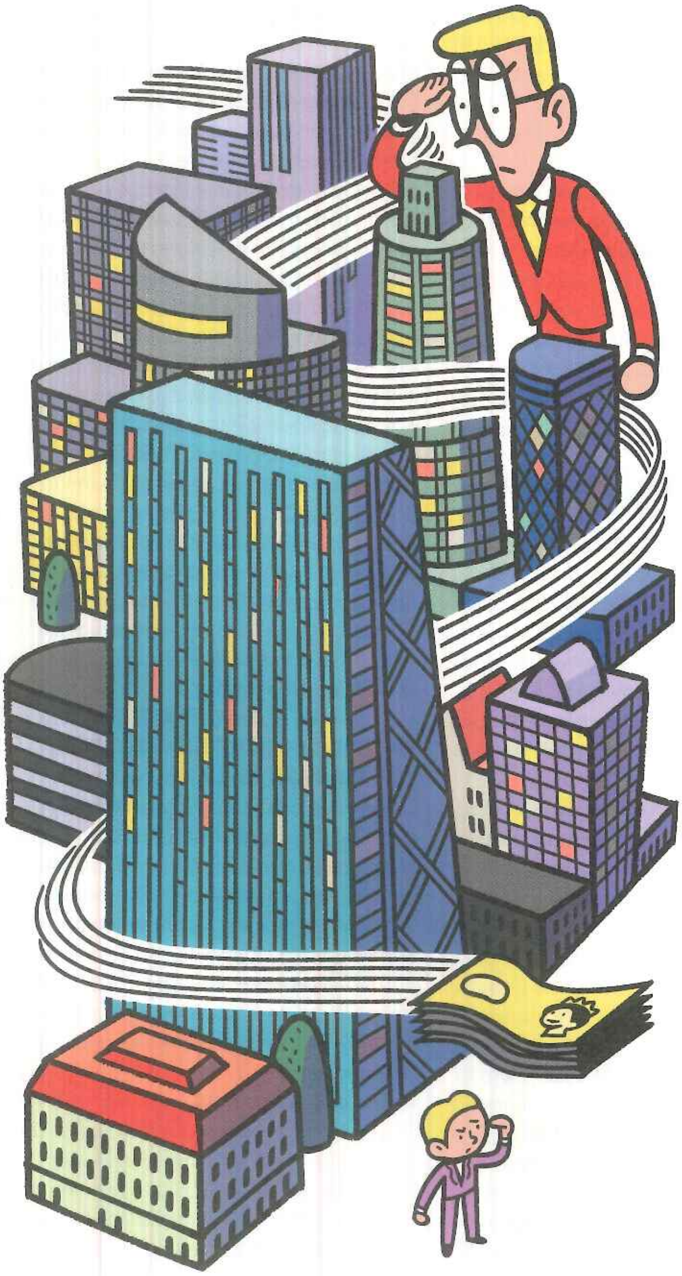
Tax avoidance clampdown

Tax charges due on disguised remuneration schemes are starting to bite, with consequences for both employers and employees, as Caroline Biebuyck finds out



Disguised remuneration schemes have long been a thorn in HMRC's side. For the best part of two decades the department has been trying to attack the arrangements in which employees were given tax-free loans instead of income in order to avoid having to pay income tax and National Insurance contributions on their earnings.

The culmination of this action came last year when HMRC announced it would impose a loan charge on everyone who has used these schemes to avoid tax. The charge will apply to any loans made after 6 April 1999 that are still outstanding at 5 April 2019, with the full amount of any unpaid loans taxed at the individual's marginal rates for 2018/19.

Disguised remuneration schemes, which have been around for a while, have long been considered abusive. ICAEW has always been concerned about these arrangements and why the government didn't take action sooner, says Tax Faculty head Frank Haskew. But there's no getting away from the consequences of finding up to 20 years' back tax payments. "Some people might be facing possible bankruptcy. That would be a terrible tragedy but in some cases might need considering," says Haskew.

SALARY RANGE

ICAEW has identified two main populations affected by the loan charge. The first is high-paid individuals receiving bonuses through employee benefit trusts; this includes self-employed individuals and partners who have entered into these kinds of arrangements in recent years. The second is lower-paid employees required to work through umbrella companies.

The concern is that many of the second group were either coerced or put into these schemes without really understanding what they were letting themselves in for. "Those sorts of people will be hardest hit as they probably didn't have much choice about what they could do," says Haskew.

HMRC estimates that disguised remuneration scheme users, on average, earned twice as much as the average UK taxpayer. However, this approximation can mask a wide range in income levels. The most famous example of a disguised remuneration scheme is that of Rangers Football Club, in which more than £47m was paid to players, managers and directors between 2001 and 2010 in the form of tax-free loans. But headline-making schemes like this are just a part of the overall picture.

While some of the people in these schemes were highly paid, says tax lecturer and practitioner Rebecca Benneyworth, many others were not. "We have heard about a large number of people,

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including nurses, who entered into arrangements with umbrella companies rather than the companies to which they provided their services. The nurses were told that if they wanted to be a bank nurse and work for certain trusts, then they had to enter into one of these arrangements.

Because the umbrella company made some deductions, which were for their charges, it's entirely plausible that the employees thought that they had paid their tax and did not understand that they were being paid by way of a loan."

HMRC reckons that 50,000 people will be affected by the loan charge, of whom it says 65% work in the business services sector. But no one really knows how accurate those figures are, says Haskew. "It's possible HMRC doesn't even know about some of the people involved. And it's not one-size-fits-all. People need to pay their taxes: we're clear about that. But there does need to be some flexibility and reasonableness. To be fair, HMRC recognises that too - hence the settlement opportunity."

SETTLEMENT OPTION

HMRC came up with the settlement option as a way of getting people who have been part of these schemes to come forward voluntarily. By opting to settle instead of paying the loan charge, each part of the total outstanding loan is related back to the year in which it was received, meaning it is taxed at the individual's marginal rates for that year.

This could lead to substantial tax savings. For example, say an individual was paid £25,000 a year for five years as a loan. If the full amount were taxed under the loan charge, then £125,000 would fall into tax in 2018/19 and be added to this year's income, with most of the income probably being taxed at 40% or even 45%. However, if the individual opts for the settlement route then HMRC would allocate £25,000 per year to each of the five years of assessment. Depending on what other income the individual had during those years, more of the £25,000 would be likely to fall into the basic rate - and some could even be covered by personal allowances.

Going the loan charge route would also affect an individual's annual allowance for pension contributions, says Benneyworth. "Adding a number of years' worth of their loans to their

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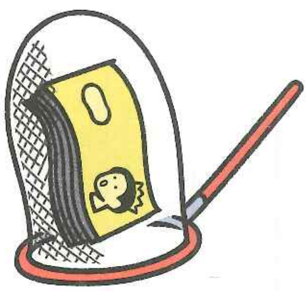

current year's income would probably reduce their pension allowance from £40,000 to £10,000," she says. "If they chose to settle instead they won't be able to backdate pension contributions but they could at least benefit from the normal annual allowance this year."

A big advantage of opting for the settlement route is payment flexibility. HMRC has said that it will allow individuals who opt for settlement to spread their payments over five years if their taxable income in 2018 to 2019 is estimated to be less than £50,000 - provided they are no longer in an avoidance scheme.

All is not lost for individuals with higher incomes or who need a longer time to make their payments, as HMRC says that any other requests for extended payment periods will be considered on individual circumstances. "Ultimately there is no upper limit," says an HMRC spokesman. "These terms only affect the amount of detail someone needs to provide in order to get an extended time to pay. If those affected need longer or earn £50,000 or more then they can get it; they just have to give us some more information about their finances."

PAYING UP

The settlement option was due to close on 31 May 2018 but earlier this summer HMRC decided to extend it until 30 September 2018. What are the options for those who did not contact HMRC in time?

One choice is to repay the loan. This won't be possible for employees and contractors who do not control the employee benefit trust and who cannot dictate the destination of the funds. "Many people won't be able to do this as they were paid through an organisation; if they repay this organisation that should have paid them a salary then they run the risk of not getting their money back," says Benneyworth.

Some people, like those who benefitted from Rangers-style arrangements, might not have needed the money that was paid via a loan. If they still have access to the funds loaned, then they could repay them. But repaying the loan might raise questions, such as what is going to happen to the money that is repaid, says Haskew. "HMRC has made it clear that entering into some other kind of arrangement to repay the loan is not going to work; you will have to repay it in money," he says.

Even now, some promoters are continuing to offer variations on discredited disguised remuneration schemes. Anyone who has missed the settlement opportunity should be extremely wary of these, says Benneyworth. "Trying to solve this by getting involved in another scheme is the last thing anyone should be doing; it's very unlikely that any of these schemes will work."

Even though the revised settlement deadline has passed, it's clear that this saga is far from over. By late August about 23,000 people had registered their interest to settle with HMRC - less than half the number of people that HMRC estimates took part in disguised remuneration schemes. This raises the question of whether HMRC might either extend the deadline or at least act more leniently to anyone who voluntarily approaches them, even after 30 September.

It's worth keeping an eye on what HMRC is saying about this, says Haskew. "It wants to settle as many cases as it can. Otherwise it will have to start raising loan assessment charges and chasing people for the tax owed. It would clearly rather people came forward of their own accord."

This issue is not going to go away any time soon. "If your clients are in this position they need to be encouraged to think about their options and think seriously about coming forward," says Haskew. "If you come forward voluntarily, HMRC might be more willing to come to some sort of compromise about how payment is made." ●