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Masters of disguise

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Helen Adams and *Sarah Stenton* examine why users of Disguised Remuneration arrangements need to carefully consider their options before the 31 May 2018 settlement registration deadline

What is the issue?

HMRC's final settlement terms allow users of Disguised Remuneration arrangements an opportunity to regularise their UK tax affairs.

What does it mean to me?

Users of Disguised Remuneration arrangements should take advice now to ascertain their situation so that they can either register to use the settlement terms and meet the Requirement to Correct or understand the consequences of missing the deadlines.

What can I take away?

Taxpayers who miss the deadlines will face consequences including the 5 April 2019 loan charge, Accelerated Payment Notices, Follower Notices and possibly Requirement to Correct sanctions.

The curtain comes down

Disguised Remuneration (DR) arrangements involve a payment of a loan (often interest free, without any specific repayment terms and unlikely to be repaid) to an employee or contractor via third parties (e.g. a trust) without deduction of PAYE and National Insurance Contributions (NICs) at source. HMRC's position is that these arrangements simply 'do not work' as they just divert earnings. HMRC relentlessly challenged users of DR arrangements for many years through the Courts and changing tax legislation on DR itself.

Over the past four years HMRC introduced new measures aimed at encouraging taxpayers to settle including Accelerated Payment Notices (APNs). APNs removed any cash-flow advantage by demanding payment of the disputed tax whilst the enquiry or appeal is ongoing.

A glimpse into the future for DR arrangements

HMRC has new powers that will affect users of DR arrangements who do not settle using HMRC's new settlement terms.

- The *Loan Charge* for DR loans arises on 5 April 2019. It applies to any loan received after 6 April 1999 through a DR arrangement that remains outstanding on 5 April 2019. In limited circumstances (e.g. if an APN is already paid) it may be possible to postpone the date on which the loan charge needs to be paid to HMRC if postponement is applied for by 31 December 2018.

  The crucial point is that this tax charge does not amount to 'settlement'. It does not clear any liabilities for historic years, so a 'double whammy' of tax could be incurred by the loan recipient.

- The *Requirement to Correct* (RTC) was introduced by Finance (No.2) Act 2017, Schedule 18. This new compliance obligation requires UK taxpayers with undeclared tax relating to offshore matters to disclose those liabilities (for all periods up to 5 April 2016) before 30 September 2018. Taxpayers who fail to correct by the deadline will face 'failure to correct' sanctions, including a minimum penalty of 100% of the tax and being publicly named, unless they have a 'reasonable excuse' for the failure (in which case standard penalties apply).

  The scope of the RTC is wide. It applies to income tax (but not PAYE), capital gains tax and inheritance tax (IHT). Consequently, the RTC may affect UK and non-UK resident trusts. Historic IHT liabilities such as 10-year charges associated with DR trust structures could fall within the RTC.

- *Follower Notices* (FNs) force taxpayers to amend their tax returns to remove entries regarding tax avoidance arrangements (TAAs) or risk suffering penalties of up to 50% of the denied advantage (FA 2014, s209). FNs are issued after the Courts decide in a similar case that the tax planning fails. Complying with the FN effectively means relinquishing the tax advantage and settling the position without litigation.

  The Supreme Court decision in *RFC 2012 plc (in liquidation) (formerly The Rangers Football Club plc) v Advocate General for Scotland* [2017] UKSC 45 was published on 4 July 2017. As HMRC has 12 months from the decision to issue FNs relying on it, all such FNs must be issued by 3 July 2018. HMRC is likely to issue FNs to companies with EBTs, EFRBS and other similar DR arrangements before this deadline, effectively collecting the unpaid PAYE and NICs, unless they register for the settlement opportunity.

- *Serial Tax Avoidance Regime* (STAR) was introduced by Finance Act 2016, Schedule 18. It applies if a taxpayer participates in one or more TAAs which fail, or from which they exit, after 5 April 2017.

  Being caught by STAR automatically means being required to submit annual information notices during a five-year warning period, giving HMRC details of the TAAs used. Taxpayers who exit from DR arrangements via HMRC's settlement terms or otherwise will be affected unless they made a full disclosure before 5 April 2017. STAR's more serious consequences (20%–60% penalties, being named by HMRC as a serial avoider and restrictions on tax reliefs) will not apply unless new arrangements are used in the warning period that are subsequently defeated.

All of the above measures are likely to prompt DR arrangement users to review their tax affairs and quantify any potential liabilities so they can decide what to do next.

HMRC's settlement opportunity

HMRC is advising DR employers and participants to withdraw from arrangements and settle their tax affairs before HMRC issues FNs. On 7 November 2017 HMRC announced a DR settlement opportunity enabling employees, employers and contractors to settle any tax and NICs due because of historical participation in DR arrangements.

Settlement terms offered by HMRC vary depending on the type of arrangement in place and whether the person approaching HMRC is an:

- Individual contractor
- Employee/ex-employee (including a director of a company which liquidated after implementing a DR arrangement)
- Employer wanting to regularise the company's position on behalf of one/all affected employees/ex-employees.

This settlement opportunity has no special terms, compared to previous settlement opportunities offering 'special terms' in exchange for settlement of historic liabilities. HMRC's position now is that 'we don't need to offer special terms, we have all the ammunition now to close these schemes now by the measures we have introduced'. The 'opportunity' is merely a way to regularise historic UK tax issues prior to the RTC deadline and before APNs and FNs are issued.

Key deadlines are:

- Register an interest to settle by 31 May 2018;
- Sufficient information to be provided to HMRC by 30 September 2018;
- Settlements to be complete before 5 April 2019.

HMRC settlement terms: practical points

1. **Collapsing the structure**: Settlement with HMRC involves paying the historic income tax and NIC associated with the structure plus late payment interest. However, it does not automatically resolve outstanding loan and IHT issues. Settlements may be structured to facilitate the collapse of the trust structure. Trustees will need to be consulted to establish what is possible and the implications of doing so. However, collapsing the structure and resolving outstanding loans (e.g. via write-offs) eliminates the 5 April 2019 loan charge.
2. **Check the history**: it is imperative to check what open enquiries and assessments HMRC issued. HMRC is unable to collect tax where valid enquiries/assessments/determinations are not in place before legislative time limits expire. However, HMRC's settlement terms indicate they wish to receive voluntary restitution in certain circumstances. HMRC will not charge late payment interest on voluntary restitution payments, which can make a considerable difference to the overall settlement
3. **Agree the tax**: this may sound straightforward but in some cases questions about grossing up and ITEPA 2003 ss 222 and 223 charges may need resolving.
4. **Previous Settlements**: settlement with HMRC should be full and final. However, HMRC's detailed settlement terms indicate that previous settlements may need to be revisited, particularly those entered into after 16 March 2016 and/or which excluded IHT.
5. **Corporation Tax (CT) relief**: some employers did not claim a CT deduction for the contribution to the trust (i.e. the amount(s) settled). Under the settlement opportunity HMRC is allowing a CT deduction for that contribution, however not necessarily in the year the contribution was made.
6. **Time to Pay Agreements**: this is arguably the area on which HMRC is prepared to be the most flexible. Where cash flow is an issue HMRC is likely to allow a reasonable period to pay the liability as part of the overall settlement in exchange for the payment of forward interest.
7. **Penalties**: In previous settlement opportunities HMRC rarely imposed penalties. This may be in part due to HMRC being slightly hamstrung in their ability to successfully levy penalties, however it was mostly to encourage voluntary settlement. However HMRC are keeping their proverbial options open in their publication of settlement terms – simply saying, 'penalties may apply'. Care should be taken when entering into any settlement discussions and the penalty position protected as far as possible.

Should taxpayers settle?

Of course there are options, but arguably legislative changes severely limit them. Stakeholders (trustees, employees,

employers and contractors) are considering more than just the tax at stake. They are looking at the position holistically: commercially and practically. Fear of the unknown and certainty of position feature heavily in discussions.

Of course some taxpayers may decide to try to resist settling at this stage, risking RTC sanctions, APNs, FNs, penalties and the 5 April 2019 charge depending on their circumstances. However, regardless of their ultimate decision, all affected users of DR arrangements (including EBTs, EFRBs and Contractor Loans) should review their positions now before deciding on whether (and, if so, what action) to take before deadlines expire.

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