STRENGTHENING TAX AVOIDANCE SANCTIONS AND DETERRENTS: A DISCUSSION DOCUMENT

ICAEW welcomes the opportunity to comment on the discussion document *Strengthening Tax Avoidance Sanctions and Deterrents* published by HM Revenue and Customs on 17 August 2016.

This response of 12 October 2016 has been prepared on behalf of ICAEW by the Tax Faculty. Internationally recognised as a source of expertise, the faculty is a leading authority on taxation. It is responsible for making submissions to tax authorities on behalf of ICAEW and does this with support from over 130 volunteers, many of whom are well-known names in the tax world.

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INTRODUCTION

1. ICAEW welcomes the opportunity to comment on the discussion document *Strengthening Tax Avoidance Sanctions and Deterrents* published on 17 August 2016.

2. We are pleased to participate in this consultation and for the opportunity to meet with the relevant team from HMRC's counter avoidance directorate.

MAJOR POINTS

ICAEW recommendations for improving these provisions

3. We support the Government taking action against the intended target of those who exploit the UK tax system in ways Parliament never intended, but we believe that the proposals as currently drafted are far too widely targeted and could catch ordinary commercial transactions and damage the UK as a place to transact business.

4. The proposals need to be revised so that they are clearly targeted at the small but persistent minority engaged in exploiting the UK tax system in ways not intended by Parliament. We believe that the proposals can be significantly improved to achieve this aim and we have five practical recommendations which are summarised below.

    1. The definition of 'enablers' should be amended.
    2. TAARs should be removed from the definition of 'relevant defeat' but if they are to be retained only specific TAARs should be included.
    3. The proposed penalties should be recalibrated.
    4. There should be improved safeguards including a defence of 'reasonable excuse'.
    5. The impact of the new provisions should be on prospective, future, advice and not affect advice that has already been given.

ICAEW support for tackling those who exploit the UK tax system

5. ICAEW supports the government's efforts to combat aggressive tax avoidance which undermines the integrity of the UK tax system.

6. We have, for example, supported the introduction of a General Anti-Abuse Rule (GAAR), enacted in 2013, but for which there have so far been no referrals to the GAAR Advisory Panel.

7. We have in the recent past made constructive comments on the proposals, now enacted, in relation to Promoters of Tax Avoidance Schemes (POTAS) and Accelerated Payment Notices (APNs) which in the words of the government have changed the economics of tax avoidance.

8. All these legislative changes, plus the reputational risk that businesses face if they engage in unacceptable tax avoidance measures, has changed the landscape of what is, or is not, acceptable tax behaviour.

9. This is the current situation as far as reputable tax advisers are concerned who are members of a professional body that has signed up the Professional Conduct in Relation to Taxation (PCRT). We believe that the proposed measures and sanctions suggested in this document do not take proper account of the changes that are being made to the PCRT as a result of the 19 March 2015 challenge and in particular the new standards that are included in it.

10. These changes should help to address any remaining problems and behaviours in this area among those who are members of professional body that has signed up to the PCRT. Further, we would mention that where HMRC identifies potential misconduct by a member of a professional body, it is able to report that to the professional body concerned under the 's

20 gateway'. We believe this provides a valuable route to ensuring high standards and reducing the incidence of poor behaviours and are continuing to work with HMRC to improve the operation of the gateway and ensure that referrals are made where appropriate.

11. If the government continues to have concerns about parts of the tax advice market place that continue to engage in egregious tax behaviours of the sort identified in this latest consultation document, we believe that efforts should be concentrated on how offshore promoters can be dealt with and also those who do not subscribe to professional behaviours and codes such as the PCRT.

12. Any further measures to address this problem and the risk it poses to the public finances must identify the nature of the risk and clearly identify the intended target of the proposed measures, namely the small but persistent minority engaged in exploiting the tax system in ways that Parliament never intended.

13. These latest measures also need to be assessed in the context of the changing UK tax scene. There have been constructive changes to the UK tax system over recent years to make it attractive for UK business and for businesses thinking of coming to the UK or expanding their existing UK operations and we are concerned that the latest proposals, in their current form, will undermine the positive message that the UK is open for business and are also likely to stop ordinary commercial activity and thereby hinder growth.

What are the continuing problems?

14. We believe that the proposals set out in the consultation document do not recognise that there is now a much more limited target area for egregious tax behaviours which need to be curtailed.

15. In principle reputable advisers such as chartered accountants should be supporting the government and HMRC's efforts to drive out those who exploit the UK's tax laws in ways never intended by Parliament.

16. We agree with the government that there remains a legitimate concern about a 'small but persistent minority' (to quote the Minister in the foreword to the consultation document) engaged in exploiting the tax rules in ways Parliament never intended and that such behaviours need to be discouraged and, where appropriate, penalised.

17. However, as drafted these measures are too widely targeted and far beyond the stated target of a small but persistent minority who exploit the tax rules in ways Parliament never intended. These proposals will include a much wider group, including reputable advisers giving professional advice on tax law. At the same time, given the intended target, we are not convinced that these measures will be an effective weapon against them.

18. Reputable tax advisers subject to professional codes of conduct such as the PCRT help make the tax system work and improve tax compliance by helping to ensure that taxpayers make correct and complete returns and pay the right amount of tax at the right time. The vast majority of tax advisers and agents are in this category and will support reasonable measures to stop the activities of the small but persistent minority engaged in exploiting the tax system. To gain the support of the vast majority, it needs to be made clear that this measure is not aimed at them and that the measure will help support them in performing their role of improving tax compliance and helping to make the tax system work.

19. There is a serious danger that these measures could be counter-productive, driving up compliance costs and reducing tax compliance as taxpayers are not able or willing to seek to seek tax advice, for example in areas where the law may be uncertain and they need to know where they stand. The wide-ranging nature of the provisions are likely to make it far more difficult for businesses to obtain professional tax advice on proposed transactions as well as impacting on other related activities, including the availability and cost of financing.

These measures could therefore run counter to the message that the UK is 'open for business' and may result in a reduction in growth and investment in the UK.

20. Therefore, while we support the policy purpose the government is aiming to achieve, we cannot support these measures as drafted because they have the ability to turn almost all tax advisers into 'enablers' and therefore liable to penalties. The proposals need to be significantly amended to reflect, more accurately, the nature of this continuing problem and provide an appropriate means of dealing with it.

Can the proposals in the consultation be better targeted?

21. We believe that many 'enablers' who are the real targets of these latest proposals are now operating offshore, thereby outside the reach of the UK and unlikely in practice to be subject to these rules. There is a serious danger that these measures will have the effect completely opposite to the policy intention – namely driving aggressive tax avoidance either completely offshore or 'underground'.

22. Hence the need to have an approach which targets the users of arrangements put in place by offshore promoters and enablers. These new proposals would not affect offshore enablers who would remain outside HMRC's influence. This may encourage the very advisers and financers of avoidance arrangements, that HMRC is seeking to influence with these proposals, to move offshore, thus making it more difficult for HMRC to successfully tackle tax avoidance. The Government may need to consider other approaches to target this group, for example by perhaps levying any penalty directly on the taxpayer who engages them.

23. Chapter 3 of the consultation document considers how to create penalties for those who use tax avoidance which is defeated and we believe that this is a constructive approach and we set out our thoughts in relation to questions 10 to 12 which deal with the proposals in chapter 3.

Targeted anti-avoidance rules (TAARs)

24. Paragraph 4.5 bullet four of the consultation document states that arrangements will be 'defeated tax avoidance' if they 'have been subject of a targeted avoidance-related rule or unallowable purpose test contained within a specific piece of legislation or regime'. The UK tax legislation contains many such examples, we have heard it suggested that there are more than 400 TAARs in the UK tax legislation, and they are usually very widely drafted and the application of them subject to considerable uncertainty. There is often very little guidance on how they will be applied and often they operate on the basis of 'taxed according to the law and untaxed by (HMRC) concession.

25. In many ordinary commercial transactions tax advisers will need to consider the application of one or more TAARs. Given that they are very widely drafted and open to considerable uncertainty as to their application, the adviser may not be able to conclude with complete certainty that a TAAR will not apply. We therefore do not believe that they are a suitable test for the purposes of this provision.

26. We do think that those who fall foul of many of these provisions are the genuine target of these latest proposals.

27. Given we now have the GAAR which is designed to tackle abusive tax avoidance arrangements, we question whether it is appropriate for the test to include reference to TAARs. If it is to do so, we recommend that if TAARs are to be retained then only a limited number of TAARs, which would be specifically identified, should trigger a 'relevant defeat' as in paragraph 4.5 of the consultation document.

Penalties

28. We believe that penalties should not be linked to 100% of the tax advantage sought and that it would be more appropriate to determine any penalty by reference to the fee charged for the advice given.

Definition of 'enablers'

29. We should like to work with government to ensure that the definition is appropriately targeted and that the law is, as stated in paragraph 2.14 'specifically tailored to the avoidance supply chain and [ensures] that appropriate safeguards are included to exclude those who are unwittingly party to enabling the avoidance in question.'

30. In the context of the offshore tax evasion legislation, set out at paragraph 2.12, the targeted adviser is 'providing planning and bespoke advice on the jurisdictions, investments and structures that will enable the taxpayer to hide their money and any income, profit or gains.'

31. But that is likely to involve tax evasion, rather than tax avoidance, and the current legislation needs to reflect the fact that it is seeking to counter what is considered to be unacceptable tax avoidance and ensure that it is properly targeted. Currently we believe it is far too widely targeted and could apply to a wide variety of intermediaries. To illustrate the potential wide scope of enabler, we have heard reports that even banks are concerned that they could be classed as enabler where they did no more than open a bank account for a taxpayer and were operating within the banking code of conduct.

A 'reasonable excuse' defence

32. There is discussion in chapter 3 of reasonable care in the context of the users of tax avoidance and we believe that there need to be appropriate 'reasonable excuse' safeguards put in place for enablers.

33. We think this defence could be linked to the behaviours expected under the PCRT of a professional tax adviser advising in this area. The PCRT sets out extensive guidance of what is expected from members when advising in this area. For example, a professional tax adviser would be expected to provide any advice based on a realistic assessment of the facts and circumstances of the client, explain the choices available to clients under the law and highlight the tax risks associated with those choices, together with ensuring that proper disclosure is made to enable HMRC to understand the facts and the tax position adopted. We believe that this type of professional behaviour should be encouraged and that those who operate within the PCRT should have a 'reasonable excuse' defence.

From what date should the new legislation be introduced?

34. We believe that the new legislation should come into effect at the earliest from the date of Royal Assent to the legislation so that past and current advice is not impacted.

35. The potentially severe penalties envisaged in the consultation document would, we believe, make the current proposals in breach of the European Convention on Human Rights.

36. We raised this point about the start date for the proposed new legislation at a meeting with HMRC on 13 September 2016 and subsequently received an email from HMRC's Counter Avoidance team as follows:

> *'*Some respondents have asked for clarification about the date from which the proposals would take effect. The policy is intended to change future behaviour. The date at which any legislation would take effect will be decided by Ministers in due course within the usual tax policy making and legislative process.'

37. We support this view and believe it should be formally published.

38. We trust that the human rights issues will ensure that the government will accept that any new law can only apply to future actions, advice etc.

SPECIFIC ANSWERS TO DETAILED QUESTIONS

Q1 – How far do the descriptions of enablers of offshore tax evasion also represent those who enable tax avoidance? What changes to these definitions would be needed to tailor them to tax avoidance?

39. For reasons set out in our general remarks above we believe the definition is too wide and would potentially catch people who are not the legitimate target of this new legislation.

40. If the wide definition of 'enablers' covers other advisers perhaps involving financing issues or company formation then not only would this appear to be far beyond the main aim of the legislation but such advisers would not be in a position to assess the tax implications of any proposed arrangements.

41. It will also potentially catch a group of separate advisers brought together to advise on the various aspects of a particular transaction/proposition.

Q2 – Are there other classes or groups of person who should be included in, or specifically excluded from, the definition of enabler?

42. See our answer to question 1.

43. We think the target for the proposed new legislation should be cut back.

44. We believe that there should be a specific exclusion for auditors.

Q3 – The government welcomes views on whether this approach is the right scope for a penalty on those who enable tax avoidance which HMRC defeats.

45. We recommend that the government recasts the penalty proposals as at the present time many of those proposed would amount to criminal sanctions even though they may not be so described in the UK legislation.

Q4 – The government welcomes views on whether a tax-geared penalty is an appropriate approach.

46. We urge the government to reconsider the merits of a tax-geared penalty. We believe that this would not be appropriate.

Q5 – How should the penalty regime apply where a scheme has been widely marketed? What safeguards might apply in these circumstances?

47. If the penalty regime is based on the fees earned by the 'enabler(s)', as is done in equivalent regimes in the US and Australia, this would provide an appropriate cap to the penalty.

Q6 – Views are welcome on whether Schedule 36 would provide an appropriate mechanism to identify enablers of tax avoidance or whether a stand-alone information power would be more appropriate.

48. We believe that Schedule 36 provides adequate information powers.

Q7 – Would safeguards similar to those in Schedule 24 to the Finance Act 2007 be appropriate?

49. We think that before a penalty can be imposed there should be the opportunity to engage an independent oversight panel with members drawn from within and outside HMRC to ensure that the approach adopted by HMRC is consistent and reasonable.

50. An alternative option is to model this on the DOTAS rules so that any penalty can only be imposed by the Tribunal. Indeed, it should still be possible to appeal any panel ruling to the

Tribunal. In addition, there are two potential issues here if the definition of 'defeat' remains as proposed (see Q13 below): the enabler may be unaware of the settlement by the taxpayer, or less scrupulous enablers may seek to dissuade taxpayers from settling with HMRC voluntarily before it is proven whether the scheme achieves its aims.

Q8 – To what extent would the approach taken in DOTAS be appropriate to exclude those who unwittingly enable tax avoidance from this new penalty? And, what steps should an agent take to show that they had advised their client appropriately?

51. The approach in this case needs to be somewhat different from that under DOTAS where one is seeking to exclude those who could not reasonably be considered to be promoters. In this case one is seeking to exclude those people who could not reasonably be expected to have assisted or have known that they were assisting in the tax avoidance. For instance a company formation agent will have been engaged to form a company and any fees they receive will reflect that limited activity.

52. We believe that advisers who just prepare returns and who were not involved in the scheme's design or implementation should not be an enabler. We also note that the discussion, in paragraph 2.30, of the work undertaken by a tax agent in relation to assistance in filing his clients' tax returns may have misunderstood the nature of the work undertaken. A tax agent does not perform an audit of the information and data contained in the tax return.

53. A professional adviser with one of the bodies signed up to the PCRT rules will need to apply the Code (see in particular paras 4.49 to 4.51) and form a judgment about the scheme and also consider what disclosures need to be made. However, we do not think that generally a tax return preparer following professional standards should be faced with a penalty as an 'enabler' and to put them in line for a potential penalty is likely to increase tax compliance costs or, more likely, discourage taxpayers from seeking professional advice in submitting their tax returns. The end result might be a reduction in compliance.

Q9 – We welcome views on whether these safeguards are appropriate, and what, if any, other safeguards might be needed.

54. We can see the merit of capping the penalty when the taxpayer is caught under more than one regime but the penalties in each regime need to be appropriate and proportionate and we have concerns about the level of penalties currently proposed under this enabler regime.

Q10 – To what extent would defining what does not constitute reasonable care enable HMRC to more effectively ensure that those engaging in tax avoidance schemes that it defeats, face appropriate financial penalties?

55. The definition of reasonable care will be very important to the integrity of this new regime but it is equally important that the level of the penalties is proportionate. The matters considered here recently received similar consideration in advance of the enactment of the Serial Tax Avoidance legislation in FA 2016. The FA 2007 legislation is yet to be tested by the Tribunal in relation to tax avoidance schemes: all cases to date such as *Litman & Newall v HMRC* [2014] UKFTT 89 (TC) are based on the pre-FA 2007 rules. It is therefore too early to identify any specific weaknesses with the definition of reasonable care in this legislation or to identify any material benefits to be obtained from any proposed changes to the rules.

56. If the government does feel it necessary to update the legislation at this early stage then the changes should mirror those in the Serial Tax Avoidance legislation which expects taxpayers to take bespoke advice (e.g. ensure that counsel's opinions take into account their own specific circumstances). Mirroring in this way would avoid there being more than one test for similar points in different parts of the tax legislation. It would also be simpler for taxpayers to understand which is one of the principles behind the design of penalty legislation. Care should be taken to ensure the reasonable care test is not set too high here and to ensure it can be flexed based on taxpayer's abilities.

57. The second, third and fourth bullet points under paragraph 3.22 of the consultation document would not provide good tests of reasonable care for the following reasons.

- Advice is often taken based on incomplete facts at an early stage in planning for a commercial transaction. The response to that initial advice then involves refining the plans etc. e.g. whether to sell shares in a company or its assets i.e. planning is often iterative.
- Advice is often paid for by the accountancy firm instructing tax counsel and the fees are onward charged to the client for convenience. This is not a hallmark of poor advice.
- Material can be produced by many parties who are not tax advisers, including printers – this seems to be out of the scope of what HMRC actually intends to affect.

Q11 – We welcome views on the extent to which placing the burden on the taxpayer to demonstrate they have taken reasonable care would ensure that appropriate penalties are charged in cases of avoidance which is defeated by HMRC?

58. We believe that the measures that the government has introduced in recent times to combat unacceptable tax avoidance has driven many of those engaged in this activity offshore, thus making it much more difficult for HMRC to target them. We are concerned doubt that any changes to imposing penalties on this target will have little the rules would make much if any practical impact on them and the Government might need to explore other ways of getting at them, for example by perhaps imposing penalties directly on taxpayers who use them.

59. More generally, we believe that HMRC already has sufficient powers – it just needs to use them effectively. HMRC has information powers in Sch 36, FA 2008 to get information from taxpayers to enable it to assess a penalty, and penalties can be charged if the information is not provided. HMRC should make proper use of its existing information powers before charging penalties.

Q12 – To what extent will these changes better ensure that those engaging in tax avoidance which is defeated by HMRC face financial penalties?

60. In the view of HMRC such people can currently escape detection so any regime is likely to be more successful but the real question is about the appropriateness of the proposals themselves.

61. As stated above, a major problem arises in that many of those engaged in promoting tax avoidance are based overseas and are beyond HMRC's reach. These proposals will not alter that fact. There is a real danger that such promoters will continue to operate and drive such behaviour 'underground'.

Q13 – Do you agree that this approach to identifying defeats of arrangements to which this measure should apply is appropriate?

62. No. We think the definition is too wide.

63. We have recommended that TAARS should be dropped from the list or, if they are to be included, only a limited number of defined TAARs should be included.

64. To give up the argument would mean, under current proposals, that the agreement not to continue would be treated as 'defeated tax avoidance'. Penalising enablers when taxpayers exit for such reasons appears unfair – the defeat should only happen if the arrangements are defeated by the courts, a follower notice is issued or a GAAR counteraction notice is issued.

65. There are many reasons why taxpayers might decide to exit arrangements, even where they have a reasonable chance of success. Many taxpayers exit via contract settlements or settlement opportunities for various reasons unrelated to the likelihood of the arrangements success e.g. wish to remove any uncertainty prior to the sale of a business, when a taxpayer is terminally ill or simply when they wish to avoid the costs of any litigation related to the arrangements. We therefore do not think that as a general principle this should amount to a

'relevant defeat'. We agree that taxpayers should be encouraged to settle cases but this provides a perverse incentive for advisers to carry on a dispute when for commercial or other reasons it would not make sense to carry on.

Q14 – Do you agree that more 'real-time' interventions, targeted at particular decision points, could sharpen enablers' and users' perceptions of the consequences of offering/entering into tax avoidance arrangements?

66. We appreciate that the new legislation will work best if it provides an appropriate deterrent to prevent taxpayers entering into unacceptable tax avoidance arrangements before they do so. But there needs to be more clarity about what sort of arrangements are in contemplation: the first two items mention arrangements without any definition as such or reference to other regimes, such as DOTAS, where relevant terms are defined.

67. It is important to remember that merely because something is notifiable under DOTAS does not mean that it fails or is 'unacceptable tax avoidance'. Also, an adviser may notify something to HMRC but it may then decline to provide an SRN.

Q15 – Could any of the options above create effective, proportionate incentives for users and enablers to change behaviour? Are there other, better ways to achieve the behavioural change government is looking for?

68. The combination of the Serial Tax Avoidance rules, existing penalty for error rules, APNs and Follower Notices plus the GAAR rules, already create a significant deterrent effect and we believe that as a consequence the incidence of aggressive tax avoidance of the type which these proposals are designed to stop has reduced. Given that much of this now appears to take place offshore or in the unregulated market, we are not convinced that further measures would be effective, and the existing rules are already pretty broad in scope. The existing suite of rules need to be given chance to 'bed in' and a full assessment undertaken of their effectiveness.