

# The Loan Charge scandal: what next?

**Matt Hall explains the part HMRC had to play in the so-called Loan Charge scandal**

The announcement on 23 January 2025 of the Loan Charge review<sup>1</sup> that is not a review of the Loan Charge has once more brought HMRC's pursuit of what it terms 'Disguised Remuneration' (DR) schemes into focus.

The Labour government, like its predecessor, appears to have been persuaded that "those who did not pay the right amount of income tax and National Insurance are required to resolve their affairs with HMRC" as the introduction to the latest review declares. Those hoping for a forensic analysis of how a scandal more than 20 years in the making has evolved will be disappointed. Significantly, this careful control of the narrative omits HMRC's own part in what many affected call the 'Loan Charge scandal'. This article therefore explores HMRC's role.

## What is the Loan Charge?

The Loan Charge was originally contained in Sch.11 FA (No.2) 2017. Very broadly, it imposed a charge to income tax and NIC on the value of any loans made by third parties to reward employees (and the self-employed) for their services. The value outstanding on 5 April 2019 was treated as a 'relevant step' within Part 7A ITEPA 2003 and thus earnings on that date. It was intended to be a one-off, catch-all provision that would allow HMRC to recover unpaid tax from many years previous and to stop at a stroke DR schemes (a misnomer, for no disguise is necessary – indeed many of the early schemes were fully disclosed to HMRC under DOTAS). As I will explain, it has failed.

## What is Disguised Remuneration?

DR schemes began in the late 1990s and early 2000s as employers, often in the banking and finance sector, sought to remunerate employees' tax efficiently.

Myriad complex schemes were developed, including by the Big 4, often involving what became 'Employment Related Securities' (ERS), ending in a game of statutory Whack-a-Mole. The use of more vanilla Employee Benefit Trusts making taxable cheap loans to employees endured. Buoyed, no doubt, by HMRC's early failed attempts to challenge them.

The earliest DR scheme in the 'contractor' sector that I am aware of was developed around 2003 to 2005, at least in part, by men who went on to become presidents of the Chartered Institute of Taxation (no, not the newly appointed Reviewer!). In those early days HMRC seemed largely ambivalent to the arrangements, even questioning, in 2006, why such arrangements were being disclosed under DOTAS (see para 96 in *Dickinson & Ors, R (on the application of) v HM Revenue & Customs*)<sup>2</sup>. However, as is often the case, their increasing prevalence saw HMRC begin to challenge them. Unsuccessfully.

It is now more than 20 years since the first EBT loan scheme reached the First-Tier Tax Tribunal. In 2003, HMRC argued that loans from an EBT were taxable as earnings but *Dextra Accessories* – then part of the Phones 4U Group – defeated HMRC's arguments. HMRC suffered a second defeat some five years later (in *Sempra Metals*) and by the late 2000s these defeats for HMRC led to an even wider proliferation of EBT Loan Schemes with promoters and users perhaps emboldened by HMRC's failures.

Over time the profile of users changed. In more recent years lower paid workers have been drawn into DR schemes, including NHS workers. 'Umbrella companies' offering ease of administration and tax efficiency led to an explosion in scheme use that saw HMRC announce a review of the whole sector<sup>3</sup>. Some users knew what they were becoming involved in, but many say that they didn't.

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<sup>1</sup> <https://www.gov.uk/government/publications/independent-review-of-the-loan-charge/terms-of-reference-independent-review-of-the-loan-charge>

<sup>2</sup> <http://www.bailii.org/ew/cases/EWHC/Admin/2017/1705.html>

<sup>3</sup> <https://www.gov.uk/government/publications/tackling-tax-non-compliance-umbrella-company-market/tackling-non-compliance-in-the-umbrella-company-market--3#:~:text=As%20announced%20at%20Budget%20on,chain%20to%20engage%20a%20worker.>

When the Loan Charge was introduced, it was [estimated that 50,000 individuals, and around 10,000 companies had used these schemes](#) but that number has grown exponentially.

### **Why was the Loan Charge needed?**

HMRC often assert that DR schemes have never worked. But this is somewhat misleading given their earlier failures. In addition to HMRC's defeats (on the earnings arguments) in both Dextra and Sempra, HMRC's earnings arguments also failed before both the FTT (October 2012) and Upper Tribunal (July 2014) in the Rangers EBT case (that became case RFC 2012 PLC v Advocate General for Scotland ). After more than a decade of trying, HMRC had failed to win a single case on their preferred 'earnings' argument.

### **Change leads to pyrrhic victory**

HMRC had for more than a decade argued, unsuccessfully, that it was the provision of the loan that was a payment of earnings. And they had opened enquiries, and issued assessments, to individuals on that basis. Although payees (the recipients of the loans) would be entitled to a PAYE credit for tax that ought to have been deducted, even where it was not, HMRC would be able to remove it using Regulation 81 Income Tax (PAYE) Regulations 2003.

However, after defeats in the FTT & UT, HMRC changed tack. Before the Court of Session in Rangers HMRC argued that the payment into trust gave rise to the charge, not the payment out. But this created a problem for HMRC. And it appears that they knew it.

Not only had HMRC largely failed to assess the 'payers' in DR schemes, but their change of argument also meant that even where they had issued determinations under Reg 80 of The Income Tax (PAYE) Regulations 2003, those payments into trust would not satisfy the conditions of Regulation 81 which would be needed to remove the PAYE credit. The payments by the employer were not 'notional payments' (for they were not made by a third party). Rangers would thus be no more than a pyrrhic victory.

And so the Loan Charge was born. It was proposed by HMRC to government in September 2015. Two months before HMRC prevailed in Rangers, and at a time when there was no legal basis for it. It was also later tweaked to ensure that any PAYE credit due upon an earlier charge was available only if that tax had been paid.

The Loan Charge is therefore controversial because not only did its introduction see all loans received from DR schemes taxed cumulatively on 5 April 2019, whether HMRC had raised assessments or enquiries or not, but because the basis upon which it was proposed is not that claimed by HMRC. It was proposed not to give effect to the Rangers decision because its proposal preceded those in HMRC's favour. It did so, not by applying the strict dicta of the higher Courts in Rangers and allowed HMRC to skirt neatly around their inability to pursue those who had received loans. It's true purpose, I believe, was to cover HMRC's own failure to issue Reg 80 determinations and the entirely foreseeable consequences of its own arguments. A cunning plan of which Baldrick would be proud.

### **Scuppered by Sir Amyas Morse?**

The Loan Charge was originally intended to capture all loans made on or after 6 April 1999. Unsurprisingly, that unprecedented (beyond criminal matters) 20-year retrospection proved controversial and following an actual review by Sir Amyas the scope of the Loan Charge was amended to remove loans received before 9 December 2010, the date upon which Part 7A ITEPA 2003 was introduced. This once more presented HMRC with a problem.

In his Loan Charge review Sir Amyas Morse said that HMRC should continue pursue DR users using their 'normal powers' where they had appropriate grounds and a legal basis to do so. But having changed their argument in Rangers and failed to assess 'payers', those 'normal powers' were redundant. HMRC could not remove the PAYE credit to which payees were entitled using Reg 81, meaning once more that HMRC would be unable to pursue those who had received loans before 9 December 2010.

### **S684(7A) ITEPA 2003**

S684(7A) of ITEPA 2003 was inserted by FA 2003, s. 145(1) with effect from 10 July 2003. But until HMRC needed another cunning plan, it had sat unused. It was first deployed 14 years after its introduction, in 2017, to avoid the consequences of the change to the scope of the Loan Charge. In 2017 its use was hidden, governed by unpublished internal HMRC guidance. Its deployment was controversial enough to require approval by the Contentious Issues Panel within HMRC. Many readers will be surprised to hear that HMRC has a Contentious Issues Panel, perhaps less so that we do not know who sits on it, when it sits, or that its decisions are kept secret save for what can be prised out of HMRC with Freedom of Information requests.

HMRC's use of this discretionary power to remove the PAYE credit was challenged. Unfortunately (for those of us who do not believe that Parliament ever intended this power to be used in this way) the Court of Appeal (in Hoey) held that HMRC does indeed have an untrammelled discretion to disapply the entirety of the PAYE code when it deems that it was either "not necessary or inappropriate for the 'payer' to comply with the PAYE regulations".

So rather than being unable to pursue payers that HMRC had not assessed, HMRC use S684(7A) to disregard the Rangers decision; to disapply the PAYE regulations and to pursue the individual recipients without having to rely on Reg 81 or Regulation 72. HMRC can do so without time limit or oversight of the Tax Tribunals (because the Court of Appeal held in Hoey that the tax tribunals do not have the jurisdiction to consider the use of this power). It can be challenged only in expensive Judicial Review proceedings.

HMRC now exercise this discretionary power as many as 20 years and more after it failed to assess the payer, to relieve them of a liability it hadn't assessed. HMRC often do so without even trying to identify the payer they are relieving!

Consequently, HMRC pursue individuals who are far less likely to have the means to pay. There is nothing normal about this power or HMRC's retrospective use of it to circumvent the removal of another retrospective charge (the Loan Charge). It is noteworthy that if HMRC genuinely thought they could use s684(7a) ITEPA 2003 in this way, they only ever needed the Loan Charge to capture those they had failed to assess.

### Why is this still dragging on?

The contortions of HMRC to pursue individual recipients of loans has been punctuated by significant delay, administrative incompetence and a significant taxpayer group largely unable to afford what is demanded of them.

Taxpayers affected are in some cases being pursued for repayment of the original loans whilst HMRC pursue them for tax on a loan that they argue, for income tax purposes, was never intended to be repaid. HMRC then pivot to argue that they were indeed genuine loans from properly constituted trusts, when seeking IHT on the same sum. Multiple taxes on one receipt.

Inevitably, more than five years after the loan charge tax was due, there are still a significant number of taxpayers who have been unable and some, we should recognise, unwilling, to settle. This is exacerbated by the current settlement terms. In addition to income tax and IHT, HMRC seek interest, APN late payment penalties plus further interest on those APN late payment penalties. HMRC then bayonet the wounded by adding 'forward interest' to payment plans for those who can least afford it. Interest over as many as twenty years, at rates as high as 8.75%, is a significant barrier for many already faced with two taxes on the same source of income.

### Abject failure

HMRC has expended a great deal of human resource, money and time in its campaign against DR schemes. Twenty years ago, HMRC was largely ambivalent to their use (see their comments in Dickinson) but today, with 10 suicides attributed to a Loan Charge<sup>4</sup> introduced under false pretences, HMRC's pursuit of these types of schemes, and the Loan Charge specifically, has been an abject failure. HMRC data shows that £500 million was lost to DR tax avoidance schemes in 2022 to 2023. The time for HMRC to take a different, fairer, approach has long since passed but in my article accompanying this one I will look at ways in which settlement terms could be made fairer and more affordable. It is to be hoped that the next reviewer, Past CIOT President and 31-year HMRC veteran Ray McCann, agrees.

• Matt Hall is a Director at Armadillo. Email [Matt.Hall@armadillosupport.co.uk](mailto:Matt.Hall@armadillosupport.co.uk)

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<sup>4</sup> <https://hansard.parliament.uk/commons/2024-01-18/debates/2DAF0F4F-46F3-446E-9594-292B97A6F3E0/LoanCharge>