ gateway are also met and a charge arises under Part 7A.

Section 415 ITTOIA 2005 takes priority so only this tax charge stands to avoid double taxation.

31. Chapter 3A of Part 10 CTA 2010 is intended to apply to loans made through third parties to participators. Where Part 7A could also apply, priority is already given to Part 7A by section 464A CTA 2010.

Example 3.8:

A close company ‘B’ enters into an avoidance scheme to confer a benefit of £20,000 to a participator ‘A’.

A charge to tax does not arise under Chapter 3. However, section 464A CTA 2010 applies a charge of corporation tax.

This transaction also falls within Part 7A so the £20,000 would be treated as employment income. The charge to income tax on A, under Part 7A, takes priority over a charge to corporation tax on B under section 464A CTA 2010.

32. The consultation also asked if there were any other instances of double taxation that should be taken into consideration beyond those already provided for by the loans to participators interactions.

Question 2.4 - Are there any other instances of double taxation that the government should consider?

33. Apart from the broad concerns about the close companies' gateway applying to non-DR arrangements, stakeholders didn't raise other potential instances of double taxation.

The close companies' gateway is provided for by the new sections 554AA, 554AB, 554AC, 554AD and 554AE introduced in paragraphs 2 and 3 of Schedule 10 of the draft Finance Bill 2017.

Part 7A charge arising paying HMRC

34. A couple of stakeholders asked for clarity about whether a Part 7A charge arises when the employer, or third party, reaches a settlement with HMRC and makes a payment to HMRC .

35. In the majority of settlements it is unlikely a charge would occur when making a payment to HMRC. However, the government wants to ensure there aren't any legislative uncertainties that would prevent settlements. Therefore, Part 7A will be amended to make clear that a payment to HMRC, from the DR scheme, for a liability from the same scheme, won't give rise to a Part 7A charge.

36. The new section 554XA will apply to payments made directly to HMRC to meet tax liabilities arising from the DR scheme. Tax liabilities can be income tax, NICs, inheritance tax and corporation tax. The payment must be a final payment to meet the undisputed liability, and not a provisional payment, such as payment on account. Payments of any tax liabilities which do not arise directly from the existing DR scheme are not excluded from a Part 7A charge.

Example 3.9:

A company 'B' agrees a settlement with HMRC for tax due from their use of a DR scheme. The trust which was used for the DR scheme 'P' makes a payment of £20,000 in full and final settlement directly to HMRC.

No Part 7A charge arises on this amount.

Example 3.10:

Close company ‘B’ doesn’t agree with HMRC that the DR scheme does not work but makes a provisional payment of tax of £5,000 to HMRC to avoid interest accruing. It makes the provisional payment from ‘P’ the DR scheme trust.

This is not a payment of tax liability as the liability has not been agreed and settled. Therefore, this payment from P could be subject to a Part 7A charge.

37. The exclusion will also apply to payments made indirectly to HMRC provided they are paid to HMRC within 60 days.

Example 3.11:

An individual ‘A’ has received loans from a trust, ‘P’ through a DR scheme. A has agreed with HMRC that these loans amount to earnings and A has an income tax liability of £10,000.

P makes a payment to A of £10,000 to cover his tax bill on 1 January 2018.
A makes a payment to HMRC of £10,000 on 2 January 2018.

As the payment from P to A was made for the purpose of A paying his tax liability, and that payment was made within 60 days to HMRC, there is no part 7A liability.

The exclusion for payments in respect of tax liability are provided for by the new section 554XA, introduced by paragraph 10 of Schedule 10 of the draft Finance Bill 2017.

4. Employer deductions

1. As set out in Chapter 2 of the consultation, the government is making changes to deny deductions for contributions to DR schemes by employers unless certain conditions are met.

2. Payments which an employer makes to reward its employees are trading expenses which can be deducted in calculating the employer's taxable profits. However, where the payment is made to a DR scheme from which employees may only benefit after some time has passed, the deduction is generally deferred under specific legislation, until the employees receive a taxable benefit derived from the payment.

3. The consultation outlined some of the ways in which DR schemes currently attempt to obtain a deduction for the employer whilst not giving rise to tax and NICs on the employee, and/or mitigate the impact when HMRC defeats a DR scheme.

4. To discourage DR schemes being entered into in future, the government proposed that employers should be denied tax relief for contributions to DR schemes unless tax and NICs were paid at the time the contribution was made. This would apply to contributions made on or after 1 April 2017 (corporate employers) or 6 April 2017 (unincorporated employers). The exceptions for certain commercial arrangements in the existing legislation would not be disturbed.

Responses

5. Around half of the technical responses commented specifically on the denial of employer deductions. The responses that focused on the underlying policy of the changes in the main did not comment on this particular part of the proposals.

Question 2.5 - The proposal is that employment taxes must be paid at the time the contribution is made. Will this affect arrangements, or transactions, that are not part of DR schemes which the government should consider excepting?

6. Of those who commented, just over half expressed concerns that the term "DR Scheme" was not clearly defined and/or would be difficult to define. A majority also had concerns that the proposals might catch commercial arrangements which did not necessarily have any tax advantage in mind. Just over half suggested that the provisions should incorporate a motive, or purpose, test to exclude an arrangement, or transaction, which did not have tax avoidance as its purpose or its main purpose.

Question 2.6 – Will the requirement for employment taxes to be paid at the time of the contribution cause any problems? Should there be a reasonable period of time before the employment taxes have to be paid, and if so how long should that be?

7. About half of those who commented expressed concerns that by denying (rather than deferring) a deduction, the proposals went against the principle of an employer obtaining a deduction for a payment of employee remuneration. There were also some concerns that employers might inadvertently enter into transactions to which the provisions applied; sufficient time should be allowed for such honest mistakes to be identified and corrected. Respondents referred to a need for a reasonable period of time, but the only specific suggestion was for the period to be 9 months after the end of the employer's period of accounts.

Question 2.7 - Are there other approaches to deductions the government should consider in attempting to discourage the use of DR schemes?

8. Several respondents expressed the view that existing legislation was sufficient and that HMRC should use existing provisions, including charging interest and penalties, to challenge DR schemes.

Proposals

9. The government has carefully considered all the responses received on these questions. It has in particular taken note of the concerns raised around commercial transactions and around the timing of the payment of the tax and NICs.

10. The government therefore proposes that the legislation will require that the employment taxes and NICs must be paid within 12 months of the end of the period in which the employer seeks a tax deduction for the contribution to the DR scheme, instead of at the time the contribution was made.

11. The government does not propose to make any further changes to the consultation proposals. In particular the government does not consider that a motive or purpose test would achieve the required outcome.

Example 4.1:

'A' is the employee of company 'B'. B makes a payment of £20,000 to trust 'P', as part of a DR scheme in February 2018.

P pays A £10,000 as a loan in April 2018. This is treated as employment income under Part 7A and the income tax and NICs are paid in May 2018.

B includes a CT deduction of £10,000 in the company accounts for the year ended 31 December 2018. The income tax and NICs have been paid within one year of the end of the accounting period.

The tax deduction is therefore allowed for the period ended 31 December 2018.

12. This timing rule will be subject to an overarching rule that a deduction for a contribution to a DR scheme will not be allowed in any period that starts more than 5 years after the end of the period in which the contribution was made.

Example 4.2: (follows example 4.1)

After the payment of £10,000 made in example 4.1, P still holds £10,000 of the original contribution.

In March 2024, P makes a loan to A of £10,000. This is treated as employment income under Part 7A and the income tax and NICs are paid in April 2024.

B cannot have a tax deduction in the year ending 31 December 2024.

That is because it is more than 5 years after the end of the period in which the contribution was made (31 December 2018).

The restriction for unincorporated employers is provided for by amendments to section 38 ITTOIA 2005 introduced by clause 34 of the draft Finance Bill 2017.

The restriction for corporate employers is provided for by amendments to section 1290 Corporation Tax Act 2009 introduced by clause 35 of the draft Finance Bill 2017.

5. Transfer of liability

1. As set out in Chapter 3 of the consultation, the government intends to broaden the powers that allow HMRC to transfer tax and NICs liabilities from the employer to the employee where a DR scheme is used.

2. In the consultation, the government set out the common DR scenarios it is concerned with and initial proposals to tackle them. The common scenarios are:

   - there is a non-UK employer set up solely for the purposes of the DR scheme and the employee provides services to a UK person;
   - the employer exists at the time the Part 7A charge arises but is unable to meet the liability; and
   - the employer no longer exists at the time the Part 7A charge arises.

Responses

3. The consultation asked two broad questions about the transfer of liability proposals, as follows:

   Question 3.1 - Do the proposals include sufficient safeguards to ensure the liability is not transferred in inappropriate circumstances?

   Question 3.2 - Are there any other circumstances in which a Part 7A liability should be transferred from the employer to the employee?

4. The responses covered both ends of the spectrum with some wholly against the proposals and others suggesting that the proposals didn’t go far enough.

5. Those that were concerned about the proposals considered that the suggested safeguards were insufficient. Some commented on the lack of control the employee had over the arrangement. In those cases, they felt it would be inappropriate to transfer and there should be a greater differentiation between participators and passive employees.

6. Some users thought the proposals may undermine limited liability status of employers because business owners could be personally liable for tax debts.

7. Others considered that the existing powers should be sufficient to deal with the common DR scenarios set out, in particular where the employer no longer exists.

8. Those that supported the proposals thought the government was taking a reasonable position. Some suggested that the proposals could go further to impose a joint and several liability in certain situations. This would result in multiple parties, being equally liable, until final payment had been made.

9. Across the range of responses, stakeholders were keen to understand the implications for NICs. Most were concerned about the possibility of the employer NICs, Class 1 secondary, being transferred to an employee. Many considered that this would be unfair.

Next steps

10. The government will continue to consider its options in order to achieve its aims, whilst maintaining sufficient safeguards.

11. More detailed proposals, including NICs, will be consulted on in early 2017. This will provide stakeholders with the opportunity to provide detailed feedback on firm proposals.

12. The changes won't be included in Finance Bill 2017 and will be made in secondary legislation. The government intends for the changes to be effective in early 2017 after consultation. .

6. The loan charge

1. As set out in Chapter 4 of the consultation, the government is introducing a new charge on outstanding disguised remuneration loans ("the loan charge") to tackle the existing use of schemes.

Application

2. The consultation set out that the loan charge would apply where the following conditions are met:

   - a loan has been made to an employee, or director;
   - the conditions of the existing, or new close companies', gateway are met on 5 April 2019;
   - the loan was made on or after 6 April 1999; and
   - the loan, or part of it, is outstanding immediately before the end of 5 April 2019.

3. The consultation asked if these were the right conditions to ensure that the loan charge applied to DR schemes.

Question 4.1 - Are there any additional criteria or conditions the government should consider to ensure the loan charge is targeted only at DR schemes?

4. Overall, the majority of the consultation responses focused on the loan charge but didn't comment directly on the questions. Many respondents were concerned about the perceived retrospective nature of the loan charge. Other were concerned about whether the date of 6 April 1999 to prevent old loans being in scope was appropriate. In particular, some thought that third parties may not have maintained records from 1999.

5. The government considers that the loan charge is an appropriate way to tackle the existing use of DR schemes and to ensure users pay their fair share of tax and NICs. The government also considers that excluding loans before 1999 is appropriate and that third parties should have records of outstanding loan balances. Therefore, the conditions for applying the loan charge haven't changed.

6. Scheme users can prevent the loan charge applying by repaying the loan or reaching a settlement with HMRC before 5 April 2019.

7. Several stakeholders stated that detailed guidance would be necessary to ensure that the loan charge was widely understood and correctly applied. HMRC will ensure that guidance is available in 2017 that sets out all of the relevant information, and processes, for the loan charge.

8. More than one stakeholder queried whether repaying the loan to the third party would be considered earmarking within section 554B. HMRC does not consider that

this would automatically be earmarking. However, once a repayment has been made it's possible that the funds could be earmarked and a Part 7A charge would arise.

The application of the loan charge is provided for by paragraphs 14 to 17 of Schedule 10 of the draft Finance Bill 2017.

Exclusions

9. The consultation made clear that the existing exclusions in Chapter 1 of Part 7A would apply to the loan charge.

10. Two exclusions that involve a loan have been modified so that they include the loan charge:

    - commercial transactions; and
    - employee car ownership schemes (ECOS).

11. Two exclusions that involve a loan have been replicated directly in the loan charge legislation:

    - transactions under employee benefit packages; and
    - other cases involving employment-related securities (ERS).

12. Detail on all four existing exclusions, and when they apply, can be found in EIM45200 onwards.

13. The exclusions for ECOS and ERS both exempt loans that meet certain conditions when they are made from triggering a Part 7A charge. If the loan isn't repaid at the end of the term then the 'fall back' charges apply to trigger a Part 7A charge at that date. This prevents the exclusions being abused by employers claiming the conditions are met at the start of the loan but the employee never repays the loan.

14. These fall back charges will continue to apply where the exclusions exempt the loan charge from applying. Therefore, a Part 7A charge can arise where the loan isn't repaid at the end of the term.

The exclusions for the loan charge are provided for by paragraphs 22 to 27 of Schedule 10 of the draft Finance Bill 2017.

Example 6.1:

‘A’ is employed by company ‘B’. A purchases a car through an ECOS scheme where ‘P’, a lender, has lent A £10,000 to buy a new car on 1 January 2016. A has to pay this money back by 31 December 2020.

No tax charge arises on 5 April 2019 as the conditions of the exclusion are met.

On 1 January 2021, the loan is still outstanding.

As this is outside of the exemption requirements, a Part 7A charge applies on 1 January 2021 for the full amount of the loan outstanding on B.

15. Several stakeholders raised concerns about the loan charge applying to existing unlisted share scheme arrangements. These existed prior to the introduction of Part 7A and involved a third party lending an employee money to purchase shares in their employer. After the introduction of Part 7A, these arrangements were no longer entered into. However, the government doesn’t want to disturb existing, or historical, arrangements.

16. Therefore a new exemption has been added to exclude loans that meet the following conditions:

- a loan was made to an employee by a third party;
- the loan was made before 9 December 2010;
- the loan was used to purchase shares in the employer;
- the purchase was made within one year of the loan being granted; and
- the shares aren’t listed on a recognised stock exchange.

Example 6.2:

‘A’ is an employee of company ‘B’, which is an unlisted private company. A wants to buy 10 shares in B and borrows £10,000 from a trust, ‘P’, on 1 December 2010 to do this.

A pays £10,000 for the shares on 31 December 2010.

A is within the exemption and therefore, the loan charge doesn’t apply to the outstanding loan balance.

17. This exclusion also has a fall back charge, in a similar way to other exclusions, to prevent abuse. This requires the loan to be repaid within one year of the shares being sold. If the loan isn’t repaid the loan charge will apply to the outstanding balance.

Example 6.3: (follows example 6.2)

A decides to sell her shares in B on 7 April 2019 for £15,000. Rather than pay back her loan she buys a new car although she agrees to pay back some of her loan every month.

On 7 April 2020, her loan of £10,000 still has £9,000 outstanding.

As all the loan hasn't been repaid within one year of the disposal, the loan charge applies to the outstanding loan balance.

This exclusion and fall back charge are provided for by paragraph 28 of Schedule 10 of the draft Finance Bill 2017.

Outstanding loan balance

18. The outstanding loan balance for the loan charge is the 'principal amount' minus any 'repayment amounts'. The consultation stated that the principal amount would broadly be, the sum initially lent under the loan agreement plus any further amounts that have been added to the loan balance. This included any interest that had been capitalised, or added to the principal, of the same loan.

19. The government has decided to remove any capitalised interest to avoid any, potentially, unfair scenarios arising. The loan charge will now only apply to the initial loan balance, plus any further amounts added to that balance, but not to accrued or capitalised interest.

20. The draft legislation now expressly excludes any capitalised interest in the outstanding loan, and quasi-loan, balance.

Example 6.4:

'A' is an employee of company 'B'. A receives a loan of £10,000 from trust 'P' as part of a DR scheme.

At 5 April 2019 the total loan balance stands at £11,250. This is made up of:

£10,000 sum lent under the loan agreement;
£ 250 administration fee from P; and
£ 1,000 interest added to the balance of the loan.

The principal amount of the loan charge is on £10,250 as the capitalised interest of £1,000 is excluded.

21. However, where unpaid, or accrued, interest is included in the principal of a replacement loan this will be form part of the outstanding loan balance.

> **Example 6.5:**
>
> ‘A’ is an employee of company ‘B’. A receives a loan of £10,000 from trust ‘P’, as part of a DR scheme, that is repayable in 10 years. Interest of 5% is due each year but isn’t paid.
>
> At the end of the term of the loan P replaces the loan, and the unpaid interest, with a new loan of £15,000.
>
> The outstanding loan balance is £15,000 as this is the principal amount.

22. Some stakeholders queried how the loan balance calculation interacts with loans that are released, or written off, under s188. There is no specific provision in the loan charge as this is dealt with in the double taxation relief provisions, set out in more detail in Chapter 7. Broadly, this requires tax to have been paid under s188 for the loan charge not to apply.

> **Example 6.6:**
>
> ‘A’ is an employee of company ‘B’. A receives a loan of £10,000 from trust ‘P’ as part of a DR scheme.
>
> The loan was released but tax isn’t paid under section 188.
>
> The loan charge applies in 2019 to the £10,000 loan, as there is no double taxation relief.

23. Some scheme users, who are shareholders, may have used their DR loan from a third party to make a further loan to their close company. This further loan is then credited to their director’s loan account.

24. The outstanding loan balance doesn’t take into consideration whether the loan has, or hasn’t, been reinvested in the employer through the director’s loan account.

Example 6.7:

'A' is the director of company 'B'. As part of a DR scheme, B contributed £10,000 to a trust 'P'.

P gave A a loan of £10,000. A then loaned B £5,000 to help with the B's cash flow. Both loans remain outstanding at 5 April 2019.

There will be a loan charge on the £10,000 loan from P to A. There will be no discount for the loan to B.

There will be no loan charge on the loan from A to B.

25. Chapter 7 sets out how the loan charge will interact with existing unpaid, or disputed, charges that overlap with the loan charge. The loan charge may be less than the outstanding existing liabilities so there could be more to pay.

    The definition of the principal amount is provided for at paragraph 16 of Schedule 10 of the draft Finance Bill 2017.

Quasi-loans

26. The definition of quasi-loans has been updated to reflect the changes made to loan transfers as set out in Chapter 3 of this document.

    The definition of 'quasi-loans' is provided for at paragraph 15 of Schedule 10 of the draft Finance Bill 2017.

Anti-avoidance

27. The government has made clear that it will not accept attempts to circumvent the loan charge. The consultation set out several proposals to ensure that the loan charge is applied as intended. These include allowing only money repayments from 16 March 2016 to be taken into consideration as repayments, and disallowing any of those money repayments where there is a connection with a further avoidance schemes.

28. The consultation asked stakeholders to consider if these were appropriate and if any other proposals should be considered or excluded.

    Question 4.2 - Are there any arrangements that could be caught by these anti-avoidance provisions that the government should consider excluding?

    Question 4.3 - Are there any additional criteria or conditions the government should consider to ensure the anti-avoidance provisions prevent attempts to circumvent the loan charge?

29. Many of the responses concerned with the loan charge didn't address these questions directly. Those that did felt the proposals were sufficient to stop further avoidance but there were some concerns about complexity. Others were concerned about catching commercial arrangements but no examples were provided. One respondent suggested that the loans made after the employment had ceased should be excluded.

30. The government considers that the anti-avoidance provisions are appropriate and they haven't materially changed.

Operation

31. Some stakeholders requested further information on how the loan charge would operate, and how it would be paid.

32. Where there is an outstanding loan balance and the loan charge applies it is deemed to be a relevant step within Part 7A. All the provisions of Chapter 2 of Part 7A will also apply to the loan charge.

33. As with any Part 7A charge the relevant step will be treated as employment income and the employer should operate Pay-As-You-Earn (PAYE) in accordance with the Income Tax (PAYE) Regulations 2003 (PAYE Regs).

34. The amount of tax due will be calculated at the applicable income tax rates at the time the loan charge arises. It will also have corresponding implications for the personal allowance, student loans and other payments that are linked to the amount of employment income.

35. As the loan charge arises on 5 April, PAYE would have to be operated before 21 April. This is because the PAYE Regs require notional payments to be included no later than 14 days after the end of the tax month. This could be unduly onerous as employers will only know the outstanding loan balance on or after 5 April. Therefore, the government will update the PAYE Regs in 2017 to allow more time for employers to gather the right information and operate PAYE.

36. The exception is where the employer no longer exists, as the employee must include the income on their Self-Assessment return or update their Personal Tax Account.

Reporting

37. Some stakeholders raised concerns that the employer may not have all the information available to calculate the outstanding loan balance. Therefore the government is introducing an obligation on both the third party, and the employee, to provide information to the employer. This will help to ensure that employers' have all the information they need to calculate the loan balance on 5 April 2019.

38. The government acknowledges that many third parties would provide this information regardless, and as such it shouldn’t represent an administrative burden.

39. For all loans, and quasi-loans, outstanding between 17 March 2016 and 5 April 2016, both the third party and employee must provide information to the employer. This must be provided within 30 days of the loan charge date, which could be after 5 April 2019 if the loan charge is postponed. The information to be provided must be enough information for the employer to calculate the outstanding loan balance. This should include details of all money repayments since 17 March 2016.

Example 6.8:

‘A’ is the director of company ‘B’. As part of a DR scheme, B contributed £10,000 to a trust ‘P’.

P gave A a loan of £10,000 which is still outstanding at 17 March 2016 and is not an approved fixed term loan.

A and P must provide information to B, by the end of 5 May 2019 (30 days after 5 April 2019) so that B can calculate the outstanding loan balance.

40. The employee does not need to provide information to the employer when they agree that the third party can provide that information on their behalf.

Example 6.9: (follows example 6.8)

A writes to P to ask them to provide the information about their loan to B and gives them permission to do so.

P confirms to A that they have provided the information to B on 1 May 2019 so A takes no further action.

41. If the employee, or third party, cannot make contact with the employer after taking all reasonable steps they should notify HMRC. They do not need to provide the information to calculate the outstanding balance to HMRC, just the name of the employer they could not contact.

42. The government is also considering whether there should be reporting requirements for the loan charge. This would be in addition to the PAYE, or Self-Assessment, requirements and would be specific to the loan charge. More information on this will be provided in early 2017.

The duty to provide information to the employee is provided for at paragraph 29 of Schedule 10 of the draft Finance Bill 2017.

Postponement for approved fixed term loans

43. Loans that are within the scope of the loan charge can be postponed where the fixed term loans conditions are met. These are broadly where:

    - the loan was made before 9 December 2010;
    - the loan has a term of 10 years, or less;
    - the loan has not been replaced, or varied, since it was made; and
    - the relevant person has made repayments of the principal at intervals not exceeding 53 weeks; or
    - the loan was made on commercial terms that fall short of the commercial transactions exemption.

44. The consultation asked stakeholders to consider whether the conditions and the application process were appropriate.

Question 4.4 - Are there further types of loan which the government should consider allowing to qualify for postponement?

Question 4.5 - Are there are any practical issues with the application process for postponement approval described above?

45. Few respondents commented directly on the postponement conditions and the application process. One stakeholder thought that HMRC should have specialised staff to deal with these applications to ensure consistency and understanding. Others felt there should be a right of appeal if the application wasn't accepted.

46. Several respondents were concerned that the application window of 1 April 2018 to 1 October 2018 was too short. It also didn't provide any discretion for late applications. They felt this could result in some genuine applications being unnecessarily rejected.

47. The government has taken these concerns into consideration and has extended the window to applications made on or after 1 January 2018 and before 1 January 2019.

48. The government also acknowledges the possibility of late applications, and HMRC can accept these where they considers it reasonable, taking into consideration all the circumstances, for the application to be have been made late.

The definition of an approved fixed term loan, the application and the qualifying payments definition are provided for by paragraphs 18 to 20 of Schedule 10 of the draft Finance Bill 2017.

Postponement for Accelerated Payments

49. The loan charge can also be postponed where an employee wishes to make a full repayment of the loan but is unable to as they have paid an Accelerated Payment (AP), under Part 4 of Finance Act 2014.

50. Some stakeholders queried the effect of the AP postponement where the scheme user subsequently won, or lost, the litigation. If the AP is repaid the employee will have 30 days to repay the remaining loan balance to prevent the loan charge from applying.

51. If the AP isn't repaid, then the matter is settled. The amount repaid to the third party can be paid out without a Part 7A charge arising, due to the double taxation relief provisions, set out in the next chapter.

Example 6.10:

An individual 'A' received a loan of £10,000 from a trust 'P' as part of a DR scheme.

HMRC issued A with an Accelerated Payment Notice (APN) of £4,000, which A paid before 5 April 2019. A repaid £6,000 of the loan to P before 5 April 2019 and A wanted to repay the remaining part of the loan but was unable to.

A made a successful application for postponement, of the outstanding loan balance of £4,000, and there is no tax charge on 5 April 2019.

Example 6.11: (follows example 6.10)

HMRC and A are in litigation over the DR scheme and HMRC win at court.

The AP covered the whole amount of the tax due. This confirms that the loan was employment income and it has been taxed accordingly.

Any amount of the loan repaid to P can be taken out of P without a Part 7A charge arising, as it has already been taxed.

Example 6.12: (follows example 6.10)

HMRC and A are in litigation over the DR scheme and HMRC lose at court.

HMRC repays the AP.

If A wants to avoid paying the loan charge, they must pay the remaining £4,000 back to P within 30 days. If they do not, the loan charge will apply to that outstanding loan balance.

The postponement of the loan charge where AP's have been paid is provided for by paragraph 30 of Schedule 10 of the draft Finance Bill 2017.

Employer deductions

52. Some stakeholders queried how the employer deductions rules at Chapter 1, Part 20 of the Corporation Tax Act 2009 and Chapter 4, Part 2 of ITTOIA 2005 will interact with the loan charge. Where the contribution isn't affected by the changes in Chapter 4 of this document, the current rules will apply in the same way they would for any Part 7A charge.

53. If tax relief in respect of the underlying contribution would otherwise be allowable but has been deferred under the existing rules, or the predecessor provisions, the employer will be able to claim tax relief in the accounting period in which the loan charge arises. This would be limited to the amount of the DR scheme contribution that was used to make the loan that is subject to the loan charge.

54. Where a contribution is made on or after 1 April 2017, or 6 April 2017 for unincorporated employers, the new provisions described in Chapter 4 of this document will apply.

Example 6.13:

In August 2002, a company 'B' makes a £20,000 contribution to a trust 'P' as part of a DR scheme.

B's employee 'A' was given a loan of £20,000 by P in September 2002 and B obtained a tax deduction in the year ending 31 December 2002 for £20,000.

At 5 April 2019, the loan remains outstanding. The loan charge arises at 5 April 2019 as all of the conditions are met.

No further tax relief is available for this contribution in the period to 31 December 2019 as the tax relief has already been received.

Example 6.14:

A company 'B' makes a £10,000 contribution to a trust 'P' in August 2010.

B's employee 'A' was given a loan of £9,000 in October 2010 by P. B does not seek a deduction in the year ending 31 December 2010.

At 5 April 2019, the loan remains outstanding. The loan charge arises at 5 April 2019 as all of the conditions are met.

B may claim £9,000 tax deduction in the year ending 31 December 2019 as this is the amount of the relevant step.

Remittance basis

55. A couple of stakeholders queried the interaction of the loan charge with the existing remittance basis provisions at sections 554Z9 to Z11A.

56. The current rules seek to tax amounts in the year they are remitted to the UK. This would mean that where a loan amount had been remitted, but not taxed, the loan charge would apply in the year it was remitted. This could be several years before the loan charge.

57. The loan charge should arise in 2019, or later if the amount is later remitted, and therefore the government will amend the sections 554Z9 and 554Z10.

Example 6.14:

'A' is a non-resident employee who holds £30,000 of funds offshore which were received as loans as part of a DR scheme.

In 2017, A remitted £10,000 to the UK in 2008 but did not pay tax on the funds.

The loan charge will apply to the £10,000 in 2019.

Example 6.15: (follows example 6.14)

A remits the remaining £20,000 to the UK on 5 December 2019.

The loan charge will apply on 5 December 2019, the date of transfer as it is after 5 April 2019.

The amendments to sections 554Z9 and 554Z10 are provided for by paragraphs 34 to 38 of Schedule 10 of the draft Finance Bill 2017.

7. Double taxation relief

1. As set out in Chapter 5 of the consultation, there will be cases where a Part 7A charge, such as the new loan charge, will apply to money, or assets, that have already been subject to an earlier income tax charge.

2. The government acknowledges that in some cases the current legislation is silent on how double taxation should be addressed. Therefore, the government is introducing comprehensive double taxation relief provisions, to ensure that no DR scheme user has to pay tax twice.

3. The double taxation relief proposals cover two scenarios:

    - a Part 7A charge arises and an earlier charge, Part 7A or other income tax charge, has been paid; and
    - two, or more, charges are unpaid and one of the charges is a Part 7A charge.

Relief where the earlier charge has been paid

4. The proposed replacement of section 554Z5 will apply where a Part 7A charge arises on an amount that has already been subject to an income tax charge that has been paid in full. The Part 7A charge will be reduced to nil.

5. This approach has not been changed and will apply from 6 April 2017.

    The replacement of section 554Z5 has been provided for by paragraph 12 of Schedule 10 of the draft Finance Bill 2017.

Relief where the earlier charge has not been paid

6. The proposed new sections 554Z12A to 554Z12C will apply where the new section 554Z5 doesn't. It will, broadly, treat a payment of one liability as a payment on account of the other liability.

7. The consultation asked if this gave rise to any unfair results or any cases where there might be still be double taxation.

    Question 5.1 - Are there any circumstances in which the second double taxation provision described above would give rise to anomalous or unfair results?

    Question 5.2 - Are there any cases where there might be double taxation involving Part 7A which are not prevented either by the two new provisions described above, or by existing double taxation provisions?

    Question 5.3 – Does the draft legislation for the second new double taxation provision described above work as intended?

8. Respondents generally thought that the provisions were comprehensive but this had made the provisions complex.

9. Some respondents commented on the lack of relief for a charge on the benefit in kind (BiK) of the loan having a low rate of interest. As set out in the consultation, this does not give rise to double taxation because the BiK isn't a charge on the disguised earnings or the loan principal. Therefore, no relief is necessary.

10. Relief where the earlier charge has not been paid can arise in two circumstances:

    - a single Part 7A charge partially overlaps once with several earlier charges; and
    - a Part 7A charge wholly overlaps with multiple earlier charges.

11. The first arises where there is a single Part 7A charge that partially overlaps with more than one earlier charge. This could arise in various circumstances but the most common is likely to be with the loan charge applying to loans made in multiple years.

Example 7.1:

'A' is an employee of 'B'. In 2007, B contributed to a trust 'P' over several years, which has provided loans to A.

There were three loans made by P, which all remain outstanding at 5 April 2019:

- Loan of £10,000 made in 2008;
- Loan of £10,000 made in 2009; and
- Loan of £10,000 made in 2010.

The loan charge applies in 2019 on the combined total for the three loans of £30,000.

12. Where such a scenario arises the proposed subsections 554Z12B(7) to (10) would apply. The amount of the overlap is considered and the notional payment on account applied on a just and reasonable basis.

Example 7.2: (follows example 7.1)

A’s loans result in the following tax liabilities:

- 2008 liability of £4,000;
- 2009 liability of £4,000; and
- 2010 liability of £5,000.

The loan charge applies in 2019 on the combined total of the £30,000 loan balance resulting in a tax liability of £13,500.

The tax liability of £13,500 overlaps with the three separate earlier liabilities so the notional payment on account of the loan charge is apportioned on a just and reasonable basis at £4,500 to each earlier liability. There is an additional £500 to pay in respect of the 2010 liability.

13. The second category is where the same overlap results in multiple charges. This is likely to occur where several relevant steps arise on the same money or asset.

Example 7.3:

‘A’ is the employee of company ‘B’. As part of a DR scheme, B pays £10,000 into a trust ‘P’.

There is a section 62 earnings liability in 2007 when B contributed to the trust.

In 2011 there was a Part 7A liability on the same £10,000 when it was loaned to A.

In 2019 the loan charge applies on the £10,000 as the whole loan remains outstanding.

These three charges all wholly overlap because they derive from the same amount of disguised income of £10,000.

14. Where that occurs the proposed section 554Z12B(1) to (6) would apply and each overlap is considered separately. It doesn’t matter which overlap is considered first but all must be considered.

Example 7.4: (follows example 7.3)

B wants to pay their liabilities arising from the DR schemes. There are:

- 2007 liability of £4,000;
- 2011 liability of £5,000; and
- 2019 liability of £4,500.

B compares each liability to the other so that the payment of one liability can be set against the other. B pays the earliest liability first of £4,000.

B compares this to the Part 7A liability of £5,000 and pays the difference to HMRC (£5,000 less £4,000 is £1,000)

B compares the £5,000 total paid to the Part 7A liability of £4,500. This is covered in full by the £5,000 already paid. In total B has paid £5,000.

B could also have paid the loan charge liability of £4,500 first and worked backwards. The end result would be the same, B pays £5,000.

15. When considering the amount of the notional payment on account the statutory late payment interest can also be included. This means that the tax and interest of one liability can be used to meet the tax and interest liability of another charge. However, the notional payment on account must always be against the tax before the interest.

Example 7.5: (follows example 7.3 and 7.4)

When B settles the following late payment interest is also due:

- 2007 liability of £2,000; and
- 2011 liability of £500.

When B pays the 2007 liability of £4,000, B also pays the late payment interest of £2,000.

This total payment of £6,000 is then used when it is set-off against the other liabilities. This is set-off against the £5,000 first and then the related late payment interest of £500 second. There is no further payment required.

There is no interest due on the loan charge in 2019 and liability of £4,500 is covered in full by the earlier payment. There is no further payment required for the loan charge.

There is £500 of the total payment that isn't being used a notional payment on account. This cannot be repaid as it is a final payment of the late payment interest from the 2007 liability.

16. These provisions will apply retrospectively from the introduction of Part 7A on 9 December 2010.

    These double taxation relief measures are provided for by the draft addition of the new sections 554Z12A, 554Z12B, 554Z12C, 554Z12D and 554Z12E introduced by paragraph 13 of Schedule 10 of the draft Finance Bill 2017.

Loan charge

17. As mentioned in Chapter 6, the loan charge interacts with the double taxation relief rules in all the scenarios set out in this chapter.

18. Where an earlier overlapping charge has been paid, the loan charge will not apply due to section 554Z5. This could be where the loan has been released and tax paid under section 188.

> **Example 7.6:**
>
> 'A' is an employee of company 'B'. A receives a loan of £10,000 from trust 'P' as part of a DR scheme. The loan was released on 1 April 2010 and tax was paid under section 188.
>
> As the earlier charge has been paid in full before the loan charge date, the loan charge is reduced to nil and no further tax is due.

19. Where the loan charge arises, and there is at least one earlier disputed, or unpaid, overlapping liability, the provisions at sections 554Z12A to 554Z12C will apply. This will mean that paying the loan charge will not be the end of the matter. There may still be unpaid tax and interest liabilities from earlier charges remaining.

> **Example 7.7:**
>
> An employer, 'B', contributes £10,000 to a trust, 'P', as part of a DR scheme. P loans £10,000 to an employee in 2009 resulting in a tax liability of £5,000.
>
> The loan charge applies in 2019, resulting in a tax liability £4,500 which B pays.
>
> This is treated as a notional payment on account of the earlier liability leaving £500 still to pay, plus late payment interest.

20. HMRC and scheme users will have to consider all of the outstanding liabilities and how they overlap with the loan charge to determine what is remaining. HMRC and scheme users will then need to decide the next course of action.

8. Additional technical details

1. Chapter 5 of the consultation also set out the interaction with AP's, under Part 4 of Finance Act 2014, and other taxes.

Provisional payments of tax

2. Where the earlier change hasn't been paid, the double taxation relief, outlined in Chapter 7, only applies when one of the two outstanding liabilities is paid and final. However, in some cases where the earlier liability is disputed, an AP may have been paid.

3. It is not the government's intention to require those who have paid an AP to then have to pay a later Part 7A charge in full, if it relates to the same underlying money or asset.

4. To prevent this, the consultation set out a proposal to allow an AP to be used to meet a later Part 7A liability. The consultation asked whether this should be an automatic set-off or the scheme user should actively opt for the set-off.

Question 5.4 - Should affected scheme users be given the choice of whether to set their AP against an overlapping Part 7A charge? Or should the amount automatically be used in payment of the later charge?

5. Respondents overwhelmingly replied that scheme users should be given the choice rather than an automatic set-off.

6. The government has listened to the views of stakeholders and will ensure that any set-off is a voluntary procedure.

7. After considering this further, the government will also extend the set-off to all forms of provisional payments of tax. These include:

   - a payment on account of income tax;
   - an AP; and
   - a payment of income tax pending determination of an appeal.

8. Section 554Z12D will now allow scheme users that have paid an AP to decide to opt to use this to meet a Part 7A liability. The effect will be that the AP is a final payment of the Part 7A liability, and that it is no longer an AP and capable of being repaid. The double taxation relief provisions at section 554Z12B, set out in Chapter 7, will ensure that tax isn't paid twice.

9. These provisions will apply from 6 April 2017.

This double taxation relief has been provided for by the new section 554Z12D introduced by paragraph 13 of Schedule 10 of the draft Finance Bill 2017.

Example 8.1:

‘B’ has a Part 7A liability of £5,000 confirmed in April 2017.

B has paid an AP of £5,000 in April 2016.

B opts to use the AP to pay the Part 7A liability and makes an application to HMRC which is approved.

B can no longer ask for the AP to be repaid and the Part 7A liability is settled.

10. Where the AP amount is greater than the Part 7A liability the balance will remain an AP and could be repaid.

Example 8.2:

‘B’ has a Part 7A liability of £3,000 confirmed in April 2017.

B has paid an AP of £5,000 in April 2016.

B opts to use the AP to pay the Part 7A liability and makes an application to HMRC which is approved.

The Part 7A liability is settled. HMRC will keep the remaining AP of £2,000 on account, which could be repaid depending on the outcome of the litigation.

11. Where the AP amount is less than the Part 7A liability, the balance will be due and payable.

Example 8.3:

‘B’ has a Part 7A liability of £10,000 confirmed in April 2017.

B has paid an AP of £5,000 in April 2016.

B opts to use the AP to pay part of the Part 7A liability and makes an application to HMRC which is approved.

B can no longer ask for the AP to be repaid and the Part 7A liability is part settled. B will be required to pay the remaining £5,000 balance to settle the liability.

12. Some scheme users may dispute that a later Part 7A charge arises. In that circumstance the government doesn't want to require scheme users to have to pay twice. Therefore, users will be able to opt to use their provisional payment to also be a provisional payment of the other charge.

13. The proposed section 554Z12E allows for a provisional payment to be treated as a provisional payment of the other overlapping charge.

Example 8.4:

'B' has a Part 7A liability of £5,000, arising on 5 April 2017, relating to a loan from a trust.

B disputes the Part 7A liability but makes a provisional payment of £2,500 on 1 Dec 2017.

The loan charge applies to the same loan on 5 April 2019 and another Part 7A liability arises totalling £5,000. B also disputes the loan charge.

B applies to use the provisional payment of £2,500 to also be a provisional payment of the loan charge which prevents some late payment interest accruing.

The remaining balance is still due and payable.

14. If the provisional payment is withdrawn, or repaid, then it will be treated as never having been paid for interest purposes. This means that the late payment interest will accrue from the date the charge arose and not from the date the provisional payment was withdrawn.

Example 8.5: (follows example 8.4)

B withdraws the provisional payment on 1 December 2019.

Interest is recalculated from 5 April 2019 for the loan charge liability.

15. If the provisional payment is finalised then the double taxation relief provisions at section 554Z12B will apply to ensure tax isn't paid twice.

Example 8.6:

An employer ‘B’ contributes to a trust, ‘P’ as part of a DR scheme.

HMRC issues an AP notice to B, and the AP is paid in full.

A later Part 7A charge arises and B requests that the AP is also treated as a provisional payment of the Part 7A charge.

The litigation is decided in HMRC’s favour and AP is now a final payment of tax of the earlier liability.

The double taxation relief rules apply so that this is also treated as a notional payment on account of the Part 7A liability.

16. As with the rest of the provisional payments interaction, any outstanding balances will be due and any excess provisional payments will remain so.

    This double taxation relief has been provided for by the new section 554Z12E introduced by paragraph 13 of Schedule 10 of the draft Finance Bill 2017.

Other interactions

17. The government recognises that there are further potential interactions between the changes in this document and other legislation, such as:

    - section 222; and
    - inheritance tax.

18. The consultation asked if there were any other interactions that the government should consider.

    Question 5.5 - Are there any other interactions between the changes set out in this document and other areas of the tax system that are of particular concern?

19. Many stakeholders agreed with the two interactions highlighted, and in particular that the application of section 222 needs to be clear.

20. The government understands stakeholders’ concerns and is considering the possible options, and implications, further. More information will be provided in early 2017.

9. Self-employed DR schemes

1. As set out in Chapter 6 of the consultation, there are other DR schemes that do not currently fall within Part 7A but have the same objective. Typically these schemes involve individuals who are self-employed, either on their own account or as members of a partnership.

2. References to an individual trading through self-employment, in this chapter and Chapter 10, also include an individual trading as a member of a partnership (including a Limited Liability Partnership). References to trade also include professions and vocations.

3. These schemes seek to achieve their objective in a variety of ways. Some involve converting what should be a taxable receipt into a non-taxable amount, whilst others seek to match a taxable receipt with a deduction for a purported business expense that is in reality a diversion of earnings.

4. The government will introduce legislation to put beyond doubt that any attempts to insert arrangements to disguise remuneration or rewards for services do not work. The changes will be made by amendments to ITTOIA 2005 and will take effect from 6 April 2017.

5. The consultation set out an initial proposal that would apply where:

   - There are arrangements in place under which an individual M performs services as a sole trader, or member of a partnership;
   - it is reasonable to assume that directly or indirectly in consequence of, or otherwise in connection with, those arrangements payments, or other sums, ("the relevant payment") arise, or accrue, to a person other than M;
   - M, or a connected person, receives a payment, or other benefit, (including a payment by way of loan or the meeting of any obligation) which it is reasonable to assume derives (wholly or in part, and directly or indirectly) from the relevant payment.
   - Where those conditions apply, the various intervening steps of the arrangement are ignored and the amount of the payment or benefit arising to M, or to a connected party, is taxable as part of their trading profit.

Responses

6. The consultation asked a series of questions to test if this initial approach was appropriate and if there were any other approaches that could be considered.

7. Most responses considered the proposals in the round rather than directly addressing the specifics of the individual questions. Overall, they were generally supportive of measures to combat this form of avoidance. There were concerns that the draft legislation might have unintended consequences. This document sets out in more detail the proposals and the government welcomes any further comments to

ensure the legislation is targeted an effective.

8. Some respondents advocated the use of the General Anti-Abuse Rule (GAAR) to combat such avoidance. However, promoters continue to sell the schemes and the government considers that a legislative response is required to put beyond doubt that the schemes do not work.

Proposals

9. The government proposes to introduce new legislation into ITTOIA 2005 to counter the self-employment schemes. The legislation will apply in two broad circumstances.

10. Firstly, where there are arrangements to secure an allowable deduction from the profits of the trade and then that deduction, or the amount represented by it, is used to provide a loan or other benefit to the individual, or to a person connected with them, then no deduction is allowed in the computation of the profits of the trade.

Example 9.1:

'M' is a self-employed professional in business. He prepares his accounts annually to 5 April each year.

His turnover is £250,000 and he normally has routine allowable expenses totalling no more than £50,000 per annum.

He enters into an arrangement, in a year, where an amount of £190,000 is paid to a third party and is purported to be an allowable deduction for his business. Instead no business expense is met from this sum but rather a sum of £171,000 is lent back to him. The £19,000 balance represents the fees for the scheme.

The amount loaned to M would (assuming that a deduction were to be allowed for the third party payment) be treated as income of M taxable in the year the loan was made. The fees would not be deductible in computing the profits of the trade.

11. Secondly, the legislation will tackle arrangements that do not treat the full amount received, as a consequence of the services provided by the individual, as forming part of the calculation of profits of the individual's self-employment. Linked to those arrangements any amount, which is excluded from the calculation of the profits, and which is then used to provide a loan or other benefit to the individual, or to a person connected to them, is to be treated as part of the profits of the trade carried on by the individual at the time the income is originally earned.

Example 9.2:

'R' is a self-employed person but has agreed to provide her services through a partnership which has been established as part of the avoidance arrangements.

R provides services as a consultant and either she, or her partnership, invoices her clients for £5,000 per calendar month.

However, R only receives £1,000 per month either directly or via the partnership as taxable profit. The balance of the amount invoiced for her services, after costs, is received as a loan.

The amounts that she receives as loans or other benefits will be taxed as if they were profits of her share of the partnership trade.

Question 6.1 - Are there any arrangements that could be caught by this proposal that the government should consider excluding?

12. Many respondents commented that the proposal outlined in the consultation could catch genuine commercial transactions. They would also not wish to see any changes to long-accepted commercial practices. In particular some noted the specific circumstances of investment managers, which they believed could be caught by new legislation if based on the consultation proposal.

13. The published legislation is designed to ensure that genuine commercial arrangements will not be affected.

Question 6.2 - Are there any additional criteria, or conditions, the government should consider to ensure that the proposal is targeted at schemes involving self-employed earnings?

14. There were fewer responses to this question. One suggested the incorporation of a gateway test involving a combination of specific circumstances similar to that used in Part 7A. The draft legislation sets out a number of circumstances that need to apply in the opening section.

15. Some respondents commented on the existing legislation in respect of IR35, personal and managed service companies and felt that no additional legislation was needed.

16. The government notes that schemes continue to be marketed and used. The government's view is that legislation is necessary to deter the use of these schemes in the future and to put beyond doubt that they will not succeed.

Question 6.3 – Is there another approach the government should consider in attempting to tackle schemes involving self-employed earnings?

17. There was agreement that such avoidance should be tackled. Some respondents suggested that users of such schemes should be deemed to be employees and thus fall within the provisions of Part 7A. Others believed the legislation should be specifically targeted, be more robust, include a promoter-based test and involve a more concerted effort in applying the current legislation.

18. These are all welcome comments and the intention is that existing scheme users will continue to be the subject of robust and detailed challenges. However, the government considers that legislation is necessary to combat the continuing use of such schemes.

    The changes to tackle self-employed DR schemes are provided for by the new sections 23A to 23D ITTOIA 2005 introduced by clause 33 of the draft Finance Bill 2017.

10. Self-employed loan charge

1. As set out in Chapter 6 of the consultation, the government is introducing a new charge on outstanding self-employed DR loans ("the self-employed loan charge") to tackle the existing use of schemes.

2. The consultation set out an initial proposal to broadly mirror the employment loan charge, set out in Chapter 6 of this document. This would apply where:

    - a loan has been made to a self-employed individual before the proposed legislation in Finance Bill 2017 comes into force;
    - the same loan would have been taxable under the new rules had it been made after the proposed legislation in Finance Bill 2017; and
    - all, or part of, the loan remains outstanding on 5 April 2019.

Responses

3. The majority of the consultation responses focused on the loan charge. Although those were primarily in relation to the employment loan charge, the comments have also been considered in the design of the proposals and legislation for the self-employed schemes.

4. Where additional general points were made in regard to these proposals the responses raised concerns on the question of double taxation. There is no intention that the same amount would be taxed more than once and appropriate provisions are included in the draft legislation.

Question 6.4 - Are there any circumstances where this measure could lead to double taxation on the same profits of a trade?

5. Some respondents did believe there was scope for double taxation. Mention was made of the interaction with AP. One respondent believed that this should not be a major concern provided the legislation addresses this particular issue.

6. The legislation will ensure that the self-employed loan charge does not lead to the same amount being taxed twice and specific provisions will deal with the interaction with any relevant APN.

Question 6.5 - Are there any loans or other similar amounts that should not be affected by this proposal?

7. The key point made in answer to this question was that the legislation should ensure that commercial borrowing and loans eligible for tax relief, for example loans to invest in certain businesses, are not caught by the provisions. The draft legislation is designed to ensure that genuine commercial arrangements are not affected.

Proposals

8. The self-employed loan charge proposals broadly mirror the employment loan charge proposals set out in Chapter 6. The charge will apply to loans that remain outstanding on 5 April 2019. Loans include any form of credit or a payment purported to be a loan. The outstanding loan balance for the self-employed loan charge is the ‘principal amount’ minus any ‘repayment amounts’. There will be rules to prevent account being taken of any money payment with an avoidance purpose.

9. The self-employed loan charge will also apply to quasi-loans, a term defined in the draft legislation to include, in addition to the definition of loan above, circumstances where there are debts incurred by self-employed person either by way of money or including transfers of assets.

10. The government has decided not to include any capitalised interest in the calculation of the outstanding loan balances to avoid any potential unfair scenarios arising. The self-employed loan charge will only apply to the initial loan balance, plus any further amounts added to that balance, but not to the accrued or capitalised interest.

11. There will also be legislation that will allow for the postponement of the charge where a loan qualifies and an application has been approved on or before 5 April 2019. The charge will be postponed until the future approved repayment date and will apply to any loan balance not repaid on that date.

Example 10.1:

‘M’ through various arrangements has outstanding loans totalling £200,000 at the end of the day on 5 April 2019, relating to a number of years’ involvement with an avoidance scheme.

The loans have no set repayment date and no interest has been charged to date.

The self-employed loan charge will apply to the £200,000 loan balance.

Example 10.2:

‘M’ through various arrangements has outstanding loans totalling £215,000 at the end of the day on 5 April 2019 relating to a number of years’ involvement with an avoidance scheme.

The loans bear interest at a rate of 2.5% per annum. The balance on 5 April 2019 includes £12,500 of capitalised interest added to the principal.

The self-employed loan charge will apply to £202,500, that is, the total balance less the capitalised interest amount.

Example 10.3:

R has a loan of £150,000, made as part of these arrangements, and applies to HMRC in 2018 to have the loan treated as approved.

The loan was made on 5 April 2010 and is due to be repaid on or before 4 April 2020. The terms of the loan have not changed since commencement. The loan meets the conditions for approval in that there have been qualifying repayments and it is on commercial terms.

HMRC confirm the loan is qualifying. No self-employed loan charge arises on 5 April 2019.

The self-employed loan charge is deferred until 4 April 2020 and will only apply to the extent the loan is not repaid by that date.

Operation

12. The self-employed loan charge will be brought into account as profits of the trade. The charge arises on 5 April 2019 so the tax year in which the charge arise is 2018/19. The resulting tax liability would be due and payable, at the latest, by 31 January 2020.

13. As is the case for the employment loan charge, the charge has the potential to increase the taxable income of the relevant tax year with all the consequential effect that has for the use of allowances, reliefs, student loans repayments etc.

14. If the trade has ceased before 5 April 2019 then the charge will be a post cessation receipt and charged to tax under the Miscellaneous Income provisions as set out in Chapter 18 Part 2 ITTOIA 2005. In such cases the charge will be treated as arising in 2018/19.

15. The government is considering whether there should be separate reporting requirements specific to the self-employed loan charge. More information on this will be provided in early 2017.

The self-employed loan charge is introduced by Schedule 11 of the draft Finance Bill 2017.

Annex A: List of stakeholders who responded

A large number of individuals responded as well as the following:

Accountancy 4 Wealth Ltd, Chartered Accountants & Business Advisers
A M Sherman & Co Limited
Armstrong Watson, Accountants and Financial Advisers
Association of Accounting Technicians
Automania Group Limited
AVA Packaging Solutions Limited
BCS Limited
BDO LLP
BEW Electrical Distributors Limited
Blow Abbott, Chartered Accountants
British Private Equity & Venture Capital Association
Business Oxygen Limited
Cash-Score Limited
Chartered Institute of Taxation
City Digital Technology Limited
Cleverly Done Limited
CoSec Compliance Limited
Crystal Clarity Consulting Ltd
David Gill & Co, Chartered Accountants
DEB Chartered Accountants
Diamond Financial (Scotland) Limited
Deloitte LLP
DK Engineering Limited
Eclecsys Limited
EcuTek International Limited
EDF Tax Defence Ltd
Egan Roberts, Chartered Accountants
Electrical Offshore Services Limited
England & Company
Epic Insulation Limited
European Polyurethane Technologies Group Limited
Ernst & Young LLP
Exceed (UK) Limited
Excel Packaging and Insulation Co Limited
Farrer & Co
Graham Martin and Co
Grant Thornton UK LLP
Green Lane Products Limited
Greenstones Accountants
Hamilton Morris Waugh, Chartered Accountants

Harwood Hutton Limited
Hillgrove Developments Ltd
Hilton Sharp & Clarke, Chartered Accountants
International Tube & Fittings Ltd
Institute of Chartered Accountants in England and Wales
Klinge Chemicals Limited
Leonard Gold, Chartered Accountants
Link Chartered Accountants
Lyness Accountancy Practice Limited
KPMG LLP (UK)
Mahon & Co, Accountants and Business Advisors
Mainline Group
Mandria Business Services Ltd
Marlow Proactive, Accountants
Mike Cattermole Ltd
Mundar Associates Limited
Parker Cavendish, Chartered Accountants and Business Advisors
Phosphor Limited
Premier Plant Engineering Limited
Pricewaterhouse Coopers LLP
PRISM Association Limited
Revolution Cycles Limited
Richardson Swift Ltd Chartered Accountants
RS Partnership
RSM UK Tax and Accounting Limited
Saleos Consultancy Services Limited
Share Plan Lawyers
STEP
Stephenson Harwood LLP
Swinton Business Advisors and Chartered Accountants
Talking Business (Southern) Limited
Taylor Roberts, Chartered Accountants
THP Chartered Accountants
Total Practical Solutions
Travers Smith LLP
WG, Chartered Accountants
Withers LLP
WTT Consulting Limited