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Retrospective taxation

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Summary

In the *Wealth of Nations* published in 1776 Adam Smith argued a tax system should have four characteristics: equity, certainty, convenience, efficiency. Smith defined the principle of certainty as follows: "the tax which each individual is bound to pay ought to be certain and not arbitrary. The time of payment, the manner of payment, the quantity to be paid, ought all to be clear and plain to the contributor and to every other person."[1]

There remains a consensus that certainty is as important as it ever was in the design of the tax system. As the Office of Tax Simplification argued in a 2010 report, "taxes should not be arbitrary, the taxpayer should know his or her tax liability and when and where to pay it. It is important for a tax to be simple to understand, so that the taxpayer can calculate his or her liability."[2]

Retrospective tax legislation overturns this principle. It imposes or increases a tax charge on income earned, gains realised or transactions concluded at some time *prior* to the legislation being introduced. Quite often governments have been willing to diverge from the principle of certainty to counter the financial risks from tax avoidance, where taxpayers may be able to take action – 'forestalling' – to avoid the impact of a change in the law before it can take effect. For many years governments have taken a consistent approach to the circumstances in which retrospective legislation can be used to counter tax avoidance, an approach codified in 1978 in the so-called 'Rees Rules'.

In December 2004 the Labour Government announced provisions to counter several schemes designed to avoid tax on employment income. At the same time Treasury Minister Dawn Primarolo made a written statement giving notice that the Government would introduce retrospective legislation to tackle any similar avoidance schemes that came to light.[3] At the time there was widespread consensus that the 'Primarolo Statement' marked a major change in the revenue authority's approach – an attempt to halt the 'arms race' that had characterised the tax planning industry over the previous twenty years.

In 2008 the Labour Government introduced provisions to counter avoidance schemes that sought to exploit double taxation treaties and to frustrate avoidance legislation that had been introduced in 1987. The Government's position was this measure - contained in section 58 of the *Finance Act 2008* - clarified the law as it stood. At the time there were many complaints that this was unfairly retrospective. However efforts to change the Government's position, or mount a legal challenge to overturn the legislation as being incompatible with the European Convention on Human Rights, proved unsuccessful.

This paper discusses the origin of the Rees Rules, and subsequent debates as to the use of retrospective changes in tax law, both in the context of 'section 58' and, more recently, in the context of the 2019 Loan Charge, which was introduced in the 2016 Budget and has also been widely criticised for being unfairly retrospective.

1 Treasury Committee, *Principles of tax policy*, HC 753, 15 March 2011, para 5
2 OTS, *Tax reliefs review: interim report*, December 2010 p5
3 HC Deb 2 December 2004 cc44-46WS

1. Introduction - the 'Rees Rules'

In 2011 the Treasury Committee published a report on the principles that should underlie tax policy. The Committee noted that "there is nothing new in seeking an overarching principle or principles for tax policy. For over two hundred years there have been attempts to define a set of fundamental principles, providing rules by which to assess objectively and apolitically, new tax policy proposals." Many witnesses cited Adam Smith's four 'canons' of taxation, set out in the *Wealth of Nations* published in 1776. Smith argued that a tax system should have four characteristics: equity, certainty, convenience, efficiency, and he defined the canon of certainty as follows: "the tax which each individual is bound to pay ought to be certain and not arbitrary. The time of payment, the manner of payment, the quantity to be paid, ought all to be clear and plain to the contributor and to every other person."[4]

Although there have been various suggestions for other principles to tax design, there remains a consensus that certainty is as important as it ever was. In a report published in 2010 the Office of Tax Simplification argued "taxes should not be arbitrary, the taxpayer should know his or her tax liability and when and where to pay it. It is important for a tax to be simple to understand, so that the taxpayer can calculate his or her liability."[5]

Retrospective tax legislation overturns this principle. It imposes or increases a tax charge on income earned, gains realised or transactions concluded at some time *prior* to the legislation being introduced. Writing on this issue in the *Tax Journal* some years ago, Philip Fisher observed, "retrospection has been a dirty word for centuries [as] … everyone believes in the principle of arranging taxation affairs with full knowledge of their consequences."[6]

Quite often governments have been willing to diverge from this principle to protect the Exchequer from the risks of 'forestalling', where taxpayer may be able to take action to avoid the impact of a change in the law before it can take effect. As the Office for Budget Responsibility have noted:

> When a policy change is pre-announced, it provides a window in which firms or individuals could change the timing of their behaviour to minimise the tax they will pay. When this relates to pre-announced tax rises that provide an incentive for taxpayers to bring activity forward to avoid paying tax at a higher rate it is known as 'forestalling'.
>
> The opposite may occur if a tax cut is pre-announced, providing an incentive for firms and individuals to defer paying tax to take advantage of a lower rate in the future. Forestalling changes the timing of a taxable activity and will therefore change the profile of tax receipts, typically boosting receipts temporarily during the period of forestalling. But since this forestalling occurs because of

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4 Treasury Committee, *Principles of tax policy*, HC 753, 15 March 2011, para 5
5 OTS, *Tax reliefs review: interim report*, December 2010 p5
6 "Morality, tax avoidance and retrospection", *Tax Journal*, 2 March 2012

> the benefit to the individual taxpayer it will lead to an overall net loss of revenue.[7]

Ministers may announce provisions to counter a specific avoidance scheme that are to have immediate effect, prior to the legislation being introduced. As the Treasury Committee has observed "where tax changes carry a significant risk of forestalling activity or could distort market behaviour, it is often appropriate for those changes to come into effect immediately upon their announcement, even if formal parliamentary approval cannot be granted for some time thereafter."[8] Very occasionally Ministers may announce provisions that are to have effect *before* the date of their announcement

For many years governments have taken a consistent approach to the circumstances in which retrospective tax legislation can be used to counter avoidance, an approach codified in the 'Rees Rules'. The origin of these rules was the announcement by the then Chancellor Denis Healey in his Budget speech on 11 April 1978 of two measures relating to tax avoidance:

> [Tax avoidance] has emerged recently in a new form which involves marketing a succession of highly artificial schemes – when one is detected, the next is immediately sold – and is accompanied by a level of secrecy which amounts almost to conspiracy to mislead. The time has come not only to stop the particular schemes we know about but also to ensure that no schemes of a similar nature can be marketed in future.
>
> So the provisions I shall be introducing this year to deal with artificial avoidance by certain partnerships dealing in commodity futures will go back to 6 April 1976, that is, before the date when the intention to legislate was announced in a parliamentary answer. My proposed measures against avoidance by means of land sales with the right to repurchase will go back to 3rd December 1976, the date foreshadowed in a parliamentary answer.[9]

Further to the last point made by Mr Healey, Treasury Minister Joel Barnett had announced, in answer to a PQ on 3 December 1976, that "the Inland Revenue has recently seen documents outlining an artificial tax avoidance scheme under which arrangements are made to sell an estate or interest in land with provision for it to be reconveyed at a reduced price. The object of the scheme is to produce large sums qualifying for relief under Section 83 or 134 of the Income and Corporation Taxes Act 1970." He added the Revenue would be examining this scheme and any others with the same purpose.[10]

These provisions formed clauses 27 & 28 of the *Finance Bill 1978*; they were enacted as ss31-2 of the *Finance Act 1978*.

When the first of these provisions was debated in Standing Committee, Peter Rees MP argued that when retrospective legislation was used to deal with tax avoidance, and Ministers had given "a warning in the

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7 OBR, *Forestalling ahead of property tax changes: working paper no.10*, December 2016 para 1.6
8 *The 2006 Pre-Budget Report*, HC 115, 25 January 2007 para 100
9 HC Deb 11 April 1978 c1202
10 HC Deb 3 December 1976 c289W

House of Commons by some recognised method – either by an answer to a Parliamentary Question or by some statement" with plans "to legislate in the subsequent Finance Bill back to the date of that warning", this practice should be subject to four conditions:

> First, the warning must be precise in form. A mere suggestion that there are vague schemes of tax avoidance that must be counted should not suffice.
>
> Secondly, the problem at which the warning has been directed should immediately be referred to a committee which I understand exists … composed of members of the Inland Revenue and of the accountancy and legal professions … [the committee] should to left … to devise the precise legislative measures which should then be introduced.
>
> Thirdly, if the committee can hit on appropriate legislative provision, the draft clause … should immediately be published in advance of the Finance Bill so that those who are likely to be in the field of fire will have a second clear intimation of what to expect.
>
> Fourthly, such a clause must, without fail, be introduced in the following Finance Bill … I believe there may be situations in which [this approach] … is the only solution if we are to counter avoidance of the sophistication and scale which we understand has been current of late. But if a Government are to adopt that remedy, it must be on [this] basis.[11]

At the Report stage of the Bill both provisions were debated, when the Conservative Opposition tabled amendments to restrict their scope – unsuccessfully as it turned out. On this occasion Geoffrey Howe, then Shadow Chancellor, argued that the approach set out in Committee by Mr Rees had been adopted by governments on numerous occasions since the since the Second World War:

> In Committee … my hon. and learned Friend (Mr Rees) said that legislation of this kind can be regarded as acceptable by the House of Commons subject to four conditions … Those rules, with their emphasis on a previous clear warning and legislation at the first opportunity to implement the previous clear warning are restating what is and has been generally accepted in this matter…
>
> If one goes back to the debates of 1949 and 1950 … Sir David Maxwell Fyfe, as he then was, said: "I put this principle forward as quite unchallengeable; that the justification for retroactive legislation is that a reasonable and definite warning has been given to people likely to practise the matter to be struck at, and they have been given the opportunity to avoid that course." - [*Official Report,* 28th April 1949; Vol. 464 c499]
>
> That practice has been followed for a number of years since then.
>
> One of the more recent examples was in the 1958 Finance Bill when Mr. Heathcote Amory, as he was, was Chancellor of the Exchequer. He said: "In my opinion, one essential pre-requisite, if retrospective legislation is to be used, is that those concerned should have every reason to be aware of the taxation consequences of their specific actions and, therefore, have a chance of avoiding it if they wish … Nothing that I have said is intended to lay down the proposition, as far as I am concerned,

[11] SC Deb (A) 6 June 1978 cc718-9

> that in no circumstances whatever would retrospective legislation, after warning, be justified." - [*Official Report,* 18th June 1958; Vol. 589, c1132.]
>
> Therefore a long tradition has developed which may be untidy but which can be regarded as an acceptable convention of the constitution along the lines set out by my hon. and learned Friend the Member for Dover and Deal in the rules that were enunciated upstairs.[12]

In his response Treasury Minister, Joel Barnett, accepted the approach to retrospective legislation as set out by Mr Rees, while rejecting Mr Howe's proposal that the implementation dates for these provisions should be revised. In doing so the Minister argued that applying this legislation retrospectively was fair, given the financial risk to the Exchequer and the wider risk to the tax system being undermined:

> In the narrow purist sense … this is retrospection, but it is in no sense of the word general retrospection. It is retrospection against what is generally accepted on all sides—I would never accuse the Opposition of wanting this kind of scheme to continue—to be an obnoxious industry and one which, without this clause, would not only continue but thrive.
>
> What is more, the only penalty in this retrospective legislation is not a penal provision. The only penalty is that tax allowances which were never intended to be given to these people will not be allowed. … [This type of scheme] has a high degree of artificiality which by no stretch of the imagination could be considered to fall within the normal tax avoidance affairs of an individual taxpayer. It is incredible to believe that this is a normal tax avoidance scheme for legitimately reducing tax liability. There is no legitimate loss. There is only the fee paid to the tax avoider. There is no financial loss to match the tax loss …
>
> The right hon. and learned Gentleman says that high rates of tax create increasing contempt in the minds of the average taxpayer. What will be the effect on the average taxpayer if he knows that two or three people are avoiding £200 million in tax? What does that do to the average taxpayer who each week has his tax deducted under PAYE? When we are considering contempt for the tax system, we must consider that aspect …
>
> The right hon. and learned Member for Surrey, East then endorsed what he called the Rees rules. They are interesting, and I want to go through them.
>
> The first rule is that the warning must be precise. The hon. and learned Member for Dover and Deal did not deny that the warning given in November 1977 was precise. Indeed, he conceded that it was absolutely precise. I agree that should be done.
>
> Secondly, the problem should be referred immediately to a tax reform committee. I agree with that proposition.
>
> Thirdly, if legislation can be drafted to deal with tax avoidance, that should be done immediately—I agree—and it should be published.
>
> Fourthly, it should be introduced in the immediately following Finance Bill. I agree with that.

[12] HC Deb 12 July 1978 cc1640-2

> The trouble, as the right hon. and learned Member for Surrey, East must know, is that if that is all we do, everything fails and this industry continues, for the reasons that I have explained.[13]

Since then, this practice seems to have been generally adhered to, and there have been very few examples of tax provisions whose effect is backdated *prior* to their being announced.

One case concerned the attempt to clarify the rate of composite rate tax to be charged on building society accounts during a transitional period of its reform, between 1985 to 1986.[14] The then Conservative Government set out its approach to retrospective taxation in answer to a PQ at this time:

> **Mr. Peter Bottomley :** To ask the Chancellor of the Exchequer if Government policy in relation to retrospective tax legislation prevents the Government from introducing new measures for a retrospective change in the law in its own favour.
>
> **Mr. Dorrell :** Where it is discovered that the tax law does not have the effect that the Government and taxpayers generally thought it had, there are circumstances in which it is right to introduce legislation to restore the position retrospectively to what it was thought to be. This is done only in exceptional circumstances and where the Government consider such action is necessary to protect the interests of the general body of taxpayers.[15]

Notably in answer to a PQ the year before, only two examples of this type of retrospective legislation were cited.[16]

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13 HC Deb 12 July 1978 cc1643-6

14 This tax was abolished subsequently in April 1991. The relevant legislation was passed as section 64 of the *Finance (No. 2) Act 1992*.

15 HC Deb 29 June 1992 cc378-9W

16 Section 62 of the *Finance Act 1987* (evaluation of North Sea oil for tax purposes), and section 116 of the *Finance Act 1989* (payment of interest by UK companies to subsidiaries based in the Netherlands Antilles): HC Deb 14 May 1991 c105W.

2. The 'Primarolo Statement' - December 2004

In the 2004 Budget the Labour Government had announced the introduction of the Disclosure of Tax Avoidance Schemes regime ('DOTAS'). The DOTAS rules require accountants, financial advisers and other promoters to notify HMRC of any new scheme they are to offer to taxpayers. Each scheme is given a reference number which, in turn, taxpayers have to use in their tax return, if they have used it. HM Revenue & Customs have used this information to track the take-up of avoidance schemes, challenge individual schemes in the courts if HMRC judge that they do not work in the way the promoter claims, or to address unintended loopholes in the law that some schemes seek to exploit. As HMRC's detailed guidance on DOTAS notes, "on its own the disclosure of a tax arrangement has no effect on the tax position of any person who uses it. However, a disclosed tax arrangement may be rendered ineffective by Parliament, possibly with retrospective effect."[17]

In the Pre-Budget Report in December 2004 the Government announced provisions to counter several schemes designed to avoid tax on employment income, following details provided by DOTAS.[18] Further to this the then Paymaster General, Dawn Primarolo, made a written statement giving notice that the Government would introduce retrospective legislation to tackle any similar 'disguised remuneration' (DR) schemes that came to light.[19]

At the time there was widespread consensus that the 'Primarolo Statement' marked a major change in the revenue authority's approach to tackling tax avoidance – an attempt to halt the 'arms race' that had characterised the tax planning industry over the previous twenty years. Over this time there had been a general trend in accountants and lawyers devising a complicated method of employers paying highly-remunerated staff – payment in fine wines or platinum sponge, say – to exploit a loopholes in the law, such as how "earnings" was defined for the purposes of tax. In turn governments had introduced complex anti-avoidance provisions to frustrate this particular scheme. Subsequently accountants and lawyers had reacted to this move by devising a new vehicle – offshore employee benefit trusts, say – to achieve the same tax saving end, leading in turn to further legislation.

The Minister's statement is reproduced in full overleaf.

17 HMRC, *Disclosure of tax avoidance schemes: guidance*, April 2018 para 2.2
18 HM Treasury Pre-Budget Report press notice PN3, 2 December 2004
19 HC Deb 2 December 2004 cc44-46WS

The 'Primarolo Statement' : HC Deb 2 December 2004 cc44-46WS

The Paymaster General (Dawn Primarolo): This Government are determined to ensure that all employers and employees pay the proper amount of tax and NICs on the rewards of employment, however those rewards are delivered. Despite the efforts of successive Governments of all persuasions over several years, we continue to be presented with ever more complex and contrived attempts to avoid paying tax and NICs on rewards from employment, particularly in relation to bonuses in the City.

In the most recent year for which we have figures, well-rewarded individuals receiving bonuses of at least £1.5 billion in total sought to avoid paying their fair share of tax and NICs. The disclosure rules in Finance Act 2004 have revealed that this kind of avoidance is still rife. Without prompt and decisive action we think there could be up to £2 billion paid this year in bonuses on which the amount of tax and NICs properly due is at risk, as a result of increasing ingenuity and inventiveness of the tax avoidance industry.

We cannot allow avoidance on this scale to continue. It is only right that everyone who should pay tax and NICs, does pay and that they pay their fair share when it is due. The overwhelming majority of employers and employees do pay their fair share. But for too long some employers and employees with the benefit of sophisticated tax advice have sought to avoid their responsibilities and to pass more of a burden onto the rest of us.

Early attempts at avoidance in this area took the form of paying bonuses and salaries in gold bullion, diamonds and fine wines. When these routes were closed, employers started to pay bonuses through shares and share options to reduce the amount of NICs they had to pay, avoid their obligation to operate PAYE, and reduce employees' tax bills. When, in 1998, assets readily convertible into cash were brought within PAYE, and NICs, avoidance schemes moved on to more complex arrangements.

Despite extensive reforms to the tax legislation in 2003, employers and their advisers are continuing to devise and operate ever more contrived avoidance schemes. One such example of which Inland Revenue has learnt involves payment of a bonus to an employee in the form of dividends on shares in a specially constructed company. This avoids tax at 40 per cent. and employer and employee NICs.

The Inland Revenue will be challenging such arrangements in the courts where it is appropriate to do so. We cannot however await the outcome in the courts before taking action. We intend that from today both tax and NICs legislation should achieve our objective of subjecting the rewards of employment to the proper amount of tax and NICs, however the rewards are delivered. Taxpayers who contribute their fair share have a right to expect that others will also do so. We also want to make it plain that to the extent that legislation may still not achieve our objective in the face of continuing avoidance, we will ensure it does.

To that end we will be including legislation in the Finance Bill 2005, effective from today, to close down the avoidance schemes we know about. A technical note explaining what we intend to do in Finance Bill 2005 will be published today. We will also ensure that NICs is charged on these schemes with effect from today.

However, experience has taught us that we are not always able to anticipate the ingenuity and inventiveness of the avoidance industry. Nor should we have to. Our objective is clear and the time has come to close this activity down permanently.

I am therefore giving notice of our intention to deal with any arrangements that emerge in future designed to frustrate our intention that employers and employees should pay the proper amount of tax and NICs on the rewards of employment. Where we become aware of arrangements which attempt to frustrate this intention we will introduce legislation to close them down, where necessary from today.

This action will not affect employers and employees who organise their affairs in a straightforward and ordinary way—the vast majority. In particular, genuine employee share schemes and share option plans will not be affected. We continue to believe these make an important contribution to the Government's productivity agenda.

Many tax professionals argued that the statement made by the Minister was a retrograde step for three reasons:

- It undermined certainty for taxpayers, both individuals and businesses, for their financial and investment planning.
- It infringed the European Convention on Human Rights.
- It undermined the credibility of the fiscal system, making the UK less attractive for individuals and investors, and encouraging aggressive tax planning for those living and working here.

In their response the Institute of Chartered Accountants stated that while it appreciated that "retrospective legislation may have some superficial attraction in countering unreasonable tax avoidance", it should be opposed to it in principle":

> **It fails the test of certainty** ... Taxpayers are entitled to assume that any actions they take will be taxed in accordance with the law in existence at the time that the action is entered into. In relation to countering tax avoidance, the current practice of making a specific announcement that a scheme will be blocked from that day, even if draft legislation follows in due course, is well understood and is reasonably certain in its effect.
>
> This practice follows closely the guidelines agreed by the Government in the Parliamentary debate about the 1978 Finance Bill (the so-called Rees Rules) where it was agreed that any warning about prospective retrospective legislation must be clear in form. We do not think that the announcement made on 2 December 2004 meets the required standard of certainty as set out in the Rees Rules.
>
> **The legal basis for retrospective legislation is now questionable, particularly in the wider context of EU and Human Rights laws.** Emerging EU case law provides that the state cannot retrospectively remove a right without a transitional period (the so-called legitimate expectation right as found in Marks-and-Spencer v C&E Commrs (C-62/00)) ...
>
> **Retrospective legislation has the potential to undermine the credibility of the UK tax system in the eyes of taxpayers.** We believe that, by and large, the UK's tax system has a high degree of credibility: the tax rules are obeyed and taxpayer compliance and honesty are good … if credibility in the system is undermined, it may have very undesirable consequences. For example it may lead to poorer compliance, potentially leading into non-compliance and possibly to evasion.[20]

In general terms the Labour Government's response to each of these arguments was as follows:

- It was disingenuous for taxpayers involved in this form of tax planning to claim that the Government's action had taken them by surprise.
- The European Convention made specific provision for governments to raise taxes in a fair and proportionate way, which applied in this particular case.

[20] ICAEW, *Retrospective legislation TAXREP 8/05*, 10 February 2005 para 10 **(emphasis added**)

- The credibility of the fiscal system was at threat from the actions of a minority of taxpayers being able to avoid tax and NICs on their employment income.

On the first of these points – that the Primarolo Statement failed the test of certainty - some commentators argued that the 'arms race' had been going on for so long that it was highly unlikely that many taxpayers would be genuinely surprised at the Government seeking to overturn any new marketed scheme. In an opinion piece in the *Financial Times* David Cohen, a partner in the law firm Norton Rose, questioned the degree to which this move could be considered retrospective:

> Government frustration at always having to use kid gloves when dealing with this particular type of avoidance has finally boiled over. In future they will use their weapon of last resort, retrospective legislation.
>
> To be fair, it is not retrospective in the full meaning of the word, which ought to be reserved, in the tax arena, for situations where taxpayers have been given no prior indication that an activity will trigger a liability. In this case, anyone who in future sets out to avoid tax on remuneration by using convoluted share-related arrangements has been clearly warned that the attempt will be futile. This is contentious territory, though any suggestion that the European Convention on Human Rights may be breached probably owes more to the self-preservation instincts of certain tax "schemers" than to a disinterested legal analysis.[21]

In June 2005 Dave Hartnett, then director general at HMRC, gave evidence to the Lords Economic Affairs Committee, and discussed the industry's reaction to the Primarolo Statement:

> I think what the Paymaster's statement did was to put everyone on notice that, if they were going to carry on doing this, they could expect Government to act and act back to that date. We had a huge number of e-mails and letters from tax advisers saying "Why did you not give this advice before? It is time all this was stopped". They did not see uncertainty, and I have to say I do not see uncertainty going forward because those who promote these arrangements know exactly what they are doing and, if they want to do it in future, they are on notice now as to what the Government's response is going to be.[22]

Turning to the second critique of the Statement, a standard guide to the law provides some commentary on the application of the European Convention to this area of the law:

> Article 1 of Protocol No 1 to the European Convention guarantees, in substance, the right to property and, in effect, comprises three elements. The first contains the general principle of peaceful enjoyment of property; the second deals with deprivation of property and subjects that to certain conditions; the third recognises that contracting states are entitled to pass laws that they deem necessary to secure the payment of taxes.
>
> This was explained by the European Court of Human Rights in *National and Provincial Building Society and Others v UK* (1997) in the following terms:

[21] "Brown's boost for genuine employee share plans", *Financial Times*, 6 December 2004

[22] *The Finance Bill 2005*, HL Paper 13-II, 4 July 2005 Q109 p 47

> *"According to the Court's well-established case-law, an interference, including one resulting from a measure to secure the payment of taxes, must strike a "fair balance" between the demands of the general interest of the community and the requirements of the protection of the individual's fundamental rights. The concern to achieve this balance is reflected in the structure of Article 1 as a whole, including the second paragraph: there must therefore be a reasonable relationship of proportionality between the means employed and the aims pursued.*
>
> *Furthermore, in determining whether this requirement has been met, it is recognised that a Contracting State, not least when framing and implementing policies in the area of taxation, enjoys a wide margin of appreciation and the Court will respect the legislature's assessment in such matters unless it is devoid of reasonable foundation."*[23]

The authors go on to discuss the application of Article 1 of Protocol 1 in a number of specific areas: recovery of overpaid tax, seizure of property; imposition of a one-off tax, and, imposition of retrospective legislation:

> Retrospective legislation is used most often in the area of taxation as an anti-avoidance measure by plugging a loophole. Would such legislation infringe the European Convention on the basis hat it undermines the rule of law and legal certainty? In *MA and 34 Others v Finland* (2003), the ECtHR stated that retrospective tax legislation was not as such prohibited by Art 1 of Protocol No 1 and that the key question was ether the backdating struck a fair balance between those affected by the change, both positively and negatively.[24]

Following the 2004 Pre-Budget Report the then Chancellor Gordon Brown gave evidence to the Treasury Committee, and on this occasion John McFall MP, then Chair, asked the Chancellor, "is this not retrospective legislation and do you think you can act in this way and stay within the Human Rights Act?" Mr Brown replied as follows:

> Well, I think that is, in my view, not an acceptable way of proceeding. If it is accepted that there is a loophole which has got to be closed, whether it is of a specific nature or in a number of different areas, then it should be closed immediately. If people are not going to act in a way that allows it to be closed through the Finance Act legislation, we just said that we would insist that it would be from the date of the Pre-Budget Report, and I think that is perfectly reasonable. Once you accept that a scheme is wrong, that as a form of avoidance it is unacceptable, then I think it is reasonable to close it on the day you have announced that you want it to stop. We are confident, I may say, that this does not conflict with the ECHR.
>
> **Chairman:** And you do not think that you will be breaching the Human Rights Act?
>
> **Mr Brown:** Well, I think the basis of the European Convention on Human Rights is that it gives a government the power on behalf of the tax-paying public to raise taxes in a fair and proportionate way.[25]

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23 Anne Fairpo & David Salter, *Revenue Law: principles and practice*, 37th edition 2019 para 57.21

24 *op.cit.* para 57.26

25 [The Treasury 2004 Pre-Budget Report](), HC 138, 27 January 2005 Ev Qs325-6

For its part the Treasury Committee expressed support for "the Government's determination to tackle unreasonable tax avoidance schemes" while recognising "some experts have indicated that their approach could lead to challenge in the courts":

> This can only finally be tested as and when the Government introduces any legislation on the basis of the announcement. It would be helpful if, at this stage, and without jeopardising their position, the Inland Revenue were to publish a paper setting out their thinking on the principles which will guide future decisions as to whether a scheme is reckoned to be within or outside the terms of the announcement.[26]

In its response to the report, published in March 2005, the Government expressed its view that, "the Statement itself sets out the principles and context and encourages individuals, employers and their advisors to read the whole statement and its context to understand how it might apply to them. Parliament will of course have the usual opportunity to debate in full any future proposals on legislation in this area."[27]

Turning to the last critique of the Statement – the need to maintain the credibility of the fiscal system – Dave Hartnett gave some examples of the unconventional ways in which employers had rewarded employees, in his evidence to the Lords Economic Affairs Committee in June 2005:

> [In the mid-1990s] we … saw schemes which involved oriental carpets, reversionary interests in trusts, shares—funny shares, if I can put it like that—and, my favourite, platinum sponge. If all the awards of platinum sponge made to employees had actually been given in the jars that platinum sponge come in, there would have been none for the catalytic converters that go into all of our cars, so vouchers and all sorts of things were used. I hope you will forgive me for putting it as colourfully as I have, but I wanted to give a sense to how odd this period was in terms of forms of remuneration.[28]

For many practices like these were proof that a minority of the most highly paid individuals could avoiding substantial amounts of tax, simply by paying for the very best financial advice. Notably both Conservative and Labour governments had introduced legislation to tackle this form of avoidance, and it is arguable that allowing such a state of affairs to continue unabated could have posed a much greater risk to the tax system's credibility. Indeed, in an official review of the impact of the Primarolo Statement, the authors suggested that the success of this approach was probably to be seen in its impact on taxpayers' attitudes:

> It is important to note that whilst the anti-avoidance announcement was one in long-line of anti-avoidance measures it was qualitatively different. Whilst previous anti-avoidance measures were targeted at specific schemes, the announcement that legislation to close down schemes would have retrospective effect was designed to engineer a permanent change in behaviour.
>
> So although this evaluation has found evidence of behaviour changing prior to the announcement as a result of targeted anti-

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26 *The Treasury 2004 Pre-Budget Report*, HC 138, 27 January 2005 para 93
27 Treasury Committee, *First special report*, HC 483, 28 March 2005 p15
28 *The Finance Bill 2005*, HL Paper 13-II, 4 July 2005 Q109 pp 46-7

> avoidance measures, it is possible that without the prospect of future legislation being retrospectively implemented, these changes would not be sustained and individuals would seek out new avoidance opportunities. As such, the anti-avoidance announcement had an impact on avoidance behaviour that was different to previous, more specific, measures.[29]

In the 2006 Budget the Government announced that it would introduce legislation to counter the use of avoidance schemes based on the use of options over shares and securities. Following the Primarolo Statement, this measure would be backdated to 2 December 2004.[30] When this provision debated in Committee Ms Primarolo opposed a number of amendments to restrict the scope of the provision, and bring forward the date for its implementation. In her comments the Minister set out the background to the Government's decision to make this Statement…

> We are talking about payments, bonuses and forms of employment remuneration that are disguised, and successive Governments have tried to deal with them. It started in 1991 with unit trusts; in 1993 it was gold bullion and other tradeable commodities, and in 1994 it was diamonds and fine wines. In 1995, there was anti-avoidance legislation on tradeable assets and vouchers, and in 1996 grants of share options in third party companies had to be dealt with, as did company share awards and options. In 1997 there was more on vouchers; and in 1998 it was conditional shares. Again in 1998, we dealt with readily convertible assets and with convertible shares; and in 1999 we dealt with the exercise of options. The relentless march against those who seek to take employment remuneration without it being properly taxed continues. The evidence is that by 2003 £1.4 billion was going through those known schemes ... When I made the statement in December 2004, a clear line was being drawn …

…and its application in this case:

> Amendment No. 137 seeks to narrow the effect of the clause by restricting its application to income tax and national insurance only. That would be an unacceptable weakening of the proposals.
>
> My statement of 2 December made it clear that
>
> "This Government are determined to ensure that all employers and employees pay the proper amount of tax and NICs on the rewards of employment, however those rewards are delivered."—[Official Report, 2 December 2004; Vol. 428, c. 44WS.]
>
> The phrase "however those rewards are delivered" in that sentence is crucial to the schemes that are devised. Avoidance schemes are being marketed to engineer a corporation tax deduction on employment reward, without a commensurate matching income tax charge on the employee. The schemes defer taxation indefinitely or until a considerable time after the employee has received the employment reward. I cannot see that using a wholly uncommercial option is anything other than avoidance, depriving the Exchequer of the proper amount of tax and national insurance and employment reward. I gave fair

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29 HMRC, *Evaluation of the December 2004 Anti-Avoidance Announcement : HMRC Working Paper 6*, April 2009 p36

30 HMRC, *Protecting revenues : employment-related securities*, Budget Note BN33, 22 March 2006. Provision to this effect was made by s92 of the *Finance Act 2006.*

> warning on 2 December 2004 that we would no longer accept that …
>
> Amendment No. 140 would limit the backdating of the clause to the date of the Budget—22 March 2006—when the provisions were announced and published. That would undermine not only the clear warning that I gave on 2 December 2004, but future Government action to tackle avoidance. It would also give entirely the wrong signal to those who abuse security options to avoid tax and national insurance by allowing them to keep some of the tax and national insurance that they have avoided.

The Minister went on to suggest that those promoting this type of avoidance were well aware of the likelihood the Government would counter it in this way:

> Let me dispel the notion that uncertainty prevails among practitioners—some of whom, I am sorry to say, perhaps supplied the amendments that we are discussing—by quoting from a post-Budget publication, issued by a firm of active advisers, appropriately called the "Tax Planning Newsletter". It states:
>
> "The main problem area for our clients would have been for those...who used one of the schemes which enabled bonuses to be taken from companies tax free. We had been warned by Dawn Primarolo that there was a danger of retrospective legislation in this area and we passed that warning on to clients. For some, however, it was a risk worth taking but it now appears that she meant what she said."
>
> Absolutely; I meant what I said. If clause 92 were only made effective from the date of the Budget, it would return us to the cat and mouse games of the past, where there was always a window of opportunity to manufacture and use an avoidance scheme before remedial legislation could be enacted.[31]

Several years after the Primarolo Statement, the House of Lords Economic Affairs Sub-Committee reviewed the Government's approach to tackling tax avoidance as part of its enquiry into the *Finance Bill 2011* – and specifically, provisions in the Bill regarding 'disguised remuneration' (DR) schemes.[32] A variety of witnesses from the private sector raised concerns that the provisions were far too lengthy and complex, potentially affecting 'innocent' transactions, a view the Committee shared:

> The legislation to address disguised remuneration avoidance is extremely complex and beyond the scope of most business people to decide whether or not it applies to them …There was clearly a very wide and deep unhappiness with this draft legislation … Notwithstanding the justifications put forward by the Exchequer Secretary in the Commons Public Bill Committee and by officials to us, we remain unpersuaded that there was no alternative to this complexity.[33]

Some witnesses argued that the Government should have used the Primarolo Statement as an alternative approach; as the Committee

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31 Public Bill Committee (Finance Bill), *13th Sitting*, 6 June 2006 cc440-443

32 House of Lords Economic Affairs Sub-Committee, *The Finance Bill 2011*, HL Paper 158, 17 June 2011. These provisions foreshadowed the introduction of the 2019 Loan Charge to counter DM schemes, discussed in section 4.1 of this paper.

33 *op.cit.* para 174-5

observed, "we recognise that in its anti-avoidance strategy, the Government stated that it would legislate retrospectively only in the most exceptional circumstances. It seems to us that a tax loss of over £1 billion each year from avoidance involving disguised remuneration is a truly exceptional circumstance."[34]

When he gave evidence to the Committee, Dave Hartnett (then Permanent Secretary for Tax at HMRC) was asked about this. In his reply Mr Hartnett noted how controversial the Primarolo Statement had been when first announced, an indication perhaps of how the problems created by mass marketed avoidance schemes had changed attitudes:

> We asked officials about the Primarolo statement. Mr Hartnett commented "The first reaction is a wry smile, if I may. When the Primarolo statement was issued, I do not think it would be an overstatement to say that in some areas of the tax industry there was complete uproar. They did not like it. It was not legislation; it was a promise of what was going to happen. A huge amount was written in criticism. So I am surprised that there is some thinking that it could be useful …
>
> What about the present Government? It has made it very clear that it sees retrospective legislation of the sort promised in the Primarolo statement as wholly exceptional … If ever HMRC was to make a case to Treasury Ministers that something was exceptional ... then a hunch ... is that this might be [such] an area … We are going to be monitoring it carefully, because it is really important that we advise our Ministers on how this legislation works."[35]

Notably in a paper on tax compliance, in a survey of the 'Mirrlees Review' of the UK tax system published by the Institute for Fiscal Studies at this time, the authors commented, "there is anecdotal evidence that this threat, coupled with the fact that it has been acted upon … has been largely successful in stopping the annual bonus scheme round, where each year a series of devices targeted at eliminating tax/NICs on 'city' bonuses appeared."[36]

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34 *op.cit.* para 183
35 *op.cit.* para 181
36 Jonathan Shaw, Joel Slemrod & John Whiting, "Administration & Compliance", in, *Dimensions of tax design: the Mirrlees Review*, IFS May 2010 p1155

3. Section 58 of the *Finance Act 2008*

3.1 Budget 2008 : provision to prevent double taxation treaty abuse

In its 2008 Budget report the Labour Government announced a number of measures to counter tax avoidance schemes, including a scheme that sought to exploit double taxation treaties – the bilateral agreements between countries to prevent income or gains that are potentially liable to tax in each state from being taxed twice:

> **4.68** The Government announces, with retrospective effect from 12 March 2008, clarification of indefinitely retrospective legislation introduced in 1987 to counter double taxation treaty avoidance schemes, so that the legislation applies as intended and is effective. This will ensure that, notwithstanding the wording of any double taxation treaty, UK residents pay UK tax on their profits from foreign partnerships. Budget 2008 announces there will also be a further measure to prevent future tax avoidance through the misuse of double taxation treaties by UK residents.[37]

More details were given in a Budget note issued at the time:

> UK law taxes a UK resident beneficiary of certain trusts on the income to which they are entitled under the trust arrangement as it arises. This means that, in cases exploiting the above avoidance scheme, the UK resident should be taxable in the UK on his or her share of the profits of the partnership comprised of the foreign trustees. But the users of the scheme claim that a provision, known as the Business Profits Article, common to most tax treaties, exempts the partnership profits from UK tax – not only in the hands of the foreign partners but also in the hands of the UK beneficiaries.
>
> The first provision will make clear that (in line with retrospective legislation introduced in Finance (No2) Act 1987) tax treaties do not exempt UK residents from UK tax on any profits of a foreign partnership to which they are entitled.
>
> The second measure will ensure that the Business Profits Article in the UK's tax treaties cannot be read as preventing income of a UK resident being chargeable to UK tax …
>
> The first measure will be treated as having always had effect.
>
> The second will have effect for income arising on or after 12 March 2008.[38]

Provision to this effect was made initially in clauses 55 & 54 of the *Finance Bill 2008*. Following the Bill receiving Royal Assent, these provisions are now ss 58 & 57 of the *Finance Act 2008*.

Following the Budget, professional bodies raised concerns about the first of these measures being retrospective. In their commentary on the Bill, the Chartered Institute of Taxation argued that there was "no

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37 *Budget 2008*, HC 388, March 2008 p72
38 HMRC Budget Note BN66, *Double taxation treaty abuse*, 12 March 2008

justification for the introduction of such legislation with such extreme retrospective effect":

> The proposal to backdate this legislation to the 1987 legislation is excessive and, whatever the issues are surrounding such avoidance, unjustified. The mischief being targeted is not new and has been known to HMRC for some time; it is referred to in the International Manual (ITH 1660). Whilst HMRC are entitled to change their minds and legislate against the planning, to take retrospective action against something that has been acknowledged this way is wrong. This sort of move gives rise to significant concerns about not only the proportionality of the measure but also whether the UK tax system has any certainty and whether the UK is a stable place in which to invest.[39]

The Tax Faculty of the Institute of Chartered Accountants also raised concerns:

> Although we understand that the clause is directed primarily at situations involving Isle of Man or Channel Isles partnerships, we believe the EU law principle of legitimate expectation needs to be respected so that taxpayers are entitled to understand the implications of any transaction that they enter into. Treating this provision as always having had effect runs contrary to Parliament's intent over the past 30 years to lay down rules whereby the tax effect of particular transactions can be 'changed' or advance warning is given of a change in tax treatment in identified circumstances.
>
> One of the earliest attempts to set out some rules that ought to apply in such situations was made by Peter Rees (now Lord Rees) in the Standing Committee debates on what became the 1978 Finance Act: these have since been known as the 'Rees rules' … The practical effect of the Rees rules was that they laid the ground rule for retroaction, i.e. the law when it was finally enacted could not have effect earlier than the House of Commons announcement of the upcoming anti-avoidance change.
>
> Another approach was adopted in the late 1980s to counter a legal decision that had gone against the Inland Revenue and which the government wished to 'reverse'. In that case although the new law was stated to have always had effect this did not influence any judicial decisions made before the new law was announced.
>
> So, for instance, s 62 of Finance Act 1987 was introduced to reverse the decision in *Padmore v IRC* and the amendment to section 153 ICTA 1970 was deemed always to have had effect, except in relation to any judicial decision before 17 March 1987, the date when the amending legislation was announced, or to any appeal therefrom. In other words the High Court decision in Padmore was not retrospectively declared to be wrong and the old law was not treated as amended for the purpose of any appeal by the Inland Revenue against the High Court's decision. The appellant in Padmore kept the fruits of his appeal, but no other taxpayer was expressly protected by the terms of the legislation.
>
> A more recent approach was the statement of the Paymaster General on 2 December 2004 to the effect that legislation would be introduced in the future, effective from 2 December 2004, in

[39] CIOT, *Finance Bill 2008: CIOT representations*, 14 May 2008 p33

> relation to: "what the Government considers to be unreasonable tax avoidance schemes involving employment income."[40]

The Faculty went on to argue HMRC should re-examine the rationale for legislation with retrospective effect:

> We wrote to the Paymaster General in February 2005 and in our letter we noted that the Treasury Select Committee had stated in a written report that: 'The Inland Revenue should, without jeopardising their position, publish a paper setting out their thinking on the principles which will guide the way they implement [the Paymaster General's] announcement.'[41]
>
> Such a paper has never been published but we believe that the philosophy underlying retrospective or retroactive legislation should now be examined in conjunction with the current move to introduce purposive, or principles based, legislation.
>
> If the underlying purpose behind any piece or legislation, or any area of tax law, is clearly articulated then any taxpayer who respects that purpose should have certainty as to the (tax) outcome of their particular transaction. If the underlying policy is to be changed then any change should, in our view, only have effect in relation to future transactions. We recommend that an appropriate modus operandi ought to be agreed by HM Treasury, HM Revenue & Customs and Representative Bodies and then published for the benefit of all taxpayers.[42]

These provisions were debated at the Committee stage of the Finance Bill on 22 May 2008, when both the Conservatives and Liberal Democrats argued that clause 55 of the Bill should only apply from the day it was announced – Budget day 2008.[43] In response the then Financial Secretary, Jane Kennedy, argued "the avoidance scheme that the clause closes down was designed to frustrate legislation passed by Parliament in 1987 to prevent this type of avoidance, also with retrospective effect … we have not come to a decision lightly [and] I am satisfied that in these unusual circumstances, retrospective clarification of the law is fair, proportionate and in the public interest. That is the human rights test that we must apply."[44]

The Minister went on to give a detailed explanation of the issue, and a long extract from her speech is reproduced over the next two pages.

First, the Minister gave some background to the introduction of legislation in 1987 to prevent the exploitation of double taxation treaties …

> In 1979, Mr. Padmore, a UK resident, worked in the UK as a patent agent. He was also a member of a Jersey partnership, which had been set up to receive some of the income from Mr. Padmore's activities as a patent agent. In line with the law as it was generally understood at the time, the Inland Revenue sought to tax him on his share of the foreign partnership's profits. In December 1986, the courts upheld his claim that the tax treaty between Jersey and the UK meant that none of the Jersey

40 ICAEW, *TAXREP 31/08: Detailed commentary on Finance Bill 2008*, May 2008 p30
41 *The 2004 Pre–Budget Report*, HC 138, 27 January 2005 para 93
42 ICAEW, *TAXREP 31/08*, May 2008 p31
43 Public Bill Committee (Finance Bill), *Eleventh & Twelfth Sittings*, 22 May 2008 cc361-384
44 *op.cit.* c372

> partnership's profits could be taxed in the UK, even those belonging to UK resident partners. The decision was a surprise, not only to the Inland Revenue but to other tax authorities and most tax advisers. It overturned the generally held view that unless explicitly specified, tax treaties do not remove a country's right to set taxes …
>
> Parliament acted at the next available opportunity—in the 1987 Finance Bill—to make it clear that the UK's treaties did not give, and never had given, tax exemption to a UK member's share of a foreign partnership's income. During the debate on the 1987 Bill … the then Financial Secretary [Norman Lamont] observed that although the provisions had caused him "considerable concern", he had concluded that the clause should apply with retrospective effect. He noted that that did not involve the "type of retrospection on which the House has normally looked with disfavour" as all that it did was to "restore the general understanding of the law to what it was before a decision of the High Court." [Official Report, 15 July 1987; Vol. 119, cc180-87]

… before discussing the use of a new scheme to frustrate this legislation …

> UK individuals and companies have been artificially routeing their income through offshore trusts and partnerships and claiming that one of the UK's many double taxation treaties exempts them from tax. That is in wilful contravention of the purpose of the treaty and the 1987 legislation. A fundamental purpose of the clause is to put it beyond doubt that a wholly artificial avoidance scheme designed to frustrate legislation passed by Parliament in 1987 to prevent such avoidance does not work, and never has. Some taxpayers were awaiting the outcome of litigation in the expectation that it would clarify their affairs. The legislative change in the clause will result in the necessary certainty, not litigation, thus enabling tax returns to be finalised.
>
> Many descriptive terms have flowed in the discussions that I have had about this avoidance scheme, one of which is "an egregious case". In such a case, the Government consider that the law already defeats the scheme and that it is clear to all concerned that the scheme is in defiance of Parliament's intent. Used in such a context, retrospection preserves the expectation that tax will be applied fairly and consistently. That will build confidence and trust in the law. Nobody could seriously think that the clause is unfair to the people who will be affected by it. Users of the scheme have deliberately tried to frustrate the will of Parliament, and they will have been aware that Parliament had closed down similar schemes 20 years ago with retrospective effect. My understanding is that that retrospectivity was unlimited, in effect, until the end of the second world war.

… the amount at risk from taxpayers using this scheme …

> The Committee might not be aware of the scale of the risk to the Exchequer as a result of this avoidance scheme. HMRC is aware of more than 2,000 scheme users, and it involves tax of £50 million a year—a not insubstantial sum. Given the increasing numbers using the scheme, the rapidly growing amount of tax at risk and the wilful attempt to circumvent the clear purpose of the legislation and of the UK's tax treaties, we consider it appropriate to legislate to provide retrospective clarification and to put the matter beyond doubt. HMRC has learned that the large number

> of taxpayers who have been using the scheme has suddenly started to grow ...

… and why, in the Government's view, this action was justified:

> The scheme is similar to the Padmore scheme except that UK taxpayers set up offshore trusts as well as partnerships. The trusts are for their own benefit, and the trustees become members of the partnership. UK taxpayers agree to work for the partnership, so that once a scheme is set up, their UK income thereafter becomes payable to the partnership and, through the trust, it is paid straight back to them in the UK. They assert that such an arrangement circumvents the 1987 legislation so that the income is tax-free. HMRC does not believe that the scheme works, but we have taken into account its scale and the wilful attempt to flout the law that retrospectively clarified how tax treaties work. The Government have developed our approach on the detail of the legislation on anti-avoidance rules generally to ensure that they are effective and properly targeted. Business welcomes that approach, and it has led to better legislation …
>
> The Government do not accept that the clause changes the meaning of the law. The law already applies to partnership profits, and we interpret that as including profits enjoyed through a trust. The measure clarifies rather than amplifies the scope of the 1987 legislation and puts beyond doubt what most people understand it to mean. We recognise and acknowledge the difficulties inherent in such legislation. Although the clause is strictly retrospective, as was the case in 1987, it does not change what is generally understood to be the meaning of the law but merely clarifies it.[45]

Opposition Members pushed the matter to a vote, but the clause was approved unamended, by 13 votes to 7.

Professional bodies continued to raise concerns. On 4 June 2008 the CIOT wrote to the Treasury, reiterating their view that, "the degree of retrospection is extreme and unjustified":

> The retrospective nature of clause 55 is apparently justified as it is said to clarify the existing law, ie as effected in 1987. If clarification is necessary, that implies the law needs changing as, presumably, HMRC are not confident that their interpretation is correct. The place to test the way the law works is in the Courts: as the Minister is aware, that is how the system of tax law operates in the UK.
>
> Taxpayers have had no warning of this apparent need for clarification. Quite the reverse: the HMRC manual has referred to the sort of planning now being attacked since 1997. Whatever the rights and wrongs of the avoidance device, taxpayers and advisers could surely be forgiven for assuming its use was accepted – or, at any rate, not seen as warranting tackling with any urgency. In particular, there was never any indication of a need to change – or clarify – the 1987 law.
>
> We do not think the case has been made in any way for a change that acts retrospectively by 21 years. We could in principle, but reluctantly, accept backdating to December 2004, in line with the PMG's statement. As the Clause stands it is damaging to the

45 *op.cit.* cc372-377

> standing and integrity of the UK's tax system and we urge you to reconsider it.[46]

On 8 July 2008 the then Financial Secretary, Jane Kennedy, wrote back to the CIOT, stating that she had "reviewed the clause, the various representations received and meetings which I have held with representative bodies and I am still of the mind that clause 55 combats a clearly abusive avoidance scheme in a proportionate and justified way"; an extract from the Minister's letter is given below:

> You suggest in your letter that the Government is seeking to change the law because they are not confident that HMRC's interpretation of it is correct, and you stress that the best place to test how the law works is in the Courts. Such schemes have been marketed for a number of years and HMRC initially dealt with them successfully by persuading the scheme's users that they had misunderstood the relevant legislation.
>
> Last year HMRC's disclosure regime revealed that the latest version of the scheme was being used on an unprecedented scale. Given this, and the wilful intent of these schemes to circumvent the clear purpose of the 1987 legislation, the Government considered it appropriate to clarify the legislation now to put it beyond doubt that such schemes do not work and, in line with the action taken in 1987, never have done. Clause 55 therefore is a provision that clarifies this situation and enables taxpayers to avoid lengthy and fruitless litigation.[47]

3.2 Subsequent debate of section 58

Public Bill Committee (Finance Bill 2009)

Following the introduction of section 58, its impact and the possibility of it being reversed, was raised a few times in the House, though the Labour Government's position remained unchanged.

In May 2009 the then Financial Secretary, Stephen Timms, restated the Labour Government's case in a written answer:

> **Mr. Drew:** To ask the Chancellor of the Exchequer (1) for what reason HM Revenue and Customs (HMRC) has decided to close schemes permitted under section 58 of the Finance Act 1987; for what reason the decision was made with retrospective effect; what factors were taken into account in determining that the period of such retrospective effect would be seven years; and what the policy of HMRC is on charging interest on sums owed as a result of retrospective closure; (2) what impact assessment HM Revenue and Customs has made of the effect of the retrospective closure of schemes permitted under section 58 of the Finance Act 1987; and if he will assess the effects of the closure on the financial situation of households operating such schemes.
>
> **Mr. Timms:** Section 62 Finance (No. 2) Act 1987 retrospectively restored the principle that double taxation treaties do not affect a UK resident's liability to UK tax on their income or gains. HM Revenue and Customs (HMRC) does not believe that any tax avoidance schemes were permitted under that legislation—

46 CIOT, *Finance Bill 2008: Clause 55 and retrospection*, 4 June 2008
47 *Letter from Rt Hon Jane Kennedy MP to Nick Goulding, CIOT President*, 8 July 2008

> although the tax avoidance schemes in question here purported to circumvent it.
>
> Evidence emerged that a large number of people were using the scheme and in light of a number of factors (including the widespread use, aggressive nature and artificiality of the scheme, the deliberate attempt to flout the clear intention of Parliament in 1987 and the need to ensure fairness and certainty for all taxpayers), the Government introduced legislation at section 58 Finance Act 2008 to put beyond doubt that none of the schemes worked—and never had done.
>
> Although, like the 1987 legislation, it is indefinitely retrospective, HMRC is not aware of any relevant schemes prior to 2001. Any tax paid late will be subject to interest in accordance with the relevant legislation on late payments.
>
> Formal impact assessments are not published in respect of measures where the impact is only on those who are avoiding tax and thus one was not published for this particular measure. Such decisions on the production of an impact assessment are taken on a case-by-case basis. As indicated in the 2008 Financial Statement and Budget Report, it is estimated that the tax at stake on the schemes that purported to circumvent the 1987 legislation is around £200 million. Those who used those schemes are, like all other UK taxpayers, required to pay tax on the profits that they earned.[48]

Prior to this, on 13 January 2009, Mr Timms had made a Ministerial Statement, confirming that the forthcoming Finance Bill would include provision to close a tax avoidance scheme that sought to exploit reliefs available for employment-related losses. The provision would take effect from 12 January.[49] On 1 April the Minister made a second statement confirming that the Bill would include provision to counter a similar scheme that had come to light, and that this would also take effect from 12 January.[50]

Provision to this effect was included in the Bill published on 28 April (specifically clauses 66 & 67). When these were debated, and approved, in Committee,[51] concerns were raised as to whether backdating the second of these measures to 12 January broached the Rees Rules and the Primarolo Statement. On this occasion speaking for the Opposition David Gauke said the following:

> We are … concerned that by backdating the effect of clause 67 to 12 January as opposed to 1 April, the Government are going beyond what we accept as allowable under the Rees rules, the Dorrell doctrine and, indeed, by the statement made by the former Paymaster General, the right hon. Member for Bristol, South (Dawn Primarolo). In December 2004, she referred to remuneration planning, an area where there has been retrospective legislation for some time.
>
> This would appear to be broader than that and my attention has been drawn to comments made by the right hon. Lady on 6 June

[48] HC Deb 20 May 2009 cc1399-400W
[49] HC Deb 13 January 2009 cc5-6WS
[50] HC Deb 1 April 2009 c63-4WS. See also, HMRC, *Avoidance using employment income legislation*, Budget Note BN58, 22 April 2009.
[51] Public Bill Committee (Finance Bill), *12th Sitting*, 16 June 2009 cc420-432. The provisions now form ss67-8 of the *Finance Act 2009*.

> 2006.[52] I interpret her remarks to mean that the approach to remuneration planning applied merely to the extraction from a company of income otherwise taxable in the form that was rendered free of national insurance, PAYE and income tax. I do not think that this is quite what we have here, so we are concerned about these provisions.
>
> Perhaps I can take this opportunity to ask the Minister where the Government stand on retrospectivity in general. In what circumstances do the Government consider that a retrospective provision is justified? Does the Minister recognise that there is a risk that HMRC may use this as a fallback against its mistakes? That was very much the nature of our case last year on partnership income and Isle of Man partnerships …
>
> We are not convinced by what we have heard so far that the Government are fully justified in dating the provisions back to 12 January rather than 1 April, notwithstanding the fact that the Government are absolutely right to seek to close that loophole.[53]

In response Stephen Timms set out the Government's case in some detail. A few extracts are reproduced below. First, the Minister gave some background on the way this type of scheme worked, and HMRC's discovery in April of its iteration …

> The general theme of artificial loss creation has been a common feature of tax avoidance for some years, with people wanting to shelter income and gains from tax. A number of previous arrangements around that general theme, but using different parts of tax legislation, have already been closed down. The avoidance that the Government are moving to close down with clause 67 is the individual seeking tax relief against genuine income for a contrived loss that the individual never actually suffered. I acted on 1 April to do that. Because it is a variant on the loophole we closed on 12 January and featured the same individuals, we made it effective from 12 January …
>
> We did not know on 12 January about the device to which the statement of 1 April refers. Information about that arrangement emerged later through a disclosure. I accept that the fine detail of the second scheme is somewhat different from that of the first, but the underlying approach is the same.[54]

The Minister went on to note that the schemes were marketed by the same promoter, who would be hoping to transfer their clients to the new scheme:

> Both schemes depend on the use of deliberate default to trigger artificial liabilities or losses for which relief would be claimed under legislation intended to provide relief for exceptional circumstances of genuine employment liabilities or losses. The people subscribing to the scheme would have known exactly what they were entering into when they decided to do so.
>
> **Mr. Jeremy Browne (Taunton) (LD):** The Minister is giving a helpful explanation. What is his estimate of the potential cost to

[52] As noted above, on this date during the proceedings of the Finance Bill 2006 the Paymaster General discussed the application of the Statement in relation to provisions in the Bill to frustrate schemes that used options for shares and securities as an alternative to normal remuneration payments.

[53] Public Bill Committee (Finance Bill), *12th Sitting*, 16 June 2009 cc423-4

[54] *op.cit.* c427

> the Exchequer were the Government to be defeated on any vote on the clause or the amendments to it?
>
> **Mr. Timms:** It would be £200 million—precisely the same as if clause 66 was not included in the Bill, because it deals with the same kind of avoidance targeted at precisely the same people by the same promoter who, having been thwarted by the announcement of 12 January, would, if allowed to do so, have simply switched all their customers into the device that clause 67 addresses.[55]

Finally the Minister argued that the element of retrospection in this provision was "justified in the circumstances":

> There is a degree of retrospection here—that is perfectly correct. I hope that the Committee will accept that that retrospection was justified in the circumstances.
>
> We ensured that all the relevant legal considerations were taken into account, including the Rees rules, the similarities between both schemes, the need to protect the human rights of potential users and previous announcements. In that respect we took account of the announcement on 12 January and the ministerial statement made the following day, as well as the statement made by the then Paymaster General, my right hon. Friend the Member for Bristol, South, on 2 December 2004 …
>
> My right hon. Friend's statement in 2004 warned that where we became aware of arrangements that attempt to frustrate our intention that employers and employees should pay the proper amount of tax, we would introduce legislation to close them down, where necessary from 2 December 2004. It therefore remains the Government's view that in rare cases like this it is appropriate for us to act retrospectively to make sure that abusive schemes are closed down rapidly and effectively.[56]

Report by the Joint Committee on Human Rights (July 2009)

In July 2009 the Joint Committee on Human Rights published a report, having received representation from a firm of tax advisers that clause 67 of the Finance Bill 2009 infringed human rights law, being unjustifiably retrospective. The Committee had also received similar representations with regard to section 58 and addressed both of these issues.[57]

First the Committee argued that "retrospective taxation requires carefully scrutiny for its justification, but it is capable of being justified by sufficiently strong arguments", citing the analysis that its predecessor Committee had done on this issue five years before:

> Our predecessor Committee set out the approach which human rights law requires to be taken to retrospective taxation in its Twelfth Report of 2003-04:[58]

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55 *op.cit.* cc427-8
56 *op.cit.* c430
57 Joint Committee on Human Rights, *Legislative Scrutiny: Finance Bill*, HL Paper 133/ HC 882, 7 July 2009
58 Joint Committee on Human Rights, *Scrutiny of Bills: Fifth Progress Report*, Hl Paper 93/HC 603, 20 May 2004

> *It is well established in Convention case-law that taxation is an interference with the rights guaranteed under [Article 1 Protocol 1 ECHR].*
>
> *However, taxation is prima facie justified under the second paragraph of Article 1 of Protocol No. 1, which expressly reserves the right of States to enforce such laws as they may deem necessary to secure the payment of taxes. The Court of Human Rights has accorded States a very wide degree of latitude in relation to taxation under the second paragraph of Article 1 of Protocol No. 1, but it is not unlimited: the second paragraph must be construed in the light of the principle laid down in the first sentence of the Article. To be lawful under Article 1 of Protocol No. 1, therefore, even a taxing measure … must satisfy the requirements of legal certainty and proportionality.*
>
> *For an interference to be lawful under the second paragraph of Article 1 of Protocol No. 1, it must satisfy the qualitative requirements of accessibility and foreseeability: the law which imposes the tax must be published, intelligible and generally available in a form which enables the individual to organise their affairs knowing with reasonable certainty the consequences of acting in different ways. … Such a [retrospective] tax would require very careful scrutiny for compatibility with the requirement of accessibility and foreseeability.*
>
> However, retrospective taxation is not automatically in breach of Article 1 Protocol 1, as our predecessor Committee pointed out in the same report:
>
> *The requirement of legal certainty in Article 1 of Protocol No. 1 does not amount to an outright prohibition on retrospective taxation. In National Provincial Building Society v UK, for example, the Court held that a taxation measure which had been enacted with retroactive effect did not violate Article 1 of Protocol No. 1 because the interference was justified.*[59]

The Committee went on to conclude that in the case of clause 67 (employment loss relief) "the Government has discharged the burden of demonstrating that the limited degree of retrospectivity involved … is, in the circumstances, justified":

> In view of the close similarity of the two schemes, the fact that it is not in dispute that it was a particularly abusive scheme involving tax relief for contrived losses, the fact that the individuals entering into the scheme were aware of the closure of the earlier scheme and of the nature of what they were entering into, the substantial cost to the Exchequer, the limited degree of retrospectivity and the absence of any evidence of personal hardship caused by the retrospectivity of the relevant provision.[60]

In the case of section 58, the Committee noted that it had received representation that "more than 2,000 people are now facing tax demands going back up to 7 years" with a significant number claiming that they could only pay off this tax debt by selling "all of their assets including the family home":

> These representations raise the question whether the Government has provided a sufficient justification for closing down this tax

59 Joint Committee on Human Rights, *Legislative Scrutiny: Finance Bill*, HL Paper 133/ HC 882, 7 July 2009 para 1.9, paras 1.7-8
60 *op.cit.* para 1.16

> avoidance scheme with what amounts to retrospective effect. The evidence of the hardship caused to a number of individuals, taken at face value, suggests that the Government failed to carry out the necessary assessment of the impact that such a retrospective taxation measure would have on the individuals affected. In the absence of a satisfactory justification for retrospection, there is therefore at least an arguable breach of Article 1 Protocol 1. Indeed, it appears that some of those affected have been granted permission for a judicial review by the High Court.
>
> **We have therefore written to the Minister asking for a memorandum setting out a detailed assessment of the impact of the measure on those affected, and the Government's detailed justification for the retrospective effect of s. 58 of the Finance Act 2008.**[61]

Writing to the Committee later that month the Minister explained that it would not be appropriate to do this, as the retrospective element of section 58 was the subject of judicial review.[62] In the event, the High Court ruled that the legislation *was* compatible with human rights law, a decision upheld by the Court of Appeal.[63] The case is discussed in more detail below.

In its report the Committee also recommended that the Government "should in future provide us with a memorandum accompanying the Finance Bill, identifying any provisions in the Bill which have retrospective effect":

> We cleared last year's Finance Bill from scrutiny without raising any human rights concerns with the Government. No representations were received at the time about the retrospectivity of the relevant provision and nothing was received from the Government identifying the provision as having retrospective effect and explaining the Government's justification for such retrospectivity. Finance Bills are invariably lengthy and highly technical in nature. In the absence of a memorandum or representations from those directly affected, it is almost impossible to identify provisions which raise human rights questions in such bills in the time available.
>
> **We recommend that in future the Government provide our Committee with a Memorandum accompanying the Finance Bill, identifying any provisions in the Bill which have retrospective effect, together with an assessment of the impact of the retrospective provision and a detailed explanation of the justification for the retrospectivity.**[64]

The Government accepted this recommendation and Ministers have submitted memoranda in later years.[65] In the first of these, submitted by

61 *op.cit.* para 1.19, para 1.22

62 Joint Committee on Human Rights, *Legislative Scrutiny: Financial Services Bill and the Pre-Budget Report*, HL Paper 21/HC 184, 21 December 2009 pp15-16; *Work of the Committee in 2008-09*, HL Paper 20/HC 185, 15 January 2010 para 32

63 *R (on the application of Huitson) v HMRC* [2010] EWHC 97 (Admin); *R (Huitson)* v HMRC [2011] EWCA Civ 893

64 Joint Committee on Human Rights, *Legislative Scrutiny: Finance Bill*, HL Paper 133/ HC 882, 7 July 2009 p3, paras 1.23-4

65 For example, Joint Committee on Human Rights, *Memorandum on the Finance Bill provisions with retrospective effect*, 5 February 2019; *Letter and memorandum from the Financial Secretary to the Treasury regarding the Finance (No.2) Bill*, 13 December 2017.

the Labour Government after the March 2010 Budget, some background was provided on the different categories of retrospection typically found in a Finance Act. An extract is given below:

> **Retrospection in the Finance Act**
>
> As the Committee will be aware, Article 1 Protocol 1 (A1P1) protects the right to peaceful enjoyment of possessions. Taxation is, in principle, an interference with the right guaranteed by the first paragraph of A1P1, since it deprives the person concerned of a possession, namely the amount of money which must be paid. However, this basic right is not absolute. The second paragraph of this Article expressly provides that a State may enforce such laws as it deems necessary to secure the payment of taxes or other contributions …
>
> Finance Acts invariably contain measures which have retrospective effect. The overall analysis of fairness turns to a significant extent on the degree to which P is being deprived of legal certainty by not being able to predict the legal consequences of P's actions.
>
> It follows that a distinction may sensibly be drawn between legislation which imposes a set of legal consequences of which P cannot be aware because P's action pre-dated any possible awareness of the legislation (unannounced retrospective effect), and legislation which imposes a set of legal consequences of which P is aware because the proposal to legislate has been announced, and the legislation is not to be made to apply before the making of the announcement (announced retrospective effect).[66]

Consideration by the courts (the 'Huitson' case)

The following year, following the General Election, the Coalition Government published a paper on tax policy making, alongside its June 2010 Budget. As part of this it announced that it would "take a more strategic approach to tax avoidance and develop a protocol for announcements taking immediate effect outside fiscal events."[67]

In response to this the CIOT published a paper on the wider issue of retrospective taxation, conceding that the Exchequer would not "not unilaterally preclude its ability to protect itself with retrospection when it detects what it considers to be unacceptable avoidance", but that, in its view, there very limited circumstances where this should be considered necessary:

> We would like to see the Government adopt a general principle that includes a presumption against retrospection. That said, this principle could set out certain very limited circumstances where the Government could make the argument that retrospection can be used because it is considered necessary (rather than desirable).
>
> Such limited circumstances might include the position where:
>
> - the law turned out, for example due to a court case, to be very different from what everyone, including taxpayers expected …

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66 Joint Committee on Human Rights, *Work of the Committee in 2008–09*, HL Paper 32/HC 459, 15 September 2010 pp15-16

67 HM Treasury, *Tax policy making: a new approach*, June 2010 p15

- an announcement is made with immediate effect, provided it is accompanied by clear and workable legislation; and
- the budgetary impact of not acting retrospectively would be crippling to the UK economy, say X% of GDP, or to avoid a financial crisis or damage to the UK"s credit rating.[68]

The CIOT went on to argue that retrospective taxation should not be used in a routine fashion to counter tax avoidance, and reiterated its criticisms of section 58:

> Even if it were possible to identify cases of "avoidance" which were obviously egregious, routinely tackling these by retrospective legislation does not justify the overall damage done to UK plc that arises from so doing.
>
> Accordingly, we strongly disagree with any suggestion that the fact that the Government is counteracting perceived avoidance justifies a harsher treatment involving retrospective taxation. Although such action may appear to a Minister as a justified attack on a particular scheme, it is seen by outsiders, particularly overseas investors, as the Government changing the rules after the event and raises concerns that such action could happen anywhere.
>
> We strongly objected to the recent Finance Act 2008 section 58, which changed the application of a double tax treaty going back 20 years.[69] Taxpayers had no warning of the apparent need for the change to the law. Quite the reverse: the HMRC manual had referred to the sort of planning which was being attacked since 1997. Whatever the rights and wrongs of the scheme, taxpayers and advisers could surely be forgiven for assuming its use was accepted – or, at any rate, not seen as warranting tackling with any urgency. In particular, there was never any indication of a need to clarify – or change – the 1987 law.[70]

The issue of section 58 was also raised in the House at this time:

> **Zac Goldsmith:** To ask the Chancellor of the Exchequer (1) what his policy is on continuing the provisions of Section 58 of the Finance Act 2008 in respect of UK residents and foreign partnerships; and if he will make a statement; (2) whether he plans to introduce proposals to repeal legislative provisions that ensure UK residents retrospectively pay UK tax on their profits from foreign partnerships; and if he will make a statement.
>
> **Mr Gauke:** UK residents are taxable on their worldwide income wherever it arises-including situations where it arises by way of foreign partnerships. Section 58 of Finance Act 2008 was enacted to help put that beyond doubt. The Government are, in general, opposed to retrospective legislation. However, the retrospective element of section 58 is currently the subject of judicial review by

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68 CIOT, *Retrospective taxation*, November 2010 para 5.4

69 The legislation is currently being considered by the Courts in *Huitson v HMRC* [2010] EWHC 97. In our view the attack on the tax scheme undertaken by Robert Huitson, and other similar schemes, by retrospective legislation in this way was extreme and unjustified.

70 *op.cit.* para 7.2-4. In a footnote the CIOT added, for the avoidance of doubt, we had no objection to the change effected by s59 FA 2008, which blocked the effectiveness of the scheme prospectively: such action was only a surprise in that it had not happened already, given HMRC"s knowledge of the arrangement."

> the courts and the Government's view is that it is best dealt with there.[71]

As the Minister noted in this answer, in January 2010 the High Court heard a claim for judicial review, on the grounds that the retrospective nature of these provisions were contrary to the European Convention on Human Rights. However, the judge *dismissed* the defendant's application, finding that, though retrospective, the legislation was 'in the relevant circumstances proportionate and compatible' with A1P1.[72]

In 2011 the Court of Appeal upheld this judgement.[73] Two short extracts from the judgement are reproduced below. First, the Court noted that in the High Court's decision the judge had underlined the point that "retrospectivity of fiscal legislation is not prohibited as such":

> [In his discussion of the potential application of Article 1] … the judge identified the "fair balance" principle: in securing the payment of taxes a national authority must strike a fair balance between the general interests of the community and the protection of the individual's fundamental rights, including the right to possessions in Article 1. In that balancing exercise the national authority has a margin of appreciation under the Convention and a discretionary area of judgment under domestic law. The area of appreciation and judgment is wide in matters of social and economic policy.
>
> The Judge said that the assessment of the fair balance requires examination of all the relevant circumstances. In this case the principle of non-retrospectivity is specially important. While there is a recognised need for legal certainty, retrospectivity of fiscal legislation is not prohibited as such. The critical point is that the balancing of community interests and individual rights should not result in an unreasonable burden being placed on the individual taxpayer.[74]

Second, in its conclusion, the Court agreed that the retrospective amendments made to the law by section 58 "were enacted pursuant to a justified fiscal policy":

> In the circumstances of this case, the liability of the claimant under the retrospective legislation of s.58 to pay the UK income tax that he would have had to pay, if he had not participated in the tax avoidance scheme, is no more an unjustified interference with his enjoyment of his possessions than the ordinary liability that his fellow residents in the UK are under to contribute, by way of UK tax on their income, towards the costs of providing community and other benefits for the purposes of life in a civil society.
>
> In summary, the crucial points on examination of all the relevant circumstances of this case are that the retrospective amendments were enacted pursuant to a justified fiscal policy that was within the State's area of appreciation and discretionary judgment in economic and social matters. The legislation achieves a fair balance between the interests of the general body of taxpayers and the right of the claimant to enjoyment of his possessions, without imposing an unreasonable economic burden on him.

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71 HC Deb 24 June 2010 cc318-9W
72 *R (on the application of Huitson) v HMRC* [2010] EWHC 97 (Admin)
73 *R (Huitson)* v HMRC [2011] EWCA Civ 893
74 *op.cit.* para 29-30

> This outcome accords with the reasonable expectations of the taxation of residents in the State on the profits of their trade or profession. The legislation prevents the DTA tax relief provisions from being misused for a purpose different from their originally intended use. There has been no conduct on the part of the State fiscal authorities that has made the retrospective application of the amended legislation to his tax affairs an infringement of his Convention rights.[75]

During this time the courts were asked to consider the retrospective nature of another tax measure, unrelated to tax avoidance.[76]

In the Pre-Budget Report on 6 December 2006, the then Chancellor, Gordon Brown, announced that the rates of air passenger duty (APD) would be doubled from 1 February 2007.[77] At the time the Treasury Committee noted that these changes could "be viewed as retrospective in two senses":

> The first element of retrospection is that airlines will be liable to pay the tax for departures on or after 1 February 2007 regardless of whether tickets were purchased before the new rates were announced. The second element of retrospection is that the liability to pay Air Passenger Duty at the new higher rates will effectively be incurred before the House of Commons has authorised the increase; such authorisation will take place only after the Budget.[78]

When he appeared before the Committee the Chancellor had been confident that the Government had legal sanction to charge the new rates before it had been authorised by Parliament,[79] and subsequently Ministers provided a number of examples of tax measures being announced and taking effect before the requisite legislation had been approved by the House.[80]

In 2008 the Federation of Tour Operators attempted to challenge the legality of the new APD rates in the Courts, but were unsuccessful, losing their appeal in the High Court and then in the Court of Appeal.[81] Commenting on the case in December 2009 the Joint Committee on Human Rights observed it is "clear that the hurdle facing anyone challenging a taxing measure under Article 1 Protocol 1 is very high":

> Both the High Court and the Court of Appeal in the Air Passenger Duty case concluded that, while the decision to increase that tax was open to criticism, on grounds that the Treasury had overlooked certain matters and it was a tax with retrospective effect, nevertheless it was impossible to conclude that the measure was "devoid of reasonable foundation", nor did it impose an excessive or individual burden on tour operators. The

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75 *op.cit.* para 94-5
76 This example is discussed in more detail in, *Air passenger duty: introduction*, Commons Briefing paper CBP413, 14 February 2019 (see section 5).
77 HC Deb 6 December 2006 c310
78 *The 2006 Pre-Budget Report*, HC 115, 25 January 2006 para 99
79 op.cit. Ev 43 Qs341-2
80 *op.cit.* Ev 81; Treasury Committee, *Third special report*, HC 423, 29 March 2007 p15; HC Deb 20 February 2007 c55WH
81 *R (on the application of the Federation of Tour Operators) v HM Treasury* [2007] EWHC 2062 (Admin); [2008] EWCA Civ 752

> Article 1 Protocol 1 challenge to the taxing measure therefore failed.
>
> It is therefore clear that the hurdle facing anyone challenging a taxing measure under Article 1 Protocol 1 is very high. They must demonstrate that the measure is devoid of reasonable foundation or imposes an excessive and individual burden which is disproportionate to the public good.[82]

The Coalition Government's Protocol on Unscheduled Announcements

As noted, in June 2010 the Coalition Government stated that it would "develop a protocol for announcements taking immediate effect outside fiscal events."[83]

Following a consultation exercise,[84] this was published as part of a strategy paper on tax avoidance issued alongside the 2011 Budget; this noted:

> Making legislation more robust is key to both preventing avoidance opportunities and countering avoidance when it does arise. This Government is committed to developing strategic defences against avoidance so as to minimise the need for frequent changes in tax law designed to address specific avoidance loopholes. But there will still be a need for such changes to protect the Exchequer from risk … So there is a balance to be struck between improving stability and predictability in the tax system and moving quickly to reduce risk to the Exchequer.[85]

The protocol is reproduced overleaf.

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82 Joint Committee on Human Rights, *Legislative Scrutiny: Financial Services Bill and the Pre-Budget Report*, HL paper 21/HC 184, 21 December 2009

83 HM Treasury, *Tax policy making: a new approach*, June 2010 p15

84 HMRC, *Tax Policy Making: Draft Protocol on Announcements Outside Scheduled Fiscal Events*, 9 December 2010

85 HM Treasury, *Tackling tax avoidance*, March 2011 p17

Protocol on unscheduled announcements of changes in tax law

The Government has made clear its aim to strike the right balance between restoring the UK tax system's reputation for predictability, stability and simplicity and preserving its ability to protect the Exchequer by making changes where necessary. In particular, changes to tax legislation where the change takes effect from a date earlier than the date of announcement will be wholly exceptional.

1. Ministers undertake to observe the following criteria when considering a change to tax law which will:

- be announced other than at Budget; and

  take effect before the legislation implementing the change is enacted.

2. Such changes to tax law will normally only be announced other than at Budget where:

- there would otherwise be a significant risk to the Exchequer;
- significant new information has emerged to identify the risk or indicate its scale; and
- changing the law immediately is expected to prevent significant losses to the Exchequer.

Announcements will usually take the form of a Written Ministerial Statement to Parliament before 2pm.

3. Legislative changes announced in this way will be confined to addressing the risk to the Exchequer that has been identified. A change in HMRC's interpretation of the law (unless prompted by a Court ruling) will not be regarded as 'significant new information'.

4. Where Ministers believe that such a change is justified, the process will be as follows:

- a Minister will make a public announcement of the intention to change the law and make clear that the change will take effect before the legislation is enacted;
- the public announcement will be accompanied by the technical detail necessary to amount to a sufficiently clear warning of the nature of the change and its timing;
- HM Revenue & Customs (HMRC) will publish the Written Ministerial Statement and draft clauses on the HMRC website as soon as practicable after the announcement to Parliament. If, exceptionally, draft clauses cannot be published on the day of the announcement, a detailed technical note explaining the nature of the proposed change and the reasons for it will accompany the announcement; and
- legislation to give the measure effect will be included in the next available Finance Bill.

5. Whilst the Government will not invite comment on the intention to legislate, the nature of the change or on its timing, it will consult after the announcement to establish whether the draft legislation would achieve its objective and change the law as intended. Subject to the risk of forestalling, consideration will be given to consulting informally in confidence before an announcement is made.

6. As part of the normal Budget process, the Office for Budget Responsibility will scrutinise the estimates of Exchequer impact associated with any change to tax policy. To ensure that this undertaking is put into practice effectively, the Forum of Tax Professionals will review announcements as a standing agenda item at its regular meetings and provide Ministers with a view on how the Protocol is being observed in practice. The Forum may recommend changes to the Protocol.

HM Treasury, *Tackling tax avoidance*, March 2011 pp19-20 (Box 4A)

In February 2012 an application for the 'Huitson' judicial review case to be heard by the Supreme Court was refused.[86] This led to many taxpayers contacting Members to make the case that the 2012 Budget should include provision to amend section 58, so that this provision applied only from Budget day in 2008.[87]

The then Chancellor George Osborne made no mention of section 58 in his 2012 Budget speech, though he did announce provisions to counter schemes being sold to avoid stamp duty land tax, and stated that the Government would introduce retrospective legislation "if inappropriate ways around these new rules are found."[88] It is worth noting that the next year the Government did, in fact, introduce provisions to this effect,[89] and that in turn this avoidance legislation was the subject of another failed application for judicial review.[90]

While the Finance Bill introduced after the Budget made no provision in relation to section 58, Nigel Mills MP tabled a new clause to require the Government to review its implementation.[91] The clause was debated briefly at the final sitting of the Public Bill Committee on 26 June 2012, when Mr Mills argued that the Government should review the approach taken in section 58, in the light of its own position on retrospection:

> No assessment was made at the time of the impact on individuals' pay. The new clause imply asks the Government to go back and consider whether what was done was consistent with how the Government now think we should use retrospection, if at all. Was the impact on those individuals fair and reasonable? Would we not be better off changing the law to close the scheme down from the date of the announcement in 2007, then litigating under the old rules to find out whether the scheme was legal? We would normally do things in that way, which would be better and fairer for the taxpayer.[92]

In response Treasury Minister David Gauke argued that this had been appropriate, given the impact that the scheme would have had on participants' liability:

> The impact of section 58 has been raised previously and it may be helpful for me briefly to say something on this subject. As the right hon. Member for East Ham (Stephen Timms) explained in a written answer in 2009, regulatory impact assessments are not published in respect of anti-avoidance measures where the impact is only upon those avoiding the tax in question. This particular scheme would have resulted in individuals paying income tax at less than 5%.
>
> Preventing egregious avoidance is not a regulatory burden, none the less, HMRC reviewed the information it held. Most of the people who would have been affected by the measures were in

86 Supreme Court, *Permission to Appeal results*, February 2012
87 Many constituents referred Members to the work of a campaign group, *No To Retro Tax*, the campaign is now closed, but details are still on its archive site.
88 HC Deb 21 March 2012 c804
89 For details see, HMRC, *SDLT tax avoidance: retrospective changes to s45 of the Finance Act 2003*, 20 March 2013
90 HMRC, *Stamp Duty Land Tax avoidance: no human rights breach in avoidance challenge (Spotlight 25)*, 20 August 2015.
91 Public Bill Committee (Finance Bill), *Notice of amendments*, 21 June 2012 p213
92 Public Bill Committee (Finance Bill), *Eighteenth Sitting*, 26 June 2012 c683

> the top 5% of earners, with a substantial proportion receiving an annual income over £100,000. They have been advised by professional tax consultants. HMRC was quite clear that the legislation would not apply to individuals, other than those seeking to avoid tax through the scheme. Let us be clear, HMRC was challenging the scheme, so its users should have taken reasonable precautions to ensure that they had funds to meet their liabilities. HMRC is not free to distinguish in principle between an individual who spent the money that should have been paid in tax and one who has not. In those circumstances, I urge my hon. Friend to withdraw his clause.[93]

Mr Mills withdrew the clause, noting that its purpose had been to "get some comments from the Minister on the record about an issue of concern to many."[94]

The following year the issue was raised during the Committee stage of the Finance Bill in June 2013, when Steve Baker MP put down a new clause, to amend section 58 so that it had effect from 12 March 2008. Mr Baker argued that without such a change, those affected would be exposed "to financial ruin at the hands of the state for conduct that they genuinely thought was lawful at the time."[95] Speaking for the Opposition Catherine McKinnell suggested that "we need to be clear that the reasons given for the introduction of the retrospective legislation in 2008 were the right ones, particularly in light of the several thousand people affected by the change."[96] In his response Treasury Minister David Gauke reiterated the Government's position that "retrospective clarification was warranted in respect of the wholly artificial scheme targeted by section 58":

> The new clause has provided an opportunity to debate the role of retrospective legislation. I understand and appreciate the concerns expressed. I believe that Government should use retrospection only after very careful consideration, even where the change does no more than clarify law or put its meaning beyond doubt. However, we must reserve the right to use retrospection in wholly exceptional circumstances, in line with the protocol we have introduced.
>
> In this specific case, it is worth pointing out that HMRC never accepted that the scheme worked, and the scheme promoters told users that HMRC was likely to challenge it and that the scheme was not guaranteed to work. The previous Government took action to put it beyond doubt that the rules worked as Parliament intended. Since then the courts have looked at this matter on issues relating to legitimate expectation, and found that the action was reasonable.[97]

Mr Baker withdrew the clause, without putting it to the vote.

Further to this, Treasury Minister David Gauke confirmed in a written answer in September 2013 that in a very small number of cases HMRC

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93 *op.cit.* c684.
94 *op.cit.* c684. The issue was also raised in a number of PQs: HC Deb 18 June 2012 c723W; HC Deb 28 June 2012 c334W; and, HC Deb 17 July 2012 c675W. This noted HMRC had "identified about 1,900 individuals who used the avoidance scheme or one of its variants and whose tax returns are currently under inquiry".
95 Public Bill Committee (Finance Bill), [Twentieth sitting](), 20 June 2013 c689
96 *op.cit.* c696
97 *op.cit.* cc699-700

had, in error, closed an enquiry into a specific tax return where the taxpayer had used this type of avoidance scheme:

> **Philip Davies:** To ask the Chancellor of the Exchequer (1) how many claims accepted by HM Revenue and Customs after inquiry in the last five years related to tax planning schemes subsequently covered by section 58 of the Finance Act 2008;
>
> (2) what recent discussions he has had with officials in HM Revenue and Customs on section 58 of the Finance Act 2008;
>
> (3) what assessment he has made of the effect of repealing the retrospective elements of section 58 of the Finance Act 2008 on the amount owed to HM Revenue and Customs.
>
> **Mr Gauke:** UK residents are taxable on their worldwide income wherever it arises, including situations where it arises by way of foreign partnerships. Section 58 of the Finance Act 2008 was enacted to help put that beyond doubt and, in so doing, made clear that a wholly artificial tax avoidance scheme involving a foreign partnership comprised of foreign trustees did not work.
>
> HMRC is unaware of any claims that have been accepted in the last five years that relate to the wholly artificial tax avoidance scheme that sought to abuse the United Kingdom/Isle of Man Double Taxation Agreement. HMRC became aware in July 2012 that during March 2006 inquiries into fewer than five scheme users who used the scheme for several years had a closure notice issued with no amendment. The closure notices were issued in error and related to only one of the years under inquiry in each case. It is not correct to say that, because an inquiry was closed for reasons other than the disputed tax claim, HMRC has accepted the validity of the claim. I am unable to give a more precise figure on the number of inquires that were closed in error as it would breach HMRC's duty of confidentiality.
>
> HM Revenue and Customs has provided policy advice and support to Treasury Ministers on various aspects of section 58 of the Finance Act 2008.
>
> HMRC considers that section 58 retrospectively clarified existing legislation, and so its introduction did not change any individual's tax position, including the amounts owed by them to HMRC.[98]

Subsequently in answer to a series of linked PQs in March 2015 then Treasury Minister Andrea Leadsom said the following:

> UK residents are taxable on their worldwide income wherever it arises including situations where it arises by way of foreign partnerships. Budget Note 66 (BN66) did not change this position, but announced new legislation to put this position beyond doubt and to close down a wholly artificial tax avoidance scheme. This scheme involved foreign partnerships comprised of foreign trustees that sought to exploit a perceived loophole.[99]

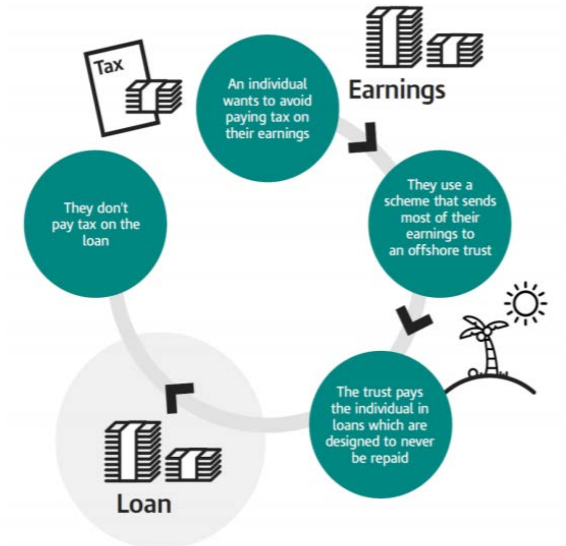
98 HC Deb 3 September 2013 c306W
99 PQ225500 & PQs 225152-4, 25 March 2015

4. Recent developments

4.1 The 2019 Loan Charge

As discussed, for many years legislation has been introduced to tackle tax avoidance schemes seeking to 'disguise' income paid to employees or contractors. In 2011 the Government introduced provisions to tackle schemes that sought to disguise these payments as loans, driven in part the rise in the number of individuals providing their services through an 'umbrella company' (a structure which provides employment to a number of individuals, signing contracts to provide individuals' labour to third parties).[100] In the 2016 Budget the Government confirmed that new loan schemes "had emerged which attempt to sidestep this legislation" often involving "individuals being paid in loans through structures such as offshore Employee Benefit Trusts", and that it would introduce legislation to counter their use, including "a new charge on loans paid through disguised remuneration schemes which have not been taxed and are still outstanding on 5 April 2019."[101]

Although the detailed arrangements for these tax avoidance schemes are highly complex their basic design can be illustrated as follows:[102]



Statutory provision for the Loan Charge was included in the *Finance (No.2) Act 2017*, with supplementary provisions in the *Finance Act 2018*. In brief, the Charge applies to the outstanding balance of disguised remuneration loans on 5 April 2019 that were made over the previous 20 years – that is, after 5 April 1999.[103] As an alternative course of action taxpayers potentially liable to pay the Loan Charge have had

[100] For details on the growth of these schemes see, HMT, *Independent Loan Charge Review: report on the policy and its implementation*, December 2019 pp14-26.
[101] *Budget 2016, HC901, March 2016 p60*
[102] HM Treasury, *Section 95 of the Finance Act 2019: report on time limits and the charge on disguised remuneration loans*, March 2019 p16
[103] HMRC, *Tackling disguised remuneration – update*, 5 December 2016

the option of settling their tax affairs before the Charge came into effect on 6 April 2019.[104]

HMRC has estimated that 50,000 individuals and an additional 10,000 employers are affected by the Loan Charge. In the latter case, over three quarters of those employers are close companies – ie, ones usually controlled by a small number of people.[105] When introduced, the Government estimated that these provisions would raise £3.2 billion over five years.[106]

The Loan Charge "stacks" loans that the taxpayer has received through these avoidance schemes, so that they are liable to pay a single charge based on the value of all outstanding loans. HMRC have estimated that of individuals who used a scheme from 2011/12 onwards, 70% did so for two or fewer years and only 16% used a scheme for four or more years. That said, the length of the look-back period creates potential for many years' usage of schemes to be taxed in a single year, and many scheme users' circumstances are likely to have changed over this time, from reduced earning potential or retirement. As has been noted, the intention behind this element of the design was to encourage taxpayers to settle rather than pay the Loan Charge.[107]

The Loan Charge has proved highly controversial, particularly in relation to taxpayers being charged for the receipt of loans in past years, potentially stretching back 20 years. Over the 2017-19 Session 155 Members signed an EDM, tabled by Stephen Lloyd MP in May 2018, criticising the 2019 Loan Charge, arguing that "retrospectively taxing something that was technically allowed at the time, is unfair" and proposing that "the Charge to apply only to disguised remuneration loans entered into after the Finance Act 2017 received Royal Assent."[108] Over this period Ministers strongly rebutted these criticisms.[109] The controversy is examined in detail in a second Commons Briefing paper.[110] For the purposes of this paper, the following paragraphs focus on the debate as to the retrospective nature of the Loan Charge.

In 2018-19 the Treasury Sub-Committee had two inquiries, on tax avoidance and evasion and on the conduct of tax enquiries. On 31 July 2019 the Committee published a report covering both of these inquiries, arguing that HMRC should be providing vulnerable taxpayers involved in tax disputes "better guidance about tax law and more

104 HMRC, *Disguised remuneration: settling your tax affairs*, updated July 2019 & *Disguised remuneration: detailed settlement terms*, updated July 2019.
105 HMT, *Independent Loan Charge Review: report on the policy and its implementation*, December 2019 p42
106 *Budget 2016*, HC 901, March 2016 p85 (Table 2.1 – item 39) & *Autumn Statement*, Cm 9362, November 2016 p23 (Table 2.1 – item 24); PQ 274514, 11 July 2019.
107 HMT, *Independent Loan Charge Review: report on the policy and its implementation*, December 2019 para 7.9, para 3.10. The Review is discussed in detail below.
108 EDM 1239 of 2017/19, 8 May 2018. see also, "HMRC tax crackdown victimises easy targets", *Financial Times*, 25 September 2018 & "Living in the shadow of a tax scandal", *Financial Times*, 26 January 2018.
109 eg, PQs152724-157732, 20 June 2018. The Minister reiterated the Government's position in a debate on the Loan Charge on 11 April 2019 (HC Deb cc565-8).
110 *The 2019 Loan Charge*, Commons Briefing paper CBP8811, 24 July 2020.

support to understand their rights."[111] On the Loan Charge the Committee took the view that "people who take a tax position that they know might be challenged by HMRC should be aware that they may ultimately have to pay the disputed tax", though the report acknowledged the strong division of opinion on whether the Charge was retrospective, and thus unfair:

> When it came to the loan charge, HMRC wielded exceptional powers to reach back and consider tax affairs up to 20 years old, a period of time that individuals may have reasonably considered closed and settled …
>
> Contractor loan schemes have operated for a lengthy period of time meaning that it is likely that some people have built up substantial loan balances and are now facing very large tax bills. People have expressed the view to the Committee and in public that the disguised remuneration loan charge is retrospective in effect because it charges tax on a loan balance which has accumulated over several years. HMRC, on the other hand, has explained to the Committee that, in its view, the loan charge is not retrospective because it will be charged only on outstanding loan balances at 5 April 2019.[112]

The Committee explored this issue when it took evidence from Ray McCann (CIOT president) in December 2018, when Mr McCann explained why, in his view, the Loan Charge was *not* retrospective legislation, but the recovery of lost tax had a *retrospective effect*. He was especially critical of the fact the Charge would affect taxpayers who had notified HMRC of their use of a DOTAS registered scheme, but HMRC had failed to use this information to open an inquiry:

> [The loan charge] is unprecedented legislation … From a personal viewpoint, I don't believe it is retrospective in the conventional sense, but it has a retrospective effect. In reality, the retrospective effect actually displaces all the protections that taxpayers are given by Parliament in terms of getting certainty for their affairs of the past. We have a situation where even an individual who has disclosed the loan arrangement to HMRC will still nevertheless be caught in April for quite an extensive period back—say, to 2006 and 2007—and will have a very substantial liability in relation to that. …
>
> I have seen examples, on request from some of the people who have contacted me, of copies of tax returns with DOTAS numbers on them … I find it quite irritating that HMRC seems on a number of occasions—I don't know how many, but my hope and suspicion is that it is quite a small number relative to the total—not to have opened inquiries even when there has been a DOTAS number on the return … [When at the Revenue prior to 2006] I feel a touch of personal embarrassment, in the sense that I put quite a lot of effort during 2004 and 2005 into emphasising that if you put a DOTAS number on your tax return, it was certain to get an HMRC inquiry …
>
> If it was actually retrospective legislation—let's assume that it is retrospective legislation that is still effective from April next year—the extent to which HMRC could apply it to an individual would

111 Treasury Committee press notice, *HMRC must do more to support vulnerable taxpayers*, 31 July 2019
112 Treasury Committee, *Disputing Tax*, HC 1914, 31 July 2019 para 25, paras 21-22

> be determined by reference to the law as it stands, in terms of how far back HMRC could go. If you go back to my earlier example of an individual who has disclosed the loan arrangements and included a DOTAS reference on their tax return, it seems to me that, without some further change in the law, that person would be beyond the reach of HMRC, in terms of applying the loan charge.
>
> In theory, it would still apply for the year, but that person would be protected by the normal estoppel that is on the Revenue under the Taxes Management Act 1970. If the Revenue had cause to believe that the person had deliberately evaded tax—as I say, in this context, that is probably unlikely—they would have a longer period of time. In most cases, it would be well beyond the point at which the Revenue could try to collect the tax.[113]

In its report the Committee noted that HMRC had recently announced a change in its approach to collecting tax from individuals in 'closed' years, if they had fully disclosed their use of a loan-based scheme, although the numbers affected by this was likely to be small:

> On 16 July, the Paymaster General and Financial Secretary to the Treasury, Jesse Norman, told the House of Lords Economic Affairs Committee that HMRC would not impose the charge on individuals in "closed" tax years in which participation in a loan-based scheme had been fully disclosed.[114] However, we note reports that this announcement is likely to only affect a few dozen of people owing the charge and that HM Treasury has since conceded that "on the scale of people who are impacted it is a smaller group of people" …
>
> HMRC asserted that cases where they had taken no action at all following a taxpayer's full disclosure of involvement in a disguised remuneration loan scheme were rare, stating that "it would be extremely unusual to find a case where there has been full disclosure to HRMC and we have taken no action at all because […] we opened hundreds and thousands of enquiries into these schemes."[115]

On 11 September 2019 the Government announced that Sir Amyas Morse, former Comptroller and Auditor General, would lead an independent review of the Loan Charge, following a commitment made earlier that month by the Prime Minister.[116] Initially Sir Amyas' review was anticipated by mid-November 2019,[117] but due to the timing of the General Election it was not published until 20 December. The review made a long series of recommendations, all of one of which was accepted by the Government; a press notice issued at the time gives a summary:

> Following the Review the Government will;
>
> - make changes so that the Loan Charge will now only apply to loans taken out on or after 9 December 2010. The

[113] Treasury Committee, *Oral evidence: The conduct of tax enquires and resolution of tax disputes*, HC 733, 10 December 2018 Q92, Q94, Q96

[114] Select Committee on Economic Affairs, *Oral evidence: The Financial Secretary to the Treasury*, 16 July 2019 Q2. See also, PQ286847, 9 September 2019.

[115] Treasury Committee, *Disputing Tax*, HC 1914, 31 July 2019 para 22, para 24

[116] HC Deb 4 September 2019 c175

[117] HM Treasury, *Disguised remuneration: Independent loan charge review*, updated 5 November 2019

Review found that legislation announced in 2010 removed any doubt that tax was due

- not apply the Loan Charge to users of loan schemes between 9 December 2010 and 5 April 2016 who fully disclosed their schemes on their tax return and where HMRC failed to take action
- allow users to defer filing their returns and paying their Loan Charge liability until September 2020
- allow taxpayers to split the loan balance over three tax years to make bills more affordable
- invest in a new HMRC team to collect tax from those who used the avoidance schemes pre-2010.

> The package of measures announced today are estimated to reduce bills for more than 30,000 people subject to the Loan Charge, more than 60 per cent of the total number of users. That includes an estimated 11,000 who will be taken out of it altogether.
>
> The Government has also announced further steps to crack down on promoters of Disguised Remuneration schemes and will announce further action at Budget to tackle their ongoing use.[118]

Sir Amyas had argued that any amount that was outstanding after someone had made instalment payments for 10 years should be written off, if that person had had an income of under £30,000 in 2017/18, but the Government *opposed* this. This was, in part, because it "would treat tax avoiders more favourably than other individuals with HMRC debts (including tax credit claimants)."[119]

In his review Sir Amyas argued that the Loan Charge was an appropriate response to the continued growth in loan-based schemes after 2011, and the fall in the number of schemes being disclosed to HMRC …

> HMRC had had considerable success in getting large corporates to settle after the introduction of new legislation in 2011. However, loan schemes were still used over 10,000 times in 2011-12. This, and subsequent usage, deprived the Exchequer of tax that was clearly due following the new legislation. It was reasonable for the government to act to ensure that this tax was collected.
>
> The Loan Charge therefore emerged in 2016 out of a desire to shut down the use of loan schemes, for reasons of fairness to other taxpayers, as well as value for money, practicality, and to collect revenue for public services. This followed over 65,000 instances of loan scheme usage from April 2011-March 2016, and a decline in the number of schemes (and taxpayer usage of them) being disclosed to HMRC.
>
> In spite of the law being clear, HMRC were therefore not always able to identify the relevant users or efficiently collect the tax that was due. This delay effectively delivered an unjustified advantage to taxpayers participating in loan schemes. Non-disclosure meant that HMRC were unable to use recently established powers – such

118 HM Treasury press notice, *Government to take new actions on loan schemes following Morse review*, 20 December 2019

119 HMT, *Independent Loan Charge Review: Government response to the Review*, December 2019 para 2.31

> as Accelerated Payment Notices (APNs) – to collect the tax quickly that was due.
>
> For those reasons, I support the essential purpose of the Loan Charge.[120]

… but he questioned whether its design, including loans made back to 1999, was fair, noting that "the Review heard many concerns about this ability to look back 20 years and found no articulated rationale by the government for choosing 1999":

> However, the design of the Loan Charge has been described to me by my legal and expert advisers, and the vast majority of contributors, as being highly unusual. Unusual is not always wrong. But it does need to be justified. In my view, elements of the Loan Charge go too far in undermining or overriding taxpayer protections …
>
> The justification for looking back to 1999 appears to be that the government always said that the schemes did not work. I found that HMRC did not consistently articulate this to taxpayers before the 2011 legislation, with approximately 40% of the pre-2011 tax years in scope of the Loan Charge not even having had an investigation into them opened by HMRC.
>
> Even if HMRC had made their position clearer, taxpayers are entitled to rely on the law as interpreted by the courts – rather than a position taken by HMRC – as the authoritative guide to their tax obligations. At the time of the 2011 legislation being enacted, the courts had not supported HMRC's view about the taxable nature of loan schemes. Indeed, the leading cases from the time had been consistently decided against HMRC's position. For the twenty year look-back period of the Loan Charge to be proportionate and justified, taxpayers would need to have acted in a way that was perverse in light of a clear legal position. This was not the case.
>
> **I therefore conclude that the Loan Charge should not apply to loans entered into by either individuals or employers before 9th December 2010**, being the point at which the law became clear.
>
> HMRC should continue being able to settle and investigate cases prior to this point under their normal powers where they have appropriate grounds, and a legal basis, to do so.[121]

As noted, the Government accepted all but one of the review's recommendations. Two extracts of its detailed response are reproduced below – first, on the proposal for a settlement opportunity for those now falling outside the scope of the Charge …

> Where the Loan Charge is no longer due as a result of changes set out in this response, but HMRC has protected its position and can recover the underlying tax[122], HMRC will continue to ensure

[120] HMT, *Independent Loan Charge Review: report on the policy and its implementation*, December 2019 pp3-4

[121] HMT, *Independent Loan Charge Review: report on the policy and its implementation*, December 2019 p25, p4

[122] Time limits on HMRC's ability to assess and collect taxes through compliance activity generally depend on the taxpayer behaviour. Assessment time limits are 4, 6 or 20 years depending on the behaviour that led to the inaccurate return. Additionally, Finance Act 2019 introduced a 12-year time limit for assessments involving offshore matters and offshore transfers.

> tax is paid by pursuing the underlying tax liability where it is legally due.
>
> HMRC will set out in due course guidance for taxpayers in this position on how to settle the tax due.[123]

… and second, on its decision to amend the rule allowing the Charge to 'look back' 20 years:

> HMRC have always maintained these schemes did not work, and tax was due. The legislation introduced in 20112 put the matter beyond doubt. Loans taken out from 9 December 2010, when the legislation was announced, will remain subject to the Loan Charge. Loans taken out before 9 December 2010 will not be subject to the Loan Charge.
>
> The Government estimates that around 15,000 individuals could be affected by this change, of which around 10,000 individuals could be taken out of paying the Loan Charge completely.
>
> While loans made before 9 December 2010 are removed from the scope of the Loan Charge, the underlying tax liability for loans made prior to this date remains. HMRC will continue to pursue those liabilities through enquiries and assessments, and where necessary through litigation. HMRC will publish updated settlement terms for all taxpayers in this position as set out above.
>
> The Government will also invest in a new HMRC team to conclude enquiries and bring in the tax due from people who in the past have used DR schemes, and other forms of tax avoidance. The team will engage positively with those who wish to settle their affairs and will have the resources and skills to pursue cases to tribunal and through the courts where that is necessary to collect what is due.
>
> This will ensure people who entered into DR avoidance schemes before 9 December 2010 still pay the tax due and make their contribution to funding public services.
>
> Further detail will be announced at the Budget.[124]

It is worth noting that at this time the High Court heard a claim for judicial review, on the grounds that the retrospective nature of the Loan Charge meant that it was contrary to the European Convention on Human Rights. The Court rejected this appeal, on the grounds that "it cannot be said that this approach to tax is illegitimate or lacked a reasonable foundation":

> The purpose of the legislation is not one which can be sensibly impugned; it is to deprive tax avoidance schemes of oxygen, and to ensure that people and companies bear their fair burden of tax, rather than throwing unfair weight on others – in particular those who do not have the opportunity to use such schemes. The legislation is rationally connected to its objective. Whether or not a less intrusive measure could have been used (which I do not need to decide), there is an insufficient proper evidential basis to form a counterweight to these factors.[125]

In a commentary on the case, the *Tax Journal* noted the changes the Government proposes to make to the application of the Loan Charge

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123 HMT, *Independent Loan Charge Review: Government response to the Review*, December 2019 para 2.8-9
124 *op.cit.* para 2.10-13
125 *Cartref & Ors v Commissioners for HMRC*, [2019] WEHC 3382 (Admin) para 225

that will "among other changes, limit its retrospectivity so that it only applies to loans outstanding at 5 April 2019 that were made on or after 9 December 2010. On the basis of the *Cartref* decision, it is likely that the amended loan charge legislation should not breach human rights law."[126] A second case decided by the High Court on 3 April came to a similar conclusion.[127]

The 2020 Budget was presented by the Chancellor Rishi Sunak on 11 March, and in the Budget report the Government confirmed its plans to implement these changes to the Loan Charge.[128] Following the Budget the House debated Sir Amyas' review on 19 March,[129] and unsurprisingly many Members reiterated concerns about the retrospective nature of the Charge. When responding to the debate, Treasury Minister Jesse Norman briefly addressed this point: "Is the loan charge retrospective? … I think it is clear that it is not. It was introduced as a new measure in 2017. It taxes a loan outstanding at a future date. It does not change any law previously on the statute book."[130]

4.2 Automated Decisions (Finance Bill 2020)

On 31 October 2019 the Financial Secretary to the Treasury, Jesse Norman, confirmed that the Government would introduce retrospective legislation in the forthcoming Finance Bill, in regard to HMRC's use of 'automated processes':

> **HM Revenue and Customs Update**
>
> The Government is committed to doing what is necessary to protect the Exchequer, maintain fairness in the tax system and give certainty to taxpayers. Therefore, the Government is announcing today that legislation will be brought forward in the next Finance Bill to put the meaning of the law in relation to automation of tax notices beyond doubt. Specifically, that legislation will put beyond doubt that HMRC's use of large-scale automated processes to give certain statutory notices, and to carry out certain functions is, and always has been, fully authorised by tax administration law. This measure will have effect both prospectively and retrospectively.
>
> The Government introduces legislation with retrospective effect only where necessary. In this case retrospective effect is necessary to close off the exchequer and operational risks presented by judicial challenges to HMRC's ability to automate certain functions. It will protect very substantial sums of tax and penalties already legitimately paid. It will preserve the status quo for taxpayers and HMRC, merely confirming the validity of HMRC's longstanding and widely accepted operational practice.
>
> Taking this action will help to guarantee the integrity of the tax base, provide certainty to taxpayers, and allow the Government to

126 "Cases: *R (oao Cartref) v HMRC*: High Court rules that loan charge is compatible with human rights", *Tax Journal*, 24 January 2020
127 *Le Roux Zeeman & Ors v HMRC* [2020] EWHC 794 (Admin)
128 *Budget 2020*, HC 121, March 2020 para 2.255. This is to be at an estimated Exchequer cost of £745m over the next five years (*op.cit.* Table 2.1 – item 63).
129 HC Deb 19 March 2020 cc1191-1223
130 *op.cit.* c1221

> continue to administer the tax system efficiently. More details will be published on the Finance Bill 2019-20 pages of GOV.UK.[131]

In recent years several functions that the tax authorities carry out have been automated, although the wording of the legislation that underpins these functions has not been amended accordingly.

As an example, taxpayers are required to complete a self assessment tax return for the tax year if they have been given notice by HMRC to do so, and are potentially liable to penalties if they fail to do so within certain time limits.[132] As with much of the machinery of the tax system, the legislative provisions regarding this process are contained in the *Taxes Management Act (TMA) 1970*; specifically, section 8(1)(a) of the Act which states, "for the purpose of establishing the amounts in which a person is chargeable to income tax and capital gains tax for a year of assessment, and the amount payable by him by way of income tax for that year, he may be required by a notice given to him by an officer of the Board."[133]

In a case in June 2018, the First-tier Tribunal overturned a penalty for a late return on the grounds that HMRC were unable to show that a named officer had issued the taxpayer with the notice to do so. A couple of extracts from this decision are reproduced below:

> Section 8(1)(a) *TMA 1970* states as follows:
>
> "(1) For the purpose of establishing the amounts in which a person is chargeable to income tax and capital gains tax for a year of assessment, and the amount payable by him by way of income tax for that year, he may be required by a <u>notice given to him by an officer of the Board</u> –
>
> (a) <u>to make and deliver to the officer</u>, a return containing such information as may reasonably be required in pursuance of the notice....." (emphasis added). …
>
> The phrase "given to him by an officer of the Board" means what it says. I would expect any such notice to be signed by a named officer and evidence provided which shows that to be the case. The officer giving the notice needs to be identified in the notice because the return must be made and delivered to that officer. In other words there must be evidence that the named officer has signed the notice or it must be otherwise made clear that he is "giving" it. …
>
> The appellant had opted into HMRC's self-assessment digital service on 18 January 2016. A taxpayer, once enrolled into this online service may file forms and returns online and see an overall picture of their tax, including payments they have made and amounts they owe. Where a taxpayer has opted for paperless contact HMRC will deliver the relevant document or notice to file a return digitally to their secure mailbox in their online account and at the same time an e-mail will be sent to the email address the customer provided to advise the customer to check their mailbox for new messages.

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131 Written statement HCWS61, 31 October 2019
132 HMRC, *Self assessment tax returns*, retrieved January 2020
133 For details see, HMRC, *Self assessment: the legal framework Manual*, para 203 retrieved January 2020

> But there is nothing that I have come across either in the Statement of Case nor in the legislation which changes the legal requirement that a notice to file under section 8(1)(a) TMA must be given by an officer of the Board.[134]

Following the Financial Secretary's statement, HMRC published a note on how it proposed amending the law to, in its words, "affirm that HMRC's practice of using automated processes to help fulfil certain functions has a firm legal footing":

> The policy intention is to make clear that HMRC's use of large-scale automated processes to serve certain statutory notices and to carry out certain functions is and always has been fully supported by legislation.
>
> The proposed new legislation will provide that for certain functions [listed below] anything capable of being done by an officer may be done instead by HMRC through the use of a computer or other electronic means, whether automatically or not.
>
> The proposed new legislation will cover the following functions:
>
> - The provisions contained in the Taxes Management Act 1970 (TMA 1970)at s8, s8A and s12AA which provide for giving notice to file a return in relation to individuals, trustees and partnerships.
> - S9ZB TMA1970, which provides for the correction of a personal or trustee's return by HMRC.
> - Paragraph 3 Schedule18 Finance Act 1998, which are the provisions for the issue of a notice to file to corporate bodies.
> - S100 TMA 1970, which contains the provisions for the making of a determination imposing a penalty under any provisions of the Taxes Acts.
> - Schedule 14 Finance Act 2003, which contains provisions for the determination of penalties in respect of Stamp Duty Land Tax.
>
> The government intends that the legislation will apply both retrospectively and prospectively in order to safeguard revenue charged since automated processes were introduced by HMRC. This means that both the automated processes themselves and anything done subsequent or pursuant to the automated process will be covered by this legislation prospectively and retrospectively. For example, where a notice to file an ITSA return was issued under section 8 TMA 1970 by HMRC using an automated process, anything done by HMRC related or pursuant to the issuance of that notice, such as charging a late filing penalty, or enquiring into any return received pursuant to the notice, will be covered by this legislation.
>
> This is not a new policy and nothing will change for taxpayers. It is intended that any taxpayers who have received a settled judgement from a court or tribunal regarding the use of automation by HMRC before the date of this announcement (31 October 2019) will not be subject to the retrospective application

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[134] *C Shaw v HMRC* [2018] UKFTT 0381 (TC) para 6, 11, 16-17. For a second example of a similar appeal see, *N Rogers v HMRC* [2018] UKFTT 312 (TC)

> of this legislation in respect of the issues covered by that judgment.[135]

This is not an issue that has come up in the House, although writing in the *Tax Journal*, Catherine Robins and Steven Porter (Pinsent Masons) were critical of the announcement, arguing that "some of HMRC's powers can have very serious consequences for taxpayers and the fact that a human being has to decide to exercise them is an important safeguard, which should not be eroded."[136]

Later in December, the Upper Tribunal considered an appeal by HMRC against both of the FTT decisions cited above, as to whether a notice to file a self-assessment return has to be issued by an actual HMRC office to be valid. Crucially the Tribunal held that "properly construed, s8 does not impose a requirement that an officer of the Board is identified in the notice as the giver of the notice", and upheld HMRC's appeal:

> Rather [section 8 of the TMA 1970] it imposes a substantive requirement that the giving of a notice must have been under the authority of an officer of HMRC. Therefore, if a police constable, for example, purported to require a taxpayer to submit a tax return that would not be a lawful request under s8 (unless the police constable happened also to be an officer of HMRC). Instead, the requirement is that whoever requires the notice to be given, whether identified or not, has the status of an HMRC officer.
>
> The FTT considered that s8(1)(a) of TMA requires a return to be delivered to "the officer", being the same officer who gives the s8 notice and relied on this conclusion as supporting its decision that the s8 notice had to be given by an identified "flesh and 11 blood" officer.
>
> However, the statutory scheme as a whole does not justify this approach. By virtue of s2 of the Commissioners for Revenue & Customs Act 2005 ("CRCA"), the "officers" of HMRC are those staff that the Commissioners of Revenue & Customs have appointed for the purposes of exercising the Commissioners' functions. Section 2(4) of CRCA provides that anything commenced by one officer can be continued by another.
>
> Moreover, s113(1A) of TMA provides that: *(1A) Any notice or direction requiring any return to be made under the Taxes Acts to an inspector or other officer of the Board*[137] *may be issued or given in the name of that officer or, as the case may be in the name of the Board, by any officer of the Board, and so as to require the return to be made to the first-mentioned officer.*
>
> Against that background, s8 cannot be construed as requiring an identified officer to give a notice requiring a return to be given to that very officer.[138]

Writing on the case in *Taxation* magazine, Emma Rawson (a technical officer at the Association of Taxation Technicians) suggested the

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[135] HMRC, *Securing the tax base: affirming the legislative framework for HMRC to use automated processes*, 31 October 2019

[136] "Retrospective law change on automated processes", *Tax Journal*, 6 December 2019

[137] Defined by s118 of TMA as the "Commissioners of Inland Revenue" which, by s50 of CRCA is defined to include the "Commissioners of Revenue & Customs"

[138] *CRC v Nigel Rogers and Craig Shaw*: [2019] UKUT 0406 (TCC) para 32-4

decision "should put to rest the argument that s8 notices are not valid simply because they are issued using automated processes":

> At the time of writing, it remains to be seen what impact the Upper Tribunal decision will have on [HMRC's plan for legislation in the forthcoming Finance Bill] … It could be queried whether legislation is still necessary … alternatively, HMRC may wish to go ahead and draw a final line in the sand for s8 purposes, as well as for the other functions named in [HMRC's] technical note.[139]

As noted above, the 2020 Budget was published on 11 March, and in the Budget report the Government confirmed that it would "legislate to confirm that HMRC may use automated processes to issue taxpayers with notices to file tax returns and penalty notices. This measure will apply prospectively and retrospectively to put beyond doubt that the rules work as designed and intended. This does not create any new or additional obligations or liabilities for taxpayers."[140] HMRC's impact assessment of this measure stated that it was not anticipated to have an Exchequer impact.[141]

In response to the announcement the Institute for Fiscal Studies (IFS) Tax Law Review Committee published a short note stating that it was "generally satisfied with the objective and scope of the Technical Note (TN) issued in October 2019", but asked if the legislation might "exclude [its] application to discretionary penalties":

> If this is not possible we ask for ministerial reassurance at Committee Stage that the powers will not be used, without proper consultation and discussion of safeguards, to replace those discretionary decisions especially about penalties currently made by human officers.[142]

The Committee also raised the question of whether it was necessary for this legislation to involve 'complete retrospection':

> We noted that the proposal in the TN that the Finance Bill provision would involve complete retrospection (always in force), subject to a limited exception where a person had received a "settled" judgment from a Court or Tribunal decision before 31 October 2019 …
>
> The number of cases where there is an appeal on those grounds which has not been already been decided by the First-tier Tribunal is likely to be very small, and the appeal will most likely have been made in 2019 or possibly 2018.
>
> In any event the clause cannot, it seems to us, have effect in relation to anything done by an officer of Revenue and Customs before the enactment of the CRCA as neither such officers nor HMRC existed before then. So it does seem to be overkill to apply the new provision as always having had effect, and a more reasonable cut-off date would draw sting from any major complaints.[143]

139 "Man versus machine", *Taxation*, 23 January 2020
140 *Budget 2020*, HC 121, March 2020 para 2.263.
141 HMRC, *Income tax automation challenges*, 11 March 2020
142 IFS, *Comment from the IFS Tax Law Review Committee to the Public Bill Committee*, 16 June 2020 p1
143 *op.cit.* paras 69, 72-73

Provision to this effect was included in the Finance Bill published after the 2020 Budget, and was debated and agreed, unamended, during the Committee stage of the Bill.[144] On this occasion the Financial Secretary Jesse Norman summarised its purpose as follows:

> Clause 100 is a technical measure that makes changes to put it beyond doubt that tasks that are being done by an individual officer of Her Majesty's Revenue and Customs may be carried out by HMRC using a computer or other means. It ensures that the intention of Parliament is appropriately reflected in the legislation and confirms that the rules work as they have been widely understood and applied over many years …
>
> [The clause] … does not introduce new or additional obligations, and will help to ensure the tax system applies fairly to all, while preventing loopholes opening up in tax law that could be exploited by people who do not wish to pay their proper share of taxes.[145]

Speaking for the Opposition Wes Streeting said, "for the reasons that the Minister has outlined, clause 100 is a perfectly reasonable and sensible provision, and it is one that we are happy to support."[146] Speaking for the SNP Alison Thewliss raised the concerns of the IFS Tax Law Review Committee, and asked "what safeguards will be put in place to ensure sure that no businesses find themselves in a situation where they cannot unpick a decision made by a computer, and to ensure that they will be able to speak to a human who has discretion and is able to exercise it effectively?"[147]

In response the Minister said, "in a rule of law society we want as little discretion as possible to be exercised—and, in particular, personal discretion—so it is important that within HMRC there is baked in a culture of accountability for decisions. … I can reassure [the hon.Member] that the issue of safeguards and the balance of powers between HMRC and taxpayers is taken very seriously, and I have specifically commissioned work within HMRC to ensure that that balance is appropriately maintained, not just at customer level but more generally."[148]

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144 This provision now forms s103 of the *Finance Act 2020*.
145 Public Bill Committee (Finance Bill), *Ninth Sitting*, 18 June 2020 cc239-40
146 *op.cit.* c240
147 *op.cit.* c241
148 *op.cit.* c241. In July 2019 the Minister announced an evaluation by HMRC of powers introduced since 2012 (HCWS1785, 22 July 2019). The review is ongoing (see, "Are HMRC's powers tilted too far against taxpayers?", *Taxation*, 9 June 2020).

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