

The current tax scandal was avoidable - and major refor...

Published: January 13, 2026, 4:54 pm

The so-called loan scheme tax charge imposed by HM Revenue & Customs mainly on those who had, in my opinion, undoubtedly engaged in tax avoidance whilst supplying services as sub-contractors through limited liability companies [has attracted much attention](#) in the last couple of days, not least because of the alleged involvement of Douglas Barrowman, husband of Tory peer Michelle Mone, in the promotion of such schemes.

Let me stand back from the political heat. Let me also stand back from the emotions around the charge, which represents an honest attempt to recover tax from those who set up structures to avoid it, however innocent or mistaken their actions might be claimed to be.

Instead, let me suggest three things. The first is that it has always been appropriate for HMRC to seek to recover tax in these cases, and since the biggest savings went to those they are now seeking to recover tax from, it is appropriate that they pay most of the tax due.

Second, let me add that HM Revenue & Customs was and still is incompetent in the management of these cases. It should have acted more quickly because the problem was apparent by about 2005. It should have acted more decisively.

And it should, when its own inaction became apparent, have been decidedly lenient with penalties and interest on people who were, to be candid, too often conned into using these schemes.

They should have also looked for recovery, at least of the employer's NIC, from the employers who obviously also benefitted from these arrangements.

And questions about the false promotion of these arrangements and the resulting penalties due for doing so should obviously have been much higher up their agenda.

The fact that none of these things happened is a clear sign of failure on HMRC's part, and ministers should now be intervening to prevent miscarriages of justice on interest

and penalties, although not I suggest when it comes to tax.

Thirdly, and actually more important than all this, though, is the fact that ministers have never done anything to address the obvious problems of tackling small business activities through the use of limited companies that were designed in the Victorian era and are obviously unsuited to modern needs, most especially when much of the tax and corporate case law surrounding their use was established for large entities. Nor have HMRC. This is the real scandal. I suggest.

I first said [so in August 2007](#) after a case on a not-terribly unrelated issue. What I said then was that the whole structure of small business taxation needed reform to make it suitable for the twenty-first century. In 2009, I was told HMRC had seriously considered my proposal but deferred it because of the global financial crisis. No one has ever been back to the issues, but I offer the following written in 2007 again because I still think that urgent reform of small business taxation in the UK is required to make it fit the economic facts of what happens in these concerns, which it does not at present.

If action had been taken when I proposed it, most of the loan charge issues would not now exist. I think that is worth noting.

I have written about the [Arctic Systems case](#), and as a result was [challenged](#) to produce a suitable response. That I have now done. The full paper is available [here](#). The summary says:

This paper analyses the way in which the owners of many small limited companies reward themselves and members of their families out of the income that their labour generates for those companies. This is particularly relevant in the light of the recent House of Lords ruling in what is known as the 'Arctic Systems' case. The paper shows that many of these arrangements do constitute [tax avoidance](#) because the rewards paid do not much the underlying economic substance of the transactions that are taking place.

In the interests of promoting tax justice for all taxpayers HM Revenue & Customs have a consequent duty to promote new arrangements that will encourage tax compliant behaviour in this sector. Tax compliance is defined as paying 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 transaction accords with the declaration made for taxation purposes.

The paper does then show that this problem is almost insoluble whilst these businesses are operated through the medium of small limited companies which were not designed for and are unsuitable for the type of activity they undertake.

As a result this paper proposes that:

1. A change in [company](#) law to allow the re-[registration](#) of small limited companies as LLPs. An [LLP](#) is tax transparent: its income is taxed as if it belongs to its members even though it is a legal entity that is separate from them for contractual purposes;
2. The introduction of new capital requirements for the [incorporation](#) of limited companies undertaking trades, and over time forced re-registration of those that do not meet that standard as LLPs;
3. The introduction of a new investment income surcharge at rates broadly equivalent to national insurance charges that would have the benefit of reducing the incentive to split income, restore the taxation balance between income earned from all sources and allow a reduction in the [base rate](#) of income tax without adding substantially to the burden of administration for taxpayers since those liable will, in the vast majority of cases, already be submitting tax returns;
4. Create new, economically justifiable and verifiable standards for splitting income in LLPs so that the risk of legal challenge to such arrangements will be substantially reduced whilst recognising the significant role that the partners of those who supply their services through owner managed corporate entities play in the undertaking of that activity.

If this were done then:

- a. The administrative burdens for many small businesses would be reduced;
- b. The certainty of the arrangements under which they can operate would be increased;
- c. The rewards that they rightly seek to pay to those who contribute to the management of these companies from within domestic relationships will be rewarded, but within appropriate constraints;
- d. The attraction of freelance status in tax terms would be retained;
- e. The current injustice that sees income from labour more heavily taxed in the UK than income from capital would be eliminated in large part without prejudicing the required favoured status of pensioners;
- f. The incentives for tax planning would be reduced, so simplifying tax administration;
- g. The tax yield might either rise, or a reduction in the tax rate might result.

The challenge in creating such a system is significant because it requires cooperation across government departments, but far from insurmountable. It is part of the challenge of creating an enterprise culture that meets the needs of the UK in the 21st century, and that is a challenge that any government needs to meet.

As I note at the end of the paper, suggestions and comments are welcome. But please do read the paper first and not just the summary.