

The Loan Charge: a principles based discussion

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A commentator on the blog asked a question in the [light of my criticism of HMRC's management](#) of the loan charge, posted yesterday. [Zacchaeus asked](#):

I'm intrigued, though: how would you draw the line between circumstance where there was — in substance and/or under Ramsey — an "employer", and where there was not?

The payments to the Rangers players would have been subject to PAYE had they not used the scheme. So too, presumably, would have been those to the club's executives. Rangers was therefore the Ramsey employer under both. Presumably you would not intend the latter group, in particular, to be exempt from the loan charge?

What sort of fact pattern do you have in mind that would indicate that there is no "employer" for these purposes? Perhaps the individual exercising management/control over the business?

This question drives to the core of my criticism of HMRC and to the core of my logic of tax compliance. It is, then, worth answering.

I define tax compliance as seeking to pay the right amount of tax (but no more) in the right place at the right time where right means that the economic substance of the transactions undertaken coincides with the place and form in which they are reported for taxation purposes.

The questions in this case are:

- * Was there an 'employer'
- * Was there an 'employee'
- * Was there an arrangement put in place that sought to ensure that the wrong amount of tax (but no more) was paid in the wrong place at the wrong time because the economic substance of the transactions undertaken was not reflected in the form in which they were reported for taxation purposes?

I am not pretending that it is always easy to identify an employer/employee relationship. There can always be grey lines. In the vast majority of loan charge cases such grey lines did not exist. There was an arrangement of service i.e. the employee did what the employer asked and was paid for doing so. The employee worked on their premises, for fixed hours, in their structures, subject to their rules and without the option of substitution. That is an employment. Indeed, many of these arrangements were put in place to get around IR35 which also tackled disguised remuneration, and which it was thought would apply.

My criticism arises in the situation where the answers to the first two questions are 'yes'. In that case since December 2004 there was no excuse for HM Revenue & Customs not to act. Dawn Primarolo, then Chief Secretary to the Treasury, [said then](#):

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.

This is the date to which backdating should have taken place as a result.

But, the backdating should take into consideration the law at the time. This law was settled in 2017 in the [Rangers Supreme Court case](#), which said it was about:

This appeal concerns a tax avoidance scheme by which employers paid remuneration to their employees through an employees' remuneration trust in the hope that the scheme would avoid liability to income tax and Class 1 national insurance contributions ("NICs"). The appeal raises a fundamental question about the nature of the income tax charge on employment income. That question is whether an employee's remuneration is taxable as his or her emoluments or earnings when it is paid to a third party in circumstances in which the employee had no prior entitlement to receive it himself or herself.

And it was decided that:

I see nothing in the wider purpose of the legislation, which taxes remuneration from employment, which excludes from the tax charge or the PAYE regime remuneration which the employee is entitled to have paid to a third party. Thus, if an employee enters into a contract or contracts with an employer which provide that he will receive a salary of £X and that as part of his remuneration the employer will also pay £Y to the

employee's spouse or aunt Agatha, I can ascertain no statutory purpose for taxing the former but not the latter. The breadth of the wording of the tax charge and the absence of any restrictive wording in the primary legislation, do not give any support for inferring an intention to exclude from the tax charge such a payment to a third party which the employer and employee have agreed as part of the employee's entitlement. Both sums involve the payment of remuneration for the employee's work as an employee.

In other words, the existence of the trusts was neither here nor there to the required tax treatment.

And as a result it was decided:

Thus, as Lord Drummond Young stated in delivering the impressive judgment of the court, the central concept in the tax regime governing employment income is the payment of emoluments or earnings derived from employment; and an employer who pays emoluments or earnings to or on account of an employee is obliged to deduct tax in accordance with the PAYE Regulations.

And so Rangers were liable for PAYE, whatever arrangement they had out in place concerning the onwads transmission of net pay to their employees.

HMRC spent a great deal of time proving this. They have claimed a great deal of tax back as a result. But not in the loan charge cases, where legislation was put in place on the wrong legal basis in 2016 before the Rangers case was decided, they have ignored this ruling and have instead claimed tax from the employees, wholly inappropriately in my opinion.

The gross miscarriage of justice is that although it is now apparent that those whom the loan charge subjects to tax - the employee - cannot have been liable for making settlement of that tax because their employer should have been, HMRC persists in asking them for it. Miscarriages of justice do come bigger than that, but systemically such deliberate neglect of what was clearly the law at the time that these loan charge payments was made is quite extraordinary.

And this is not a new conclusion on my part. Read this, [which I wrote in 2011](#), where I noted discussion between me and John Whiting, then of PWC, before the House of Lords and note that I said:

Yesterday [before the House of Lords committee] John Whiting agreed with me: Primarolo's statement may have appeared to be retrospective legislation at the time, but it straightforwardly worked where nothing else had. In the face of knowing that any attempt to abuse the law would be stopped, retrospectively, people stopped trying to

abuse PAYE regulations. And NIC abuse died out for some time.

Until that is Employee Benefit Trusts came along.

And it was John Whiting who wondered out loud why a) the Primarolo principle was not being applied to Employee Benefit Trusts because there seems no reason why it should not be b) it had seemed to be forgotten, which he thought an error c) (and I think this came out of our exchanges) it was not now influencing the current debate on the GAAR because the evidence was emphatic - it works.

What we were saying was HMRC had all the tools they needed to make employers pay, so why weren't they doing so? I stress, this was in 2011. The question remains valid. And it undermines everything HMRC are doing to ask the wrong people to pay tax now when they themselves have won a case to show that it is not the employees but the employers who should be settling.

So, what if there is no employer and the structure giving rise to the loan charge was used? In essence the question is a simple one. Was the company set up by, in this case its employee, pursuing a trade and not acting as a sham to disguise an employment? The single biggest test would be were there multiple engagements of economic significance with different parties, or could substitutes be offered? I know all the difficulties at the margins, but again, in most cases this is pretty easy to determine. I stress, in most cases. And here, multiple engagements with multiple parties would suggest employment was unlikely and that this was tax avoidance at the instigation of the employee, who should then pay the tax.

It's not hard to use a principles-based basis for determining liability here.

HMRC are acting in an unprincipled fashion.

No wonder people are angry.