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## INSURANCE CONTRACT LAW REFORM – INSURABLE INTEREST

The Law Commission and the Scottish Law Commission (together referred to here as the Law Commissions) have been consulting on insurable interest for a number of years which have resulted in consultations in 2008, 2011 and 2015.

There was a draft Bill published in 2016, followed by a short consultation. Even though most consultees agreed with the overall direction of the proposals in 2016, concerns were expressed over some of the details, and in particular their interaction with current market practice. Hence the further two years' delay.

On 20th June the Law Commissions finally published updated draft legislation intended to pull the law of insurable interest into the 21st century. Comments are invited on the detail of the new draft, and the potential impact of the proposals, by 14 September 2018.

Speaking on behalf of both Commissions, Law Commissioner Stephen Lewis said:

"If the Insurable Interest Bill were implemented, it would make the law more modern and flexible, allowing people to better protect themselves and their families.

We are publishing an updated draft to give stakeholders the chance to make sure that the legislation works as intended."

As in the 2016 draft the focus is on life-related insurance.

From stakeholder responses to the Law Commissions' last consultation on insurable interest, it was clear that there was little demand for reform of the law in the area of indemnity and non-life insurance. The updated Bill therefore focuses on life insurance and other insurances which relate to human life, such as accident and health cover.

The Bill suggests broadening the concept of insurable interest for life-related insurance in the following ways by:

- Providing that individuals have an automatic insurable interest in cohabitants, not just spouses or civil partners.
- Extending insurable interest to cover children and grandchildren, so that they could lawfully be covered under travel or health policies.
- Confirming in law that pension trustees and other administrators of group schemes have an insurable interest in the lives of members of the group. This would ensure that employers' life and health policies have the full support of the law.
- Allowing for trustees of private trusts to purchase life insurance bonds if the settlor or truster of the trust would have had the necessary insurable interest to do so.

As part of the process of seeking views the Commissions would also welcome further comments from stakeholders as to how and why this Bill is needed and how it would better support the insurance market.

***COMMENT***

*It is good to see progress being made on this. It is hoped that the final draft Bill when produced will be suitable for the special parliamentary procedure for uncontroversial Law Commission Bills and that finally the 1774 Life Assurance Act will be repealed and the law will be brought up to the 21st century standard.*

## HOW THE GOVERNMENT IS TACKLING DISGUISED REMUNERATION

HMRC's recent decision to extend the deadline to register for the disguised remuneration final settlement opportunity from 31 May to 30 September 2018 has resulted in a barrage of questions in parliament from one particular MP.

Broadly, disguised remuneration schemes involve using a loan, or other payment, which is unlikely to ever be repaid, to reward employees, directors or contractors, via a third party such as a trust or other vehicle, instead of salary or other taxable income or benefits. Legislation applies to tax transactions entered into on or after 9 December 2010.

Now, such loans made on or after 6 April 1999 and which remain outstanding at 5 April 2019 will attract a tax and National Insurance charge – known as a loan charge.

The amount subject to tax and National Insurance will be the outstanding loan amount on that date. Loan amounts repaid before that date will not be subject to the new loan charge, subject to certain anti-avoidance provisions which are designed to ensure that a genuine repayment has been made.

Similar provisions, including the new loan charge, also apply to the self-employed.

To avoid or mitigate the loan charge it's necessary to register an interest with HMRC and provide all required information by 30 September 2018.

Recent parliamentary questions on this topic, all raised by the member for Eastbourne, Stephen Lloyd, include:

- what estimate has the Chancellor made of the number of disguised remuneration schemes operating in the UK?
- what recent steps has HMRC taken in respect of disguised remuneration schemes and the promoters of such schemes?
- how many individuals declared the use of a loan scheme on their tax return for the most recent year for which figures are available?
- how many tax inquiries on disguised remuneration schemes have been open for more than five, seven and 10 years?
- what steps is HMRC taking to pursue employers and scheme operators for liabilities resulting from the 2019 loan charge?
- how many people will be affected by, and incur liabilities, due to the 2019 loan charge; and of those people who are or were doctors, nurses, teachers and social workers?
- what estimate has the Chancellor made of the number of people working in the NHS that will owe money as a result of a 2019 loan charge and what assessment has he made of the effect of the 2019 loan charge on the NHS?
- what assessment has the Chancellor made of the effect of the 2019 loan charge on the contracting and freelancing sector and the economy?

Mel Stride, Financial Secretary to the Treasury, responded:

"The charge on disguised remuneration (DR) loans is targeted at artificial tax avoidance schemes where earnings were paid via a third party in the form of 'loans' which in reality were never repaid.

DR scheme users took home almost all of their pay tax-free. However, these schemes never worked and the amounts paid were always taxable under the law at the time.

The Government has taken this action to ensure that everybody pays the taxes they owe and contributes towards the public-funded services from which they benefit.

HMRC has provided a number of opportunities for DR scheme users to settle their tax affairs, and is actively encouraging scheme users to come forward and settle their tax position ahead of the loan charge arising. HMRC will help those who are in genuine financial difficulty by allowing them to pay their tax bill over time.

The charge on DR loans is specifically targeted at these contrived tax avoidance schemes and is not expected to have significant effects on the economy or the NHS.

The Government estimates that up to 50,000 individuals will be affected by the charge on DR loans.

The loan charge applies to all users of DR tax avoidance schemes. It does not single out a specific group or industry. No estimate of the number of individuals affected at sector level is available.

Fewer than 30 individuals declared the use of a loan scheme on their Self Assessment tax returns for the 2016/17 tax year. No estimate has been made of the number of schemes currently operating in the UK. HM Revenue and Customs (HMRC) continues to challenge avoidance schemes that are declared, and carries out extensive investigation work to track down those that are not.

Enquiries into DR tax avoidance cases can be time consuming and take several years because of the very complex nature of the arrangements. HMRC also relies on the cooperation of scheme users to provide information and agree to pay the tax they owe. A breakdown of the number of DR cases open by the number of years they have been open is not available, as HMRC's operational data is not held in a way where this information is readily accessible.

Pay As You Earn (PAYE) liabilities fall on the employer in the first instance. The loan charge will not change this principle and HMRC will pursue employers who have used DR schemes for the tax that is due. HMRC will only go to the employee to settle their income tax liability in cases where it cannot reasonably be collected from the employer, for example where the employer is no longer in existence.

HMRC pursues those who promote or enable tax avoidance schemes to ensure that nobody profits from selling avoidance. HMRC is able to charge tough penalties of up to one million pounds where promoters do not provide clear and accurate information to their clients, and penalties of 100% of the fees earned by anyone who designs, sells, or otherwise enables the use of tax avoidance arrangements.

HMRC is proactively reporting DR scheme promoters to the Advertising Standards Authority and professional bodies where they make misleading claims about their products and services or provide misleading advice.

HMRC will also consider criminal investigation where appropriate. Promoters of tax avoidance schemes have been prosecuted, leading to convictions and jail terms."

***COMMENT***

*Despite relatively strong words from the Government, there still appears to be quite a large gap between the number of taxpayers participating in these schemes and those who are complying with the law. It will be interesting to see how many join the register by the 30 September deadline. However, its deferral from the original May deadline possibly tells its own story.*

*However, concerns are also being raised because if HMRC cannot pursue the employer, or the promoter of the scheme, for the loan charge, perhaps because they no longer exist, or because the individual was a contractor working through their own intermediary company, it will instead pursue the individual. The Loan Charge Action Group estimates that even a contractor on a modest £30,000 salary with five years in a remuneration scheme could face a bill of £42,324.*

*On this front, Mr Lloyd also put forward an 'early day motion' on 8 May, calling on the Government to revise the legislation to avoid significant damage to independent contractors and freelancers in the UK for the charge to apply only to disguised remuneration loans entered into after Finance Act 2017 received Royal Assent.*

# HMRC LOSES A PUBLIC SECTOR IR35 CASE

HMRC is pressing ahead with IR35 reform, despite experiencing some recent set-backs in its ambitions to tighten the grip of IR35, losing a number of appeals.

The contractor in Jensal Software Limited and HMRC effectively won his appeal based on a lack of control by the end client.

IR 35 is aimed at identifying individuals who, in the view of HMRC, are avoiding paying tax and National Insurance by supplying their services to clients via a structure, such as their own personal service company, when the individual is acting like and is being treated like an employee of the end client.

Under the off-payroll working rules, public authorities / public sector bodies (PSBs) are responsible for deciding if IR35 applies to a person providing services through their own intermediary, such as a personal services company (PSC).

If the public authority decides that IR35 applies to a worker, the public authority, agency or other third party who is responsible for paying the worker's intermediary must deduct tax and Class 1 National Insurance contributions and pay and report them to HMRC.

## The Jensal Software Case

This case is unusual on a number of fronts.

Firstly, this is thought to be the only time HMRC has brought two IR35 cases against the same contractor. HMRC lost its first case against him too.

Secondly, as the end client in this case was the Department for Work and Pensions (DWP), this is the first public sector case since the new off-payroll working rules were introduced in 2017 and so HMRC was effectively up against another Government department.

In this case the judge, Jennifer Dean, rejected HMRC's arguments, alleging control by the DWP, deciding that the contractor was able to "work at any site he deemed necessary" and that any instructions he received were "limited" and check-ups on his work "minimal". She said that the contractor "utilised his skills to decide what was needed, how those needs could be met and the timescales in which the task could be completed."

HMRC argued that the recruitment process of the contractor "bears the hallmarks of recruiting temporary employees" and the contract between the DWP and Capita "bears the hallmarks of a temporary employee recruitment provider".

A framework agreement the DWP had in place with recruiter Capita Resourcing stated 'Interim Personnel assigned to the Authority shall be under the supervision and control of the Authority'. And in further support of HMRC's case, the framework agreement also said: 'the Authority shall be responsible for the operational direction, supervision and control of Interim Personnel assigned to the Authority under any Services Order.'

However, the judge described the framework agreement as generic, saying:

"The framework does not assist in determining the terms of the hypothetical contract in this case; it was clear from the evidence that no such operational direction or supervision existed and the ultimate responsibility held by the DWP was no more than would exist in the case of an independent contractor."

Based on this, the judge agreed with the contractor that he "was not subject to the degree of control which would be necessary to constitute a contract of employment", adding:

"I am satisfied that this [evidence from one of two DWP employees] did not amount to 'supervision' as such, but rather to ensure that Mr Wells [the contractor] understood the nature of the DWP's request and that all workers understood how the task was to be carried out."

Another unusual aspect of this case is that the two DWP employees referred to by the judge were actually appearing as witnesses for HMRC. It seems that their evidence might have helped sway the judge to find against HMRC!

HMRC also alleged that the contractor only sought the right to substitution, ie. the ability to supply a replacement contractor, because he knew it was a key indicator of being outside of IR35. The contractor argued that he was "unaware of (having never seen) the clause in the contract between Capita and the DWP which required a contractor to be vetted." He confirmed that he had a security pass for the DWP buildings which identified him as a contractor and that he had a DWP laptop and password protected profile, and hadn't considered how a substitute would have been paid or how he/she would have accessed his laptop. However, he argued that substitution was a viable option stating that "it existed in the contract and was entirely feasible." The judge agreed with the contractor, ruling that he could rely on the substitution clause.

And whilst HMRC was successful in arguing there was mutuality of obligation, in the judge's view it did not go beyond the "irreducible minimum" and so "the mutuality of obligation does not of itself demonstrate a contract of services". The DWP was not obliged to offer further contracts and there was a period between the short contracts when DWP offered no work.

***COMMENT***

*This case demonstrates how difficult HMRC can find it to present a case against a contractor who is well versed in the IR35 rules, and may give hope to contractors that it is possible to win an appeal against IR35. However, HMRC's apparent lack of a proper argument in this case doesn't bode well for its proposed rollout of the off-payroll working rules to the private sector.*

*And whilst the Jensal case concerned the pre-2017 IR35 rules, when authorities could seek assurance from a worker engaged through their own personal service company that they were outside the scope of IR35, rather than on the new off-payroll working rules, it nevertheless highlights how the Government could effectively end up arguing with itself, and potentially face penalties, over public sector body IR35 decisions.*

## 'NHS TAX INCREASES'

Some commentators had expected the Prime Minister's recent announcement of an extra £20.5bn for the NHS to be followed by the Chancellor giving some clues about where the additional cash would come from in his Mansion House speech on Thursday 21 June. Unsurprisingly, Mr Hammond avoided the topic.

So how might another £20.5bn be found? Before jumping to an answer it is worth understanding precisely what is involved: politicians have a habit of going for big numbers that are not so great when viewed from other angles. What the pledge appears to amount to is a 3.4% real terms (ie. after inflation) increase in NHS England expenditure from 2019/2020. In 2017/2018, NHS England spending was £111.5 billion (in 2018/19 prices). Thus, there is no question of finding the entire sum next year – the real terms increase initially will be about £4bn.

The Chancellor is enjoying a lucky streak when it comes to his borrowing numbers. The latest figures show that 2017/2018 borrowing is now estimated to be £39.5bn, £5.7bn below the OBR's estimate at the time of the Spring Statement. Borrowing in the current year is also down, with the deficit in the first two months of the financial year £4.1bn less than last year and the lowest since 2007. These numbers give the Chancellor wriggle room as he could increase borrowing to bring it back into line with the OBR's forecasts. The problem is that such financial windfalls cannot be relied upon in the long term – as the Institute for Fiscal Studies (IFS) once remarked, what gets found down the back of the sofa in one year can get lost in the same place in the next year.

The Conservatives' 2017 manifesto presents a problem too, as it ruled out increases in income tax rates, NICs (Class 1 only, it later transpired) and VAT rates. And, looking ahead, there is a commitment to a £12,500 personal allowance and a £50,000 higher rate threshold by 2020/2021. A 2% cut in corporation tax to 17% from 2020 was legislated for in the Finance Act 2016.

An interesting note from the IFS pointed to the following three revenue-raising possibilities:

- *Increase all NIC rates by 1%*. This would be borrowing an old Gordon Brown NHS-funding trick and would raise about £8.5bn a year. However, it breaks the election pledge and could be difficult to sell to the Government's backbenchers, even if branded an NHS supplement.

- *Freeze the personal allowance and higher rate threshold once the targets are reached in 2020/2021*. That would be worth £3.5bn and has the dubious virtue of not being perceived as a tax increase (just one more dose of fiscal drag).

- *Stop the cut in corporation tax*. This would bring in about £5bn a year initially. To a limited extent this would spike the Labour Party's plans (their target is 26%) but would be a loss of face and hard to present as the UK being "open for business post-Brexit" as the transitional period came to an end.

1% on income tax or VAT would each give about £6bn, but either is probably too toxic an option this side of the next election.

***COMMENT***

*In the short term, the Chancellor can probably avoid any tax increases in 2019/2020, but the situation further out is much less rosy.*

## TAKING ADVANTAGE OF THE TRANSFERABLE TAX ALLOWANCE

According to a recent press release from HMRC, around three million couples across the UK have boosted their finances by taking advantage of the transferable tax allowance.

The transferable tax allowance enables a spouse/civil partner, born after 5 April 1935, who is not a higher or additional rate taxpayer, to transfer up to 10% of their personal allowance (ie. £1,190 rounded up for 2018/19) to their spouse/civil partner provided the recipient is not a higher or additional rate taxpayer.

For the current tax year 2018/19 the tax saving could therefore be up to £238 where £1,190 is transferred – as the recipient would receive a reduction in tax equal to 20% of the amount transferred.

And, since the start of the new tax year, couples can backdate their allowance to include any tax year since 6 April 2015 and boost their payment by up to £900 as shown below:

| Tax year | Personal allowance | Transfer up to 10% | Tax saving at 20% |
|---|---|---|---|
| 2015/2016 | £10,600 | £1,060 | £212 |
| 2016/2017 | £11,000 | £1,100 | £220 |
| 2017/2018 | £11,500 | £1,150 | £230 |
| 2018/2019 | £11,850 | £1,190 | £238 |
| TOTAL | | | £900 |

When it was first introduced some people felt that claiming the transferable tax allowance might not be worth the effort. However, the process of applying for the transferable tax allowance is now quick and easy and once an application is completed it is processed immediately. The new online form takes less than ten minutes to complete and eligible customers will receive backdated claims of up to £662 (i.e. for the past three tax years) as a lump sum.

## INCOME WITHDRAWAL RATE FOR JULY 2018

The appropriate gilt yield, used to determine the ‘relevant annuity rate’ from HMRC’s tables for an adult member commencing income withdrawals (or reaching an income withdrawal review date), in July 2018 is 1.5%.