

TAXREP 24/04

TACKLING DIRECT TAX AVOIDANCE – DISCLOSURE REQUIREMENTS

Memorandum submitted in June 2004 by the Tax Faculty of the Institute of Chartered Accountants in England and Wales to the Inland Revenue in response to the invitation to comment on draft Statutory Instruments

CONTENTS

	Paragraph
INTRODUCTION	1
WHO WE ARE	2- 4
EXECUTIVE SUMMARY	5 - 9
OVERVIEW	10 - 12
THE TEN TENETS	11 – 32
GENERAL COMMENTS	33-58
DETAILED COMMENTS ON REGULATIONS AND DRAFT GUIDANCE	59-140
TAX FACULTY TEN TENETS FOR A BETTER TAX SYSTEM	Appendix

Tax Representation

TACKLING DIRECT TAX AVOIDANCE – DISCLOSURE REQUIREMENTS

INTRODUCTION

1. We welcome the opportunity to comment on the draft Regulations published on 17 May 2004 on the Inland Revenue website as well as commenting on the Disclosure Forms published on 28 May. We have also commented on the Draft Guidance on the Disclosure Requirements.

WHO WE ARE

2. The Institute of Chartered Accountants in England and Wales ('ICAEW') is the largest accountancy body in Europe, with more than 125,000 members. Three thousand new members qualify each year. The prestigious qualifications offered by the Institute are recognised around the world and allow members to call themselves Chartered Accountants and to use the designator letters ACA or FCA.
3. The Institute operates under a Royal Charter, working in the public interest. It is regulated by the Department of Trade and Industry through the Accountancy Foundation. Its primary objectives are to educate and train Chartered Accountants, to maintain high standards for professional conduct among members, to provide services to its members and students, and to advance the theory and practice of accountancy, including taxation.
4. The Tax Faculty is the focus for tax within the Institute. It is responsible for tax representations on behalf of the Institute as a whole and it also provides various tax services including the monthly newsletter 'TAXline' to more than 11,000 members of the ICAEW who pay an additional subscription.

EXECUTIVE SUMMARY

5. We believe that the current proposals fail seven out of our ten tax tenets which we believe should underpin all taxation legislation. Our ten tenets are reproduced in the Appendix.
6. We believe that this failure will result in serious problems if the proposals are introduced in their current form.
7. We are particularly disappointed that the assurances that were given at meetings and in published material are not reflected in the current proposals. These assurances indicated that the proposals would not impact on ordinary tax planning and should not affect the majority of advisers.
8. We are concerned that the draft legislation and Regulations currently before us are unreasonable, excessive and will not receive the support of business or the tax profession.

Tax Representation

9. We would like to see as a matter of urgency the following action:
- That there is an immediate commitment to open consultation on the detail of the measure;
 - That there is a review of the key definition rules to ensure that they are certain in scope and properly targeted so that disclosure is required only for marketed tax avoidance schemes;
 - That full account is taken of the competition concerns;
 - That the 5 day deadline is extended to 30 days;
 - That detailed consideration and consultation is undertaken to see how the rules can be simplified;
 - That the start date is put back to allow for proper consultation and for firms to put in place the necessary systems to comply with the law. Only schemes marketed after the start date should be disclosable.

OVERVIEW

10. The draft Regulations are complementary to the provisions in Clauses 290 to 302 Finance Bill 2004 and will be laid before Parliament in their final form as soon as the Finance Bill has received Royal Assent some time in July 2004. As the Regulations and primary legislation form a single package we will be reiterating the major points we have made earlier in our Representations on the provisions in the Finance Bill.
11. We submitted comments on 30 April 2004 to the Chancellor on the Finance Bill provisions (published as TAXREP 19/04, see http://www.icaew.co.uk/taxfac/index.cfm?AUB=TB2I_64552,MNXI_64552).
12. We have a number of major concerns with the current proposals. As currently drafted, they do not reflect the Government's stated objectives for this legislation. As explained in more detail below, the proposals as drafted fail most of our ten tenets.

THE TEN TENETS

13. In our representations on the Finance Bill, we set out how the Finance Bill breached our ten tenets for a better tax system. The ten tenets are reproduced again in the Appendix.
14. These proposals fail the ten tenets on a number of counts, as set out below.

Tax Representation

Statutory

15. It was our understanding that most of these rules would be included in primary legislation. However, much of the key detailed provisions have been left to Regulations which are not subject to detailed Parliamentary scrutiny. Worse still it would appear that at present a lot of interpretation is being placed in Revenue guidance – which is non-statutory – or it is being assumed that public announcements by the Revenue in meetings will filter down to everyone to assist in compliance understanding. We do not think this is acceptable. The law needs to be clearly set out in primary legislation or at worst secondary legislation. It should not be necessary to rely on, or resort to, tertiary legislation.

Certainty

16. The proposals are extremely widely drafted and uncertain in scope. This result is contrary to the objective in the Regulatory Impact Assessment (RIA) where it is stated that ‘it will be crucial that these [definitions] are clearly defined and understood’ (paragraph 12). In particular the definitions of promoter and financial products need major revision and clarification. We appear to be heading towards a situation in which the rules provide that certain transactions are disclosable, but the guidance suggests that they are not. The guidance must be consistent with the rules. This emphasises our previous point that guidance is being used to ‘water down’ the legislation but this is not an appropriate way to deal with legislative issues.

Simplicity

17. The Regulations are far too complicated. For example, it is very difficult to understand how the $T + B - C \geq 0$ formula is supposed to work in practice and the published guidance confuses rather than clarifies. We also understand from remarks made by the Revenue at the meeting with Representative Bodies on 9 June that the current published Guidance is wrong in certain instances: the errors were not identified at that meeting.

Properly targeted

18. The policy purpose behind the proposal is, we understand, to receive advance notice of tax avoidance schemes which are actively promoted and marketed at the same time that they are made available to potential purchasers. As we stated in our earlier representation, this is a reasonable policy. However, the provision is not properly targeted: it appears that a wide variety of mundane tax planning situations are likely to be disclosable. The submission of many unnecessary reports is likely to negate the policy purpose behind the proposals.
19. We believe that bespoke tax planning by advisers for their clients should not be subject to these proposals. It has always been stated that the main target of the proposals is marketed avoidance schemes which exploit lacunae or loopholes in the legislation. No case has been made for extending this to general tax advice and doing so has created the majority of the problems identified in our representations.

Subject to proper consultation

Tax Representation

20. The measure should be subject to proper consultation. We do not think that the Inland Revenue has adequately discharged its responsibilities as set out in the Regulatory Impact Assessment (RIA), as follows:

Consultation

55. As this is a Budget measure directed at tax avoidance consultation is not considered appropriate. We do however intend to work closely with the Accountancy and legal profession after publication of the Finance Bill to ensure that the rules are effectively targeted.

21. We do not think that calling one large meeting on 9 June (and with only limited advance notice) satisfies this published statement and we think that the Revenue needs as a matter of urgency to begin a proper consultation exercise on these proposals.

Fair and reasonable

22. There are many aspects of these proposals that are not fair and reasonable.
23. The need to provide comprehensive disclosure will place an unrealistic and unreasonable regulatory and administrative burden on UK business.
24. The transitional period between 18 March and 31 July gives rise to a considerable number of practical difficulties. It is not practical for business to attempt to identify notifiable proposals and transactions until they are clear what the initial form of the rules will be, which will not be until some time in July. It is not feasible to train employees to identify and notify appropriate disclosures in respect of the preceding four and a half month's during a two week period especially as it is in the middle of the holiday season.
25. The 5 day notification period is neither reasonable nor realistic, particularly for bespoke advice. If a tax scheme is being developed, the disclosure rules will form part of the thinking process, but ad hoc meetings, telephone calls and other transactional based work that falls foul of the wide definitions will lead to considerable compliance issues if disclosure within this time frame is expected.

Competitive

26. These proposals are likely to damage competitiveness, both in respect of the provision of UK tax avoidance schemes marketed by overseas promoters and also within the UK tax profession.
27. There remains considerable concern that although the proposals are intended to put overseas promoters into the same position as UK promoters, the rules do not achieve this with the result that overseas promoters will have a competitive advantage over UK promoters.
28. In respect of the UK profession, we understand that the UK Bar is generally of the view that barristers will not be required to disclose advice given to clients as such advice will be protected by Legal Professional Privilege (LPP). If this is correct this will give them an unfair advantage as against other advisers who will come within the disclosure requirements. In paragraph 4.5 of the draft Guidance it is stated that 'LPP

Tax Representation

does not in itself provide justification for not disclosing a scheme if it meets the criteria for disclosure'. If this statement is based on legal advice then we would ask for this advice to be published. If the view of the UK Bar proves to be correct then we believe the Government should consider what steps should be taken so that a 'level playing field' is maintained for professional advice.

29. We doubt whether measures which discriminate against a particular section of advisers satisfy the UK's obligations under the Treaty of Rome.

Conclusion

30. We are disappointed that these proposals fail all seven of the ten tenets, out of the ten set out in the Appendix, which are relevant to the proposal. We believe that this result reflects the serious problems that will arise if this measure is introduced in its current form.
31. We are particularly disappointed that the assurances which were given at our meetings on 18 and 31 March and in the published material do not appear to be reflected in the reality of the legislation. These are that this measure would not impact on ordinary tax planning and should not affect the majority of advisers. If the proposals as announced originally were to be legislated, there is no reason why they should not receive the support of the tax profession. However, we are concerned that the legislation and Regulations currently before us are unreasonable, excessive and will not receive the support of business or the tax profession.
32. We would like to see as a matter of urgency the following action:
- That there is an immediate commitment to open consultation on the detail of the measure;
 - That there is a review of the key definition rules to ensure that they are certain in scope, and properly targeted so that disclosure is required only for marketed tax avoidance schemes;
 - That full account is taken of the competition concerns;
 - That the 5 day deadline is extended to 30 days;
 - That detailed consideration and consultation is undertaken to see how the rules can be simplified;
 - That the start date is put back to allow for proper consultation and for firms to put in place the necessary systems to comply with the law. Only schemes marketed after the start date should be disclosable.

Tax Representation

GENERAL COMMENTS

The likely volume of disclosure

33. The proposals are very widely drafted and we believe that the current definitions of financial products will leave a very considerable number of unexceptional and uncontentious transactions that will need to be declared.
34. In addition the majority of taxpayers and their advisers will want to comply with the legislation and if there is any doubt as to whether a particular proposal or transaction needs to be disclosed there will be a tendency to err on the side of caution and make a disclosure.
35. The Revenue has consistently stated that they only want to target those people whom they believe are potentially abusing the system and ‘avoiding’ their legitimate taxation liabilities. In order to do this they stated in the RIA, published on 18 March 2004, that:
12. *The (current) proposal therefore introduces a new disclosure rule requiring production of details of the scheme at an early stage. To ensure the intended effect of this proposal it is necessary to identify and define who are the promoters, what schemes and arrangements should be disclosed and what information is required. It will be crucial that these areas are clearly defined and understood.*
13. *It is considered preferable to focus on areas of high risk and to construct the disclosure requirements narrowly by targeting particular types of avoidance thereby reducing the overall compliance costs of both promoters and taxpayers.*
36. We believe the current proposals go far beyond the proposals as set out in the above paragraphs. Every adviser taking account of the tax consequences of proposed transactions and every business considering the tax implications of an intended course of action is likely to be drawn within the disclosure requirements, not merely purveyors of artificial avoidance schemes.
37. This will put an enormous and disproportionate burden on UK business which will find that it will have to report to the Revenue a very considerable number of ordinary transactions carried out in the normal course of business.
38. We have made similar representations ever since the legislation was drafted and despite the Revenue assurance in the RIA that ‘[the Inland Revenue] intend to work closely with the accountancy and legal profession after publication of the Finance Bill to ensure the rules are effectively targeted’, (paragraph 55) the meeting on 9 June was the first such meeting for several months and the first since the Regulations had been published. At that meeting there was very little substantive evidence that points that had first been made almost three months previously had received any serious consideration. We believe this to be an extremely regrettable situation which could have serious consequences.

Tax Representation

The legislation needs clear definitions which can be easily understood

Promoters

39. We pointed out in our representations on the Finance Bill that the definition of 'promoter' is so wide that many persons will be deemed to be promoters of schemes who will not have the requisite knowledge to make the return required under the provisions. In the current Representations we note with regret that the Regulations make only the most limited exclusion from the definition of promoter.
40. We believe a major difficulty has arisen because the legislation seeks to include in the definition not only persons who are selling pre packaged schemes for reward but anyone who is advising a client on the taxation implications of a proposed transaction if as part of their advice they propose variations in the manner of implementation. The latter we referred to earlier as bespoke tax planning advice.
41. A reasonably sized commercial transaction with several counter-parties is likely to have a set of advisers for each participant, namely bankers, lawyers and accountants, all of whom are likely to be promoters of the scheme under the current definition. There may be others who advise only on a particular aspect of the arrangements, for instance a patent agent dealing with intellectual property rights issues, who recommends some amendment to the existing proposal. That person is also likely to have a reporting obligation as what he has done 'involves the provision to other persons of services relating to taxation [if] he is to any extent responsible for the design of the arrangements'.

Financial products

42. We believe the definition and exclusion of a 'simple loan' needs to be expanded to make it clearer. For example, is a secured overdraft a simple loan?

Transitional period

43. We believe there is a strong case for disclosure to be required only for notifiable proposals and arrangements which are made after the provisions come into force on 1 August 2004 or a later date if action is taken to defer the start date as recommended in paragraph 32 above.
44. If this is not accepted then it would be extremely invidious to exempt some but not all organisations from the disclosure of activities during the transitional period from 18 March to 31 July. There have been reports in the national press that the largest legal practices have sought an exemption for their own organisations from the need to disclose for events during the transitional period.
45. We believe the Government needs to give serious and urgent consideration to the practicalities of reporting events during this transitional period.
46. The broad outline of the scheme was set out in the Finance Bill published on 8 April 2004. But as we said in our Representations on the Finance Bill, sent to the Chancellor on 30 April, the proposals are extraordinarily widely drafted and we strongly urged that they should be restricted to reflect the actual purpose of the

Tax Representation

proposals, 'to receive an 'early warning' of marketed schemes'. We also noted that the provisions were uncertain in scope. Even with publication of guidance on 17 May 2004 it is still far from clear what the proposals cover and what disclosure will be required. The Finance Bill will not receive Royal Assent until the middle of July and the Regulations will then be immediately laid before the House.

47. Because of the potential wide scope of the rules and the very significant number of disclosures that are likely to be required, professional firms have not been in a position to train their staff on the new requirements. This cannot happen until it is clear what is covered and how it should be reported. The meeting with the Revenue on 9 June demonstrated incontrovertibly that at that date there still remained a very considerable amount of uncertainty about the scheme.
48. This means professional firms will have less than two weeks before the introduction of the new regime, in the middle of the holiday period, when they will begin to finalise their procedures and processes for dealing with the new regime and train their staff.
49. It does not make sense to have to report all notifiable proposals and arrangements that have taken place between 18 March and 31 July inclusive by 1 or 6 August: the currently proposed reporting deadline is not clear under the draft Regulations.
50. We would strongly recommend that the Revenue considers this matter urgently and agrees with representative bodies what is a realistic and reasonable time table for the introduction of the proposals.

Five day notification period

51. We believe that the proposal for disclosure to be within five days is not workable for reasons which we set out in our comments on the draft Information Regulations.
52. We recommend that the common tax reporting deadline of 30 days is adopted.

The $T + B - C \geq 0$ formula

53. On the face of it the formula looks very straightforward but the reality is that it is far from clear.
54. We understand from what was said at the meeting on 9 June that it is intended to be a cash flow test and to catch arrangements which create a pecuniary benefit in the first two years.
55. We question whether this is the right approach. It must be remembered that tax is only one consideration. We hope it is not entirely facetious to point out that any business that enters into transactions that are not cash flow positive will sooner or later go out of business.
56. More seriously, the terms are confusing and probably wrong. Very few companies would regard the taking on of a liability (in the form of a loan) as a 'benefit' and equally investing money in an ISA is not a cost, it is using cash to buy an asset of

Tax Representation

equal value. Also while a loan is a benefit the interest that is paid subsequently is a cost i.e. principal and interest are on opposite sides of the calculation.

57. Indeed we question the policy of trying to use a cash flow test at all. Why should an arrangement be any more or less offensive because it happens to leave the taxpayer holding a liquid asset, rather than actual cash, at the one or two year point?
Conversely why should it make a difference whether the taxpayer happens to discharge a liability just before or just after either of those two time periods?
58. We wonder what is the position if one cash item is lent through several group companies. Suppose the top plc company borrows and backs the loan through a finance company for forex etc management purposes. The loan then goes to an overseas local holding company and that company on lends to the overseas operating company. This is common in purely commercial transactions but, since the rules require you to look at the tax position of associates, it is difficult to see how you deal with the double, triple or more counting.

Start date

59. As noted above, the proposed 1 August 2004 start date should be deferred to allow time for proper consultation and for firms to put suitable procedures in place to comply with the new rules.

DETAILED COMMENTS ON THE REGULATIONS AND DRAFT GUIDANCE

Tax Avoidance Schemes (Information) Regulation 2004 – sections 292, 293(1), 294 and 297(1) and (3), FA 2004

Regulation 3

60. This Regulation prescribes the information which must be provided where returns are made under sections 292, 293 or 294. In the RIA it is suggested that ‘plain English’ would have to be used in making these returns and at the private meeting held with the Tax Faculty to discuss REV BN 28 it was suggested that the returns required would be quite simple running to perhaps a couple of pages. In fact, a person making a return must provide ‘the legal provisions relevant to the operation of the proposal’. That is not limited to statutory provisions (as REV BN 28 said that it would be) nor is there any limitation according to the importance of the provisions. The taxation rules applicable to even the simplest and most routine of transactions are often extraordinarily complex. Quite straightforward transactions may require returns of dozens of pages under the proposed wording. More complex transactions will require far more.
61. As it is clear that these provisions will require returns of many transactions which are not their ostensible target, this will impose a very considerable cost on business and other taxpayers generally. What is more, the overarching rule that the person concerned must provide ‘sufficient information as will enable an officer of the Board to comprehend the manner in which the proposed is intended to operate...’ is not only very onerous but imprecise. It is inevitable that persons making returns will feel

Tax Representation

obliged to provide very large amounts of information so as to protect themselves against an accusation that they have left out something which is necessary to inform the officer's comprehension.

Regulation 4

62. When such extensive information is required a deadline for the provision of the information of five days is unrealistic and unworkable. Tax planning steps are often not specified in writing in great detail because the parties concerned understand the background information to the transaction and, sometimes, assume a prior understanding of how taxation will apply to that transaction. In order to comply with Regulation 3, however, it would not be possible for the writer to assume that background information and understanding. It will therefore be necessary to write descriptions of the tax planning from scratch simply for the purpose of the return setting out exactly the taxation effects of the proposals and their related commercial considerations. That is a major task which it is unrealistic to expect to be performed in five days. A more realistic deadline would be the common tax return deadline of thirty days.

Regulation 5(2)

63. We do not understand why it should be necessary for a taxpayer to put the reference number on his return each year. Surely, once the Revenue knows that a person has done a tax scheme, it is in a position to decide whether or not to enquire into it? In these circumstances, if the scheme is going to give an advantage over a period of time we cannot see why a taxpayer should have to continually re-notify the Revenue.

Regulation 5(6)(e)

64. We see no reason why the person making the declaration should be required to provide his telephone number or email address. It is surely sufficient that he supplies a correspondence address. Email and telephone may be convenient methods of communication if they are voluntarily adopted by both parties but it is an intrusion of privacy to require a telephone number to be provided irrespective of the wishes of the person concerned.

Tax Avoidance Schemes (Prescribed Descriptions and Arrangements) Regulations 2004 – section 290 FA 2004

General

65. In our comments on the Finance Bill we warned that we doubted whether it would be possible to define notifiable arrangements which fall within the provisions with sufficient precision to avoid bringing many arrangements which are not their ostensible target within these rules. The publication of these Regulations has convinced us that that this warning was justified.
66. The guidance provides some derogations from the rules in the legislation and Regulations. Although these are welcome, we do not believe it is acceptable to introduce wide-ranging imprecise legislation and Regulations and then implied (but also imprecise) concessionary treatment. We, as a professional body, must advise our members to follow the law. It is inevitable that widespread precautionary disclosures

Tax Representation

will be made, with the inevitable implications in terms of cost and inconvenience for advisers and for the new Avoidance Investigation Unit (AIU).

67. We are also not sure that the Regulations tie in properly with the legislation. At the meeting on 9 June the Revenue stated that there are a series of tests and one needs to go through the series before deciding what is caught. These tests seem to be:
- (a) Do the arrangements enable a person to obtain an advantage in relation to any tax that is so prescribed? (clause 290(1)(b))
 - (b) If so, is the main benefit or one of the main benefits that might be expected to arise from the arrangements the obtaining of that advantage? (clause 290(1)(c))
 - (c) Does the arrangement fall within a prescription prescribed by the Regulations? (clause 290(1)(a))
 - (d) If so, is it let out under the Regulations? (clause 290(1)(a))
68. We have the following problems in applying these tests.
- None of the Regulations seem to us to prescribe a tax or taxes. The definition of tax in clause 301(1) covers virtually all UK taxes. Accordingly, as, for example, a FURBS can result in a saving of IHT a contribution to a FURBS will create a tax advantage if the clause 301(2) definition applies. On the other hand it seems that the definition does not apply automatically but will only do so if the Treasury prescribes it for the purpose of clause 290(1)(b).
 - We find it hard to envisage very many transactions that will be let out under the main benefit test as it looks at the benefit that might be expected to arise from the transaction to which the arrangement relates. For example, the main benefit of selling one's business is to realise the value of that business. If the purchaser wants to buy the shares in a family company instead of buying the business, whilst the main benefit of the sale remains to realise the value of the business the main benefit of the arrangement (i.e. that consists of selling the shares rather than the business) could be argued to be the obtaining of a stamp duty advantage for the purchaser, so a notification is needed.
- Regulation 2(1)*
69. Regulation 2(1) is presumably intended to be a prescription within Section 290(1)(b). If that is the case it should say so explicitly. We would welcome confirmation that arrangements which do not provide tax advantages in relation to income tax, corporation tax or capital gains tax will not fall within the new rules whether or not they provide advantages for the purposes of other taxes.

Tax Representation

Schedule Part 1 – Arrangements connected with employment

Paragraph 1

70. The wording of this paragraph should be amended. It refers to paragraphs 3 to 5 but it does so only in the context that an arrangement which involves one of the items listed in paragraphs 3 to 5 needs to be notified if it satisfies the conditions in sub-paragraph (2). However, paragraphs 3,4 and 5 contain exceptions. We accordingly believe that paragraph 1 needs to state at some point that it is subject to paragraphs 3 to 5 so as to provide for the benefit of those exceptions.

Paragraph 3

71. This seems to cover virtually any share issue even if the employee is taxed on the benefit that he receives. This is because Schedule 23, FA 2003 allows the employer a corporation tax deduction for the issue of shares and therefore the employer (being any other person) obtains a tax advantage (as defined in Regulation 1(2)) by reason of the employee's employment.

Paragraph 3(6)(a)

72. The words 'Schedule 5 to that Act' need to be clarified. We believe it is in fact referring to ITEPA 2003, not to either of the Acts specified in sub-paragraph 5 which is what we would imagine sub-paragraph 6(a) would, under normal circumstances, have been referring back to.

Paragraphs 3 and 5

73. Paragraphs 3 and 5 both contain an exclusion using the formula, or a variation of it, 'if the arrangement in its entirety constitutes ...'. There seems to be no exclusion where the arrangements fall entirely within exclusions found in more than one paragraph of the Schedule. For example arrangements where one part falls within paragraph 3(3) and another part falls within paragraph 5(2)(a). The wording should be amended.

Paragraph 4

74. This seems to catch all payments to funded unapproved retirement schemes (FURBS), even though such a payment triggers an income tax charge on the employee under the benefit in kind rules, because a pension fund pays tax at a lower rate than an ordinary trust. When the Government capped pension funds it said specifically that people could of course put extra money into FURBS, so presumably the Government regard FURBS as 'as good thing' and not as an avoidance arrangement. The wording should be amended so as to exclude them.

Paragraph 5

75. Is a short term loan to an employee payable out of future earnings, such as a season ticket loan, a notifiable transaction? It seems to us to defer the employees PAYE liability as he does not pay tax on the amount advanced until he would have received his normal salary payments, but he has the benefits of the amounts advanced earlier. We think such a loan should not be caught and we would welcome clarification.

Tax Representation

Schedule Part 2 – Arrangements in relation to financial products

Paragraph 6

76. It is difficult to see what the paragraph adds. At the meeting on 9 June the Revenue were suggesting that this test is intended to provide a 'safe harbour' and is therefore meant to be for the taxpayer's benefit. In practice it is likely to cut out so little, and at such great cost in terms of complexity, that it would probably be better to delete it entirely.
77. A proposal was made by the Representative Bodies at their meeting with the Revenue on 9 June that the formula should be discarded and the definition of tax advantage amended to include only advantages accruing within two years. We support that proposal.

Paragraph 7

78. The definition of 'user' is extremely wide. What does 'entering into arrangements' mean? Does it mean being a contracting party to them or simply being involved in their implementation? Even if it is the former, the definition will still be excessively wide if it is satisfied where a person is a contracting party to some but not all of the transactions constituting the arrangements. For example, a professional trustee company managing a trust as part of a set of arrangements which are notifiable may be a user for this purpose.
79. It is unclear whether the test is to be applied separately in relation to each user or in aggregate to all users. If in aggregate it is unclear how one is to deal with transactions between users; for example transactions which are a cost of one user and a benefit to another.

Paragraph 8

80. The use of hypothetical rates of tax here without any reference to the particular circumstances of the person concerned may result in a person being deemed to realise a tax advantage for this purpose when in fact he does not.
81. Consider also the following example. Mr A decides to make a gift in favour of his son and family. He could make a simple gift to the son. Instead, he decides to create a discretionary trust of which his son, his son's wife and his son's children and his remoter issue form the beneficial class. Had he made the outright gift the income would have been taxable upon the son even if the son had in turn spent that money for the benefit of his children. By making a discretionary trust, it is possible for the trustees to apply part or all of the income for the benefit of the son's children thus reducing the effective rate of income tax on the income. The son and father are to be the trustees of the trust and are parties to the deed.
82. The assets settled by the father include assets within paragraph 11. Both the father and the son are 'users' because they are persons who enter into the arrangement. In relation to the father, paragraph 6(2) is not satisfied because it is clear that the cost to him of the arrangements (the amount settled) would be greatly in excess of the tax benefit. The condition in paragraph 6(2), however, will be satisfied in relation to the

Tax Representation

son. There is no cost to the son of the arrangements whereas there is a modest tax advantage.

- 83. This assumes that the test is applied separately to each user. The point would seem to be good even if one were to look at all the users in aggregate.
- 84. It seems entirely inappropriate that a return should be required in such circumstances.
- 85. The example above illustrates one of the uncertainties of these rules. How is one to estimate the tax advantages which are to arise when they are dependent upon future uncertain events?

Paragraph 9

- 86. This illustrates the general difficulty of the cash flow approach underlying the formula to which we have already referred above. Acquiring a valuable asset (presumably for full consideration) does **not** confer an economic benefit in the normal sense of that expression. Paragraph 9 uses the term 'economic benefit' in a sense which is not defined and which is apparently intended to include many things which are not economic benefits, such as the receipt of the proceeds of sale of an asset or, at least in some circumstances, of the principal of a loan.

Paragraph 9(1)

- 87. If, as seems to be assumed, the receipt of a loan is to be regarded as an 'economic benefit', then the receipt of any loan is included in the calculation of B as a result of the general reference to 'economic benefits expected to be received' in the first line of paragraph 9(1). What, then, is the function of the reference in paragraph 9(1)(c) to a particular class of loans?

Paragraph 9(2)

- 88. The wording here is unclear and confusing. If you receive tax-free income (say 100), the economic benefit is the receipt of that income (still 100). The tax advantage is the fact that the income is tax-free (valued at 40 for an individual). We cannot see how it can be said that the economic benefit is also the tax advantage, though you could possibly say that it includes it.
- 89. The example of the cash ISA in the draft guidance illustrates the practical consequences of this confusion. The example excludes the whole of the interest income from B on the spurious grounds that it "is also the tax advantage". If the test is to have any sort of logical consistency, only the actual amount of the tax advantage should be excluded from B, leaving an economic benefit of 127.

Paragraph 10

- 90. It is unclear why the computation of C should be by way of an exclusive list whereas the computation of B in paragraph 9 is to be made by reference to a general principle expanded by specific inclusions.
- 91. The paragraph seems to assume that there will only be one user of any particular set of arrangements or proposal whereas it is clear that in most circumstances there will be several users.

Tax Representation

92. It is not clear why a fee which is subject to a contingency should be left out of account. If uncertain tax benefits are to be estimated, as they are under paragraph 8 why should not contingent costs be estimated under paragraph 10? Contingency fees should certainly be recognised to the extent that the contingency is expected to be satisfied within the one or two year period.
93. It is also unclear why only tax payable outside the UK is treated as a cost (sub-paragraph 1(c)). Since it is evidently intended that the 'economic benefit' is to be computed pre-tax, it is not clear why one should not deduct any tax actually payable on it as a cost, whether in the UK or overseas? In fact, the example on 'plain vanilla' leasing in the draft guidance does assume that UK tax is a cost, despite the absence of authority in paragraph 10.

Paragraph 11

94. The definition of a 'simple' loan is far from simple.
95. It is surprising to see the term 'deep gain securities' used. This is a term previously statutorily defined in legislation repealed as long ago as Finance Act 1996. It is not clear why the term has been used in the Regulations when it is then defined to be a modified version of the term 'relevant discounted security' which is the term which replaced deep gain security in the Finance Act 1996. A new term should be used. If this is not acceptable please clarify why the term was used.
96. The 'arms length' condition seems to be far too widely drawn. For example, if a person has an existing mortgage loan and the mortgagee makes a further advance to that person, the terms of the further advance will be affected by the amount of the original advance and the security previously given. So it will not have been made on terms which have been agreed by parties acting at 'arms length' in the absence of any other transactions forming a part of a series as required by paragraph 11(2)(a).
97. The extension of 'loan' to any combination of contracts has the effect that many transactions will be treated as loans which nobody would normally categorise as such, for example, a hire purchase transaction or entering into a finance lease. What is more, this provision does not identify the person who is entering into the arrangements.
98. Presumably any person that is a party to the transaction taking place under the arrangements is such a person. In that case, will not an insurance policy be a 'loan' for this purpose? The insurance company which is a party to the contract represented by the policy will account for its obligations under the policy as a financial obligation. We feel that the extension of the Regulations to '...other financial asset or obligation' will not only catch insurance policies but it will extend more generally to many other arrangements.
99. From all this it is clear that the category of asset labelled 'loan' is not restricted to assets which are loans in anything approaching the normal sense of that word.

Tax Representation

100. In paragraph 11(2) it is not clear why preference shares should be included in the list of specified financial products.
101. The final category is so widely drawn that it is very difficult to know what will fall within it and what will not. For example, is the issue for redeemable shares a contract which is in its substance the making of a loan? Is the settling of a trust of which the settlor is one of a class of beneficiaries and of which he is the sole trustee in substance the making of a loan? Both of these transactions are common transactions in business or personal life. If it is the intention to bring them into the scope of 'financial products' it would have been better to have done so directly.

Tax Avoidance Schemes (Promoters and Prescribed Circumstances) Regulations 2004 – section 291(3) FA 2004

General

102. It was pointed out in our representations on the Finance Bill that the definition of 'Promoter' is so wide that many persons will be deemed to be promoters of schemes who will not have the requisite knowledge to make the return required under these provisions. It is particularly disappointing, therefore, that only the most limited exclusion has been made under this regulatory power. In particular, a person can still be a promoter by reference to actions which do not involve the provision of taxation services.

Title and preamble

103. The draft instrument refers to the exercise of a power conferred by section 291(3) FA 2004. However, this needs to be amended as there is no such sub-section.

Draft Guidance

Paragraph 2.1

104. The guidance refers to the requirement that 'promoters' must provide details of certain defined schemes. As we have said, however, promoter has a specific statutory definition and it is quite clear that many people will be promoters in relation to tax planning strategies who would not be called 'promoters' in any ordinary use of that word. The danger of referring to promoters without pointing out that it has an extended and highly artificial meaning is that readers will assume that nothing that follows has any reference to them. The guidance should be redrafted to make it more helpful.

Paragraph 2.2

105. This states that 'in the majority of cases, taxpayers using the schemes and arrangements will only be required to include the reference number of the scheme on their tax return'. That ignores the duty to provide information under Clause 297(1) (b). We have already pointed out that the requirement to provide that information will impose an onerous duty to determine the matters in relation to which the information is required.

Tax Representation

Paragraph 3.1

106. One of the uncertainties about the test in Clause 290(1)(c) is the extent to which, where a number of transactions are planned together, one has to look at all of the transactions to decide what is the main benefit which one might expect from them or whether one can look at any one or more of them. This obviously is a question which has been important in relation to section 135, TCGA 1992 and it is one which requires comment in the draft guidance.

Paragraph 3.4

107. We have already pointed out that one of the problems with Clause 290(1)(c) is that it is neither a wholly-objective nor wholly-subjective test. This paragraph of the guidance notes gives one no help at all in dealing with the uncertainties raised by this clause.

Paragraph 4.3

108. In paragraph 4.3 it is stated that:

‘Organisation or management, however, does not include, for example, a bank or other financial service provider which in the ordinary course of its business provides an instrument such as a currency swap which is then used in an arrangement designed or marketed by another party.’

109. It seems to us extremely unlikely that this is an accurate statement of the law. A person is a promoter who satisfies certain conditions and is ‘to any extent responsible for’:

- (i) the design of the arrangements, or
- (ii) the organisation or management of the arrangements.

110. That is almost certainly sufficient to cover services provided by banks, trustee companies, financial advisers and those offering a financial execution service.
111. What the guidance may be trying to achieve is a distinction between banks which are actively involved in marketing a tax efficient funding structure and those that are simply providing funds which other advisers turn into a tax efficient product. If that is the case, and to clarify the point, banks should be added to the list of advisers mentioned in the first sentence of paragraph 4.3. It would then be clearer that the second sentence, which we have quoted above, is only a caveat to the basic principle.

Paragraph 4.5

112. In many circumstances, where the taxpayers concerned are high profile or have unique business features, it will be impossible to comply with the disclosure obligation without giving sufficient information for the client to be identified. For that reason these provisions strike at the heart of client privacy.

Tax Representation

Paragraph 4.9

113. This paragraph needs redrafting as it is misleading. The responsibility for making the return falls on all of the promoters. It is only when one of them actually does make a return that the rest are relieved from the responsibility of doing so. What is more, that only applies where the return made by the promoter complies with the detailed requirements for making a return. So a promoter may determine that a return has been made to the Revenue by another promoter but, for example, if that return does not adequately explain the significance of each step contained in the proposal, the promoter will not have been relieved of his duty to make a return. If the promoters are to rely on clause 292(4), therefore, they would have to engage professional advice to review the other promoter's return to ensure that it complied with the Tax Avoidance Schemes (Information) Regulations 2004 and would have to undertake due diligence to ensure that the factual description of the arrangements was correct for, as we pointed out in our representations on the Finance Bill, many persons who are promoters in relation to schemes will not have full information about them.
114. The result is that the exclusion in clause 292(4) is very limited and a promoter would be unwise to rely on it. This paragraph of the draft guidance should be redrafted to take account of the above concerns.

Paragraph 4.11

115. This paragraph provides a particular interpretation of what 'available for implementation' may mean. We are not convinced that the interpretation is correct. It should indicate that this is merely one possible interpretation and, if it is the Inland Revenue's view of the law, state that fact.
116. It seems to us doubtful that a scheme or arrangement is available for implementation simply when sufficient details are made available to a client to consider whether or not he wishes to implement that strategy. Tax planning strategies are often communicated to clients on terms whereby the client is prevented from implementing them unless the client enters into particular transactions with particular persons. It is arguable, therefore, that 'a notifiable proposal [is] available for implementation' when that transaction has been undertaken or alternatively, when the terms on which that transaction is to be undertaken have been agreed.
117. On the other hand, it is also possible to argue that there may be a notifiable proposal which is not in fact implemented by implementation of the notifiable arrangements. That is because clause 292(2) (a) does not speak of making 'a notifiable proposal to a person' but making 'a notifiable proposal available for implementation by any other person'. That seems to indicate that a pre-existing proposal is being made available to any person.
118. From that it might be argued that the proposal consists of a generic idea not its particular application to a client's circumstances. The Draft Guidance should consider these possibilities and indicate that the view which is taken in the draft is merely the Revenue's interpretation of legislation. Another area of uncertainty is whether communication to an adviser constitutes making 'a notifiable proposal available for implementation by any other person ...'. The communication to the adviser might be

Tax Representation

made without reference to any particular client or by reference to particular clients of the adviser. In the former case, it is likely to be made in order that the adviser can subsequently consider the relevance of the tax planning to his clients. Arguably, whether or not this involves making 'a notifiable proposal available for implementation by any other person' will depend upon whether or not the adviser is acting as the agent of his clients.

Paragraph 4.12

119. Again this is a mere expression of opinion about an uncertain matter.

Paragraph 4.13

120. While this may not be of assistance in every case, it does provide some guidance as to when schemes that are under discussion are not to be treated as 'available for implementation'.
121. A corollary of sub-paragraph (iii) would seem to be that if a presentation at a tax conference does go into the detailed mechanics of how a scheme would operate, as is quite common at public tax conferences, this would in the Revenue's opinion constitute a notifiable proposal. Does the Revenue really want to receive returns from lecturers at public tax conferences? If it does not then this should be amended.

Paragraph 4.15

122. This presumably refers to the provisions of clause 292(5). But the test of whether that section applies is whether or not notifiable arrangements are 'substantially the same' not whether 'there has been a fundamental change in the way in which a scheme operates'. If this is meant to be a gloss on clause 292(5) it is not a helpful one. The formulation in paragraph 4.15 appears to be an interpretation which is generous to the taxpayer. If that is the intention then this should be stated to be an extra statutory concession. If it is not, we cannot see how the change in wording makes the meaning of the provision any clearer.

Paragraph 4.16

123. The gloss here is of little practical use. By what principle is one to decide whether the return is in need of amendment?

Paragraph 5.1

124. Not only does the final sentence of this paragraph contradict paragraph 2.2 (see our comments above) but it also contradicts the first sentence of this paragraph itself. It needs to be amended.

Paragraph 5.17

125. This paragraph relates to the provisions of clause 293. As we have pointed out the relief from the duty to make a return provided by clause 293(2) is of very little use to the taxpayer. How is the taxpayer to know that the promoter has complied?

Paragraph 6.4

126. Is the phrase 'straightforward description' intended to be synonymous with the requirement of the Regulation that sufficient information is to be provided 'as will enable an officer of the Board to comprehend the manner in which the proposal is

Tax Representation

intended to operate ...' ? Describing the exact tax effects of even quite common tax planning transactions is often extremely complex. It may not be possible to give a 'straightforward' description in such circumstances and still conform to the requirements of the Regulations.

127. The Regulations refer to 'legal provisions relevant to the operation of that proposal'. But the guidance here refers to 'legal provisions relied on'. Please clarify that these are synonymous.

Paragraph 8.16

128. As we pointed out in our representations on the Finance Bill, although clause 290(1) (b) and the definition of 'advantage' in relation to tax contained in clause 301(1) are based on section 703, ICTA 1988, the saving proviso to section 703 which is based on a wholly subjective test is not reproduced. Instead clause 290(1) provides a partially objective and partially subjective test of considering what might be 'the main benefit, or one of the main benefits, that might be expected to arise from the arrangements ...'. As we said in our previous representations, this uncomfortable half-way house will cause considerable difficulties of interpretation.
129. This paragraph of the guidance notes illustrates the above difficulty. It simply assumes that the benefit concerned is a main benefit without explaining why that is. Let us consider a transfer of value to an employee of £10,000. If this is paid by way of salary the employee will pay £4,000 of tax on that amount.
130. If an arrangement is adopted whereby the employee receives a value of £10,000 without a tax charge arising, it is clear that under the section 703 definition of a tax advantage the condition in clause 290(1)(b) has been satisfied.
131. But is the tax advantage the main benefit or one of the main benefits of the transaction? The transaction has been undertaken to pass value to the employee. Even if it were to be done in a taxable form value of £6,000 would have been passed to the employee. By arranging it in a non-taxable form an additional value of £4,000 is passed to the employee. Is the tax saving of £4,000 a main benefit of the arrangements as a whole when it is only a minority part of the total benefits conferred?
132. How is one to distinguish a 'main benefit' from a mere 'benefit'. It is to be presumed that clause 290(1) refers to the expectations of the hypothetical reasonable man but it does so in relation to what main benefit might be expected to arise from the arrangements not as to whether a benefit is or is not a main benefit.

Paragraph 8.29

133. We find it difficult to understand this paragraph. Just imagine that £10,000 of income is received in a non-taxable form by a person who normally pays income tax at 40 per cent. The person has received a benefit of £10,000 from the income. Of that benefit only £4,000 relates to the tax advantage. So how can the economic benefit of the receipt of this income be said to be also the tax advantage? It may be partly composed of the tax advantage but that is a different thing. This is the point we have

Tax Representation

already made earlier in relation to paragraph 9(2) of the Tax Avoidance Schemes (Prescribed Descriptions of Arrangements) Regulations 2004.

Paragraph 8.36

134. Characterising deep gain securities for this purpose as loan agreements is misleading as evidenced by the inclusion of Capital Redemption policies in the list of assets which are deep gain securities. Capital Redemption policies are not loan agreements under the normal definition of the term. They are however deemed to be deep gain securities under the complex definition given in the Regulations. Having been deemed by the Regulations to be deep gain securities, they are further deemed to be loans. So the Guidance here is currently the wrong way around. Deep gain securities are not special forms of loan. Loans has an artificially extended meaning for the purposes of the Regulations to include deep gain securities which in turn has an artificially extended meaning to include capital redemption policies.

Paragraph 8.40

135. It is difficult to see how a 'sale of the right to receive any periodic payments' can in substance be the making of a loan. Surely the mark of a loan is that a capital sum is repaid, normally at the end of its life. It is difficult to envisage circumstances in which the sale of the right to receive any periodic payments can be anything else in substance than the sale of the right to receive any periodic payments.

Examples of Financial Products which qualify for disclosure

136. In the time available we have not been able to analyse the examples in detail and we are also aware, from the comments made by the Revenue at the meeting on 9 June, that some of the examples are not correct. Such comments as we feel able to make at this stage are included below.
137. The 'double benefit leasing' example seems to be inconsistent in its approach to the quantities T and C in the formula, in a way which illustrates the difficulties of interpretation which we have mentioned above. It treats the tax benefit as being the tax relief obtained for the 'capital' element (only) of the lease rentals. This is fair enough if one is measuring the 'benefit' by comparing the lease with a straightforward loan, tax relief being obtainable in either case for the loan interest or for the 'interest element' of the lease rentals. However if one is taking that approach the 'cost' of the leasing arrangement, to be taken into account in calculating C, should also surely be limited to the capital element of the lease payments: the interest element would be payable either way. (In fact the capital element would be payable either way as well, but that has to be included in C to balance the fact that receipt of the lease premium has been included in B.)
138. The example of the 'plain vanilla' lease gets into similar difficulties, only more so. Again the tax advantage is said to be the tax relief obtained for the capital element of the lease rentals, implying that the relevant comparison is with acquisition of the same asset funded by a simple loan. But if that is so it is not appropriate (and impracticable) to treat the income earned by using the asset as being the economic benefit of the arrangement. That income would be received regardless of the method of financing. The example also fails to mention the position in relation to capital allowances. The fact that these are not available to the lessee is a cost of the

Tax Representation

arrangement and should be included in C: if the definition in paragraph 10 of the schedule to the Regulations does not allow this, it should be amended so that it does.

139. The example of the cash ISA, which treats the whole of the cash invested as a 'cost', is a good illustration that the cash flow test applied by the formula is unworkable and needs to be revised. You can withdraw the cash from an ISA at any time so, for a start, many investors would have no way of estimating whether it is likely to be withdrawn within two years. Certainly the promoter would not. If, however, it is expected to be withdrawn within that time, the net cost of the arrangement becomes zero, and the formula condition is then satisfied. Now assume that the ISA deposit is at a variable rate, as most are, and not linked to a 'reference rate' (whatever that means: the term seems not to be defined). The deposit is then not a simple loan, and the arrangement is reportable. (The example, incidentally, is also defective in stating that the deposit is a simple loan without having even stated what its terms are.)

Disclosure Forms (Clauses 292, 293 and 294)

140. We would welcome clarification as to whether or not it is necessary to disclose a scheme by completing the Revenue's series of forms. If a promoter wants to send the Revenue the documentation rather than trying to summarise the arrangement, we believe he ought to be entitled to do so, provided such documentation contains all the information prescribed by Regulation 3 of the Information Regulations.

IY/FH
18 June 2004

THE TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM

The tax system should be:

1. **Statutory:** tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.
2. **Certain:** in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.
3. **Simple:** the tax rules should aim to be simple, understandable and clear in their objectives.
4. **Easy to collect and to calculate:** a person's tax liability should be easy to calculate and straightforward and cheap to collect.
5. **Properly targeted:** when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.
6. **Constant:** Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.
7. **Subject to proper consultation:** other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.
8. **Regularly reviewed:** the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.
9. **Fair and reasonable:** the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.
10. **Competitive:** tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.