MACFARLANES

STRENGTHENING TAX AVOIDANCE SANCTIONS AND DETERRENTS

HMRC SETS ITS SIGHTS ON THE ENABLERS OF TAX AVOIDANCE

On 17 August 2016, HMRC published a consultation on "Strengthening Tax Avoidance Sanctions and Deterrents", which is open until 12 October 2016.

Over the last few years, the Government has introduced various measures to weaken the demand for, and starve the supply of, tax avoidance schemes. The Government recognises that there is money to be made in tax avoidance schemes even if they are later found not to work, and is now proposing to tackle the supply side further with sanctions not only for promoters of tax avoidance schemes but also for anyone else who benefits financially from setting them up: the "enablers".

THE ENABLERS

The term is a broad one and reaches all the way along the "supply chain", from the lawyers and accountants advising on the design of a scheme and the IFAs and accountants earning a commission for marketing it; to the company formation agents, trustees, bankers, auditors, accountants and lawyers implementing it.

The consultation paper proposes various exclusions from the definition of "enabler", including employees of promoters (unless there are no other UK residents against whom HMRC might enforce a penalty) and advisers who tread the thin line between merely "explaining legislation" and potentially contributing to a tax loss to HMRC.

DEFEATED AVOIDANCE

The proposed sanctions on enablers would be triggered by "defeated avoidance". What, then, is avoidance, and when is it defeated? "Avoidance" itself is not defined. Instead, the Government proposes four categories of "arrangement", itself a widely drawn term, which would be within the scope of the penalty regime. An arrangement could be:

- one counteracted by the general anti-abuse rule (the GAAR);
- anything which is the subject of a follower notice;
- one notifiable under the Disclosure of Tax Avoidance Schemes (DOTAS) or the VAT disclosure regimes; and
- anything which "has been the subject of a targeted avoidance-related rule or unallowable purpose test within a specific piece of legislation".

These categories make for a wide definition of "avoidance":

- The GAAR sets a high hurdle for HMRC and many see it as unobjectionable that arrangements which are likely to fall foul of the GAAR also carry the risk of enabler penalties.
- Follower notices are most likely to be issued to users of marketed schemes after HMRC has won a test case against a user of the scheme and the taxpayer has not successfully appealed. That may be because the court finds against the taxpayer, or because the taxpayer decides not to appeal through lack of funds or otherwise. However, all that is required for a follower notice is that the taxpayer has claimed a tax advantage from "chosen arrangements"; the taxpayer's return is under enquiry; or the taxpayer has appealed, and HMRC is of the view that there is a final ruling which is relevant to the taxpayer's case. That theoretically includes a wide range of less aggressive tax planning with which HMRC and the court disagree. An enabler therefore potentially runs the risk of a penalty with any planning, and equally may have no influence over, or indeed notice of, tribunal or court proceedings.
- DOTAS is also likely to focus on marketed schemes, so the enabler penalty here would broadly align with HMRC's stated aim of weakening the supply of and demand for such schemes. However, the scope of the proposed inheritance tax DOTAS hallmark suggests that the scope of DOTAS may broaden in due course beyond such schemes. Therefore, the corresponding risk of an enabler penalty will also broaden.
- Any adviser, banker or corporate service provider working on a commercial transaction which, because of its factual context, comes within a targeted anti-avoidance rule (TAAR) could potentially come under the definition. Again, and particularly with new TAARs on which there is little guidance from the courts, this could very well result in enabler penalties being imposed for unaggressive planning in such a transaction.

These arrangements will be "defeated" when there is a final (i.e. unappealed or unappealable) judgment of the tribunal in HMRC's favour or when, in broad terms, the taxpayer gives up outside litigation and agrees with HMRC that the arrangement does not have the tax effect that the taxpayer claimed. Such agreement, again, may not be because the taxpayer agrees that he / she has avoided tax, but because they simply have no appetite for a prolonged dispute with HMRC.

PENALTIES FOR ENABLERS

The Government proposes that an enabler be charged a penalty in relation to each person whom it enables to enter into an avoidance arrangement. A marketer may therefore attract multiple penalties, while a lawyer advising a single taxpayer could only be liable for one.

It is proposed that the penalties be a percentage either of the financial reward received by the enabler or of the tax understated by the taxpayer. There may be a cap to ensure the aggregate penalties do not exceed the tax loss to HMRC, although it is unclear how the penalties would be split between the various enablers. A person liable to penalties under both the proposed new regime and as an enabler of offshore evasion (under proposals in Finance Bill 2016) would only be liable for the larger penalty.

The quantum of the proposed penalties is therefore still very much unclear, as are questions of information and enforcement. How exactly would HMRC obtain the necessary information on professional fees and other charges in case the legislation ultimately bases the penalty on the financial benefit to the enabler? How will penalties affect non-UK entities? Will directors of enabler companies be personally liable?

If the Government ultimately settles on penalties based on the tax understated by the taxpayer, they could be entirely disproportionate to the financial benefit for the enabler.

USERS

Where a taxpayer uses a tax avoidance arrangement which ultimately is found not to work, HMRC is likely to impose a penalty on the basis that the taxpayer's initial tax return was inaccurate. The penalty for an inaccurate return will depend on whether the taxpayer took reasonable care in preparing the return. If the taxpayer relies on marketing and / or advice from a scheme promoter, has he / she taken reasonable care? The burden falls on HMRC to prove that a taxpayer has not taken reasonable care, and they often struggle to obtain sufficient evidence from promoters and advisers.

HMRC proposes two changes to help them: shifting the burden of proof to the taxpayer; and specifying steps which would not amount to taking reasonable care. Examples in the consultation paper include the taxpayer relying on generic advice prepared for the promoter rather than taking advice on his / her own particular circumstances or taking advice from someone with a direct financial interest in them entering into the scheme.

This could significantly increase the burden on a taxpayer, given that if the taxpayer takes no independent advice, they could automatically be careless (with a penalty of up to 30 per cent of the tax bill). If they do seek independent advice, they may be advised that it will work. In that case, filing their return on that basis with proper disclosure should not make them careless. Proceeding against such advice could make the inaccuracy deliberate, not careless, so it would attract a much higher penalty of up to 70 per cent of the tax at stake. This is likely to work in tandem with the new penalty surcharges for "serial avoiders" and tax-geared penalties for arrangements counteracted by the GAAR.

FURTHER NUDGES

As well as penalties, the paper sets out HMRC's plan to ensure it has a chance to put its view forward whenever a taxpayer is tempted by an avoidance arrangement, for example:

- requiring promoters to report individuals to whom a scheme is being marketed, so HMRC can warn the potential users and tell them directly if it is litigating or enquiring any arrangement;
- requiring promoters to tell potential users how much they are paid for promoting the scheme, explain the consequences of not notifying under DOTAS, if applicable, and provide HMRC health warnings to potential users;
- renaming the DOTAS "scheme reference number" to a starker "avoidance enquiry reference";
- imposing penalties on promoters and enablers if they do not tell users that HMRC is challenging the scheme;
- charging a penalty surcharge if responses to HMRC's enquiries are delayed, withheld or evasive; and
- further steps to bring arrangements which are not notified under DOTAS within it.

At present, these are just ideas, and the paper provides no detail on implementation.

Many will find penalties for promoters unobjectionable in the context of highly artificial, marketed schemes, but the possible scope of the rules as they stand may make many advisers / service providers wary of involvement in any complex tax planning, and could catch even those who do not consider themselves to be involved in any contrived arrangements. Industry bodies have already issued strong initial responses, calling for the proposed sanctions to be more carefully targeted. We await HMRC's consultative response with interest.

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SEPTEMBER 2016