FB 2017: Enablers of Defeated Tax Avoidance and Penalties for Users of Defeated Avoidance (clauses 91 and 92)

Management of taxes

01 February 2017

An update on HMRC's response to the recent consultation and reflections on the draft legislation for inclusion in Finance Bill 2017.

HMRC's consultation document 'Strengthening tax avoidance sanctions and deterrents' was published in August 2016 and set out the Government's proposals for:

- introducing a penalty for those who design, market or facilitate the use of tax avoidance arrangements which are defeated by HMRC; and
- modifying the way the penalty regime works for those whose tax returns are found to be inaccurate as a result of using such arrangements by defining what does not constitute the taking of 'reasonable care' and placing the requirement to prove 'reasonable care' onto the taxpayer.

In the December edition of Technical Newsdesk I reported on the CIOT's response to the proposals. We expressed support for the Government's ambition to tackle and alter the behaviour of the 'shrinking but persistent minority' of promoters and advisers who continue to market tax avoidance schemes, but we raised serious concerns that the proposals were too widely drawn and could have penalised advisers who gave perfectly reasonable and legitimate advice to clients on commercial transactions.

The main points in our response were:

1. The breadth of 'tax avoidance' for the purpose of the rules needed to be cut down to apply only to arrangements caught by the General Anti-Abuse Rule (GAAR) and the Disclosure of Tax Avoidance Scheme (DOTAS) rules;
2. The definition of 'enabler' needed to be limited to those who devise and play a deliberately active role in the promotion of tax avoidance schemes;
3. The financial penalty proposed (based on the tax avoided) was disproportionate. The size of the penalty should be limited to the amount of net fees or commission received by the enabler in respect of the advice given;
4. No consideration had apparently been given to the significant work HMRC and seven accounting and tax professional bodies, including CIOT, had recently been engaged in to cut down the supply of tax avoidance schemes (new Professional Conduct in Relation to Taxation effective 1 March 2017 (PCRT));
5. It was unclear whether the proposals only covered arrangements entered into after enactment of any new legislation or whether they would also apply to an arrangement entered into many years ago but with a 'relevant defeat' after enactment;
6. Turning to taxpayer penalties, we did not favour introducing legislation that describes what does not constitute reasonable care. Whether or not reasonable care has been taken is a question that should be left to the tax tribunals to decide as it will vary on a case by case basis. We also disagreed with the proposal

that the onus of proof should be put on the taxpayer to demonstrate reasonable care. This would be a significant change which, in our view, was not justified.

HMRC published its response on 5 December 2016. Draft legislation for inclusion in Finance Bill 2017 was published on the same day.

Penalties for Enablers of Defeated Tax Avoidance

Significant changes have been made to the original 'enabler' penalty proposals which have addressed our main concerns. The definitions are more narrowly focused on 'abusive' arrangements which have been defeated, using the principles of the GAAR: that is the test will be based on the GAAR concept of double reasonableness (whether arrangements entered into could reasonably be regarded as a reasonable course of action). This should ensure that genuine commercial transactions are not inhibited. The penalty will apply only where the defeated arrangements meet this test, so it will be regardless of whether they are within DOTAS or VAT Disclosure Regime (VADR) arrangements, are counteracted by the GAAR or defeated by a Targeted Anti-Avoidance Rule (TAAR) or unallowable purpose rule. The draft legislation provides for regulations to be made enabling or requiring the GAAR Advisory Panel to provide opinions as to whether arrangements are abusive tax arrangements. HMRC will be consulting further with stakeholders on how the governance process will operate.

Abusive tax arrangements will be treated as being defeated when there is a final determination of a tribunal or court that the arrangements do not achieve their purported tax advantage, or, in the absence of such a decision, there is an agreement between the taxpayer and HMRC that the arrangements do not work.

The definition of who is an 'enabler' draws the distinction between (on the one hand) those who design, manage, market or otherwise facilitate avoidance arrangements that are implemented from (on the other hand) those who solely advise, report or otherwise provide a second opinion on such arrangements, and whose advice does not result in any amendment to the arrangements or any resulting arrangements. Advice which goes on to suggest how the arrangements could be modified to achieve the intended or other tax advantages would constitute enabling unless it would be reasonable to draw the conclusion from reading the advice that the person giving it is recommending that the arrangements or modified arrangements should not be implemented.

HMRC's response document (but not the draft legislation) makes reference to the new PCRT stating that: 'There are strong parallels with the reasonableness test so, provided members act wholly within the spirit of the 'Standards' for tax planning contained in Part 2 of the PCRT, the Government would not expect that they would normally be affected by this policy'. However, this is simply a statement of the Government's expectations and there is no actual legislative carve-out.

The measure will include safeguards (a 'knowledge condition') to ensure that those who are unwittingly brought into avoidance arrangements will not be within the scope of the penalty. This should protect, for example, a company formation agent providing a normal service.

The legislation is being effectively 'future proofed' by providing a power to add categories of enablers and to provide exceptions by regulation, and is prospective, applying only to actions taken on or after Royal Assent to the Finance Act 2017.

There will be a fixed 100% fee based penalty on everyone in the supply chain with a right of appeal against the penalty assessment. FA 2008 Sch 36 will be modified to provide information powers in order for HMRC to obtain any necessary information to identify enablers.

In seeking to demonstrate that they have not acted as an enabler of a defeated avoidance scheme, lawyers bound by Legal Professional Privilege (LPP) might not be able to provide evidence of the advice they gave, as LPP will remain with the client who may be unwilling to waive this right. The Government will provide a way in which the lawyer could, in appropriate cases, show that they do not fall within the scope of the penalty provisions without disturbing LPP rights. This will involve them making a declaration. HMRC will consult with the legal profession's representative bodies on the wording of the declaration. The declaration will be subject to a penalty for making a misdeclaration.

HMRC will be producing guidance on the above measures, which will include reference to PCRT. Given the seriousness of this new penalty, we have said to HMRC that the guidance should be published before the measures come into effect.

Errors in Taxpayers Documents (Penalties for users of defeated tax avoidance)

In contrast, measures to modify the existing penalty regime in FA 2007 Sch 24 for users of defeated tax avoidance arrangements (which is very widely defined), by describing what does not constitute the taking of reasonable care and to place the requirement to prove reasonable care onto taxpayers, are being taken forward as proposed. Examples of 'disqualified advice', which cannot be relied upon to show reasonable care has been taken, include:

- advice addressed to a third party and/or without reference to the taxpayer's specific individual circumstances and use of the scheme
- advice commissioned or funded by a party with a direct financial interest in selling the scheme or not provided by a disinterested party
- advice given by parties without the relevant tax or legal expertise/experience to advise on complicated tax avoidance arrangements.

What this in effect means is that a level of care that a tribunal might have accepted as reasonable is being deemed not to be so. In many cases the taxpayer will not know (and perhaps cannot be expected to know) that certain advice will be disqualified. Often the taxpayer will have had an honest belief that his tax return was correct and he will have relied fully on the advice he received from his accountant and on what he believes to be the expertise of any promoter. It may not be very clear to the taxpayer what actions will now constitute taking reasonable care. Indeed, advisers might in future need to consider if, when providing advice to clients, they should alert them as to whether their advice would be 'disqualified' under these proposals.

In defending the proposals, HMRC have pointed out that a tribunal might still conclude in individual cases that a taxpayer has acted reasonably, despite the disallowance of some specific disqualified advice. Indeed we would expect tribunals to be inclined to be sympathetic to taxpayers in such a situation. However, this is undoubtedly a significant change to the penalties legislation and poses a risk that HMRC will extend the obligation on the taxpayer to prove that they had taken reasonable care, along with defining what does not constitute the taking of reasonable care, into other areas of tax.

HMRC's promised guidance will also cover these provisions.

The CIOT will continue to engage with HMRC on these measures over the coming months.