STRENGTHENING THE TAX AVOIDANCE DISCLOSURE REGIMES FOR INDIRECT TAXES AND INHERITANCE TAX

ICAEW welcomes the opportunity to comment on the consultation document *Strengthening the Tax Avoidance Disclosure Regimes for Indirect Taxes and Inheritance Tax* published by HM Revenue & Customs on 20 April 2016.

This response of 12 July 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. Appendix 1 sets out the ICAEW Tax Faculty's Ten Tenets for a Better Tax System, by which we benchmark proposals for changes to the tax system.

We should be happy to discuss any aspect of our comments and to take part in all further consultations on this area.

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ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value.

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MAJOR POINTS

Key point summary

1. We continue to support the government's efforts to challenge tax avoidance which seeks to achieve unacceptable tax savings in ways which were clearly not intended. Similarly, we continue to support the government's efforts to ensure that, through the DOTAS regimes, it can obtain contemporaneous information about tax avoidance schemes to ensure that it can take action against those schemes which it considers to be unacceptable.

2. We believe that in the case of inheritance tax, there is a need for the legislative provisions to be more comprehensive and detailed in order to avoid unnecessary disclosure. Alternatively if the current proposals are retained, in order to make the rules operate in a more focussed manner, there needs to be a more extensive list of excepted arrangements than currently proposed.

3. We also see a role to be played through the publication of detailed DOTAS guidance and would request that this is circulated in draft to various professional bodies such as the Tax Faculty of the ICAEW prior to the new rules coming into effect. This is to ensure that the new DOTAS regime for inheritance tax begins its operation as smoothly as possible.

General comments

4. The Disclosure of Tax Arrangements (DOTAS) regime was introduced in 2004, with the VAT Disclosure of Avoidance Schemes (VADR) being introduced at the same time. The ICAEW continues to support the government's efforts to limit the spread of unacceptable tax avoidance, as well as the use of the DOTAS and VADR regimes to obtain contemporaneous information in order to challenge such arrangements.

5. We believe that the operation of the regime should be made more efficient so that disclosure will result in HM Revenue and Customs receiving disclosure of potentially abusive tax avoidance schemes rather than receiving a large number of disclosures which are of no interest or relevance to them.

6. As part of a continuing process of updating these tests the government published a consultation in July 2014 entitled "Strengthening the Tax avoidance Disclosure Regimes". This recognised that very few disclosures had been received in relation to inheritance tax owing to the very narrow way that the hallmark introduced in 2011 had been drafted. In the light of this, proposals were made to widen their scope. The Tax Faculty of the ICAEW, together with other commentators and professional bodies, expressed concern that the proposed hallmarks were too wide, and would require the disclosure of some legitimate and non-abusive use of reliefs. In acknowledgement of these concerns the government published revised hallmarks on 2 February 2016, and this tax representation is in response to the new proposals.

7. The revised draft retains the informed observer test, and Condition 1 has not changed significantly. Condition 2 in the previous draft regulations has been removed. The previous Condition 3 is now effectively new Condition 2. As a result of these changes the revised conditions, both of which have to be met, are:

7.1. Condition 1 - the main purpose, or one of the main purposes, of the arrangements is to enable a person to obtain a tax advantage, and

7.2. Condition 2 – the arrangements are contrived or abnormal or involve one or more contrived or abnormal steps without which a tax advantage could not be obtained.

8. Undertaking any form of estate planning necessarily involves seeking to achieve tax savings, which means that all forms of inheritance planning will necessarily satisfy Condition 1. It is at this stage that Condition 2 should apply to narrow the number of cases where disclosure is required, but unfortunately the way that the condition is currently worded does not permit this.

9. We recognise that Condition 2 has been adopted in an attempt to introduce a degree of consistency across the various hallmarks. Unfortunately it is not appropriate here; there is no commercial benchmark as regards the making of gifts or trusts, whether during a person's lifetime or arising under their Will. This makes it very difficult to identify when an arrangement transitions from being 'normal' to being contrived or abnormal either by reference to its nature or the steps undertaken. Moreover, circumstances will change from one person and one family to another. Except as regards either very artificial schemes, or the most basic planning arrangements, estate planning arrangements are tailored to the circumstances of those involved. Seeking to apply a test of whether planning measures are contrived or artificial, is virtually impossible to apply in a meaningful way in such a context because of the degree of variation involved.

10. Equally there is a timing issue that is relevant to the operation of the DOTAS regime as it applies to inheritance tax. Wills are drawn up and modified often over long periods of time. They sometimes include additions being made to various settlements that have been established during a person's lifetime, the terms of which will similarly change. It would appear that the effect of the rules has to be considered at each stage that changes are made to the Will and related entities. This places quite a burden on those involved, especially as the changes involved are often of a highly personalised nature specific to the nature of the assets held.

11. Accordingly, our concern is that the proposed hallmarks in relation to inheritance tax are still too wide. They could be further narrowed by making the provisions more detailed, thereby adding legislative colour to their terms, as well as being made more comprehensive, or by extending the number of excepted arrangements if the current proposals are to be retained.

12. As a matter of policy we believe that tax rules should be set down in clearly drafted principles based legislation. We also consider that there is a place for detailed guidance issued by HMRC. In this case we would welcome the issue of detailed guidance rather than guidance with high level examples. We would also welcome the opportunity to comment on such guidance in draft, together with other professional bodies. This is to ensure that the new DOTAS regime for inheritance tax begins its operation as smoothly as possible.

13. We would also like to highlight the need for guidance to be issued no later than at the time any new regulations become law. This practice has not been followed, for example, in relation to the recent publication of the hallmarks relating to financial products. This has caused quite serious difficulties for some of our members to whom the hallmarks are more directly relevant causing increased expenditure of time and resource in an attempt to comply with the new rules. This represents an additional business cost which could be avoided by coordinating the issue of any regulations with the entry into force of any new regulations.

14. We would like to conclude by saying that it is now more important than ever that great care is given to the drafting of hallmarks. In light of the various other provisions which now turn on DOTAS (APN's, POTAS etc) there are potentially severe consequences for advisors arising from both incorrect disclosure and incorrect non-disclosure. It is therefore imperative that the legislation is clear and targeted. Clearly drafted legislation will ensure a level playing field for all advisors and a consistency of application.

15. Inheritance tax (IHT) and VAT are dealt with by different teams in the Tax Faculty, and we are sure it is the same at HMRC, and as such it would have been administratively simpler to have had separate consultations for the two taxes.

RESPONSES TO SPECIFIC QUESTIONS

VADR – Disclosure of avoidance schemes

Q1: Do you agree that reforming VADR in this way would provide a clearer and more timely picture of the nature and extent of avoidance?

16. We broadly agree. However, there will need to be a time specified within the legislation to clarify when a disclosure should be made. A mere discussion of ideas in relation to an imminent transaction should not of itself require disclosure. Under current rules a notifiable scheme is one which is either a designated scheme or one which includes a hallmark of avoidance and has as its main purpose the obtaining of a tax advantage. Under a system requiring promoters to disclose arrangements it would ultimately depend upon which arrangements a promoter would be required to disclose and by what date.

Q2: If you disagree, what suggestions do you have for reforming VADR so that it provides HMRC with a clear and timely picture of the nature and extent of avoidance?

17. We agree.

Q3: To what extent do you think the DOTAS rules on who is a promoter and circumstances when a scheme user has to disclose an avoidance scheme would be effective in a revised indirect tax disclosure regime?

18. We believe that this would be equally effective to how it is for direct taxes as far as promoters are concerned.

Q4: To what extent would the DOTAS 'benefit' test be a clearer and more objective test for disclosure of indirect tax avoidance schemes?

19. It is easier to establish whether or not a tax benefit has actually been obtained than it is to decide if it was the intention to obtain one. As such, we agree that the proposed change is sensible.

Q5: To what extent would removal of turnover thresholds ensure HMRC is more fully sighted on VAT avoidance?

20. If the requirement to disclose an avoidance scheme is placed upon promoters, then a turnover limit is unnecessary, as the promoter should be required to make the disclosure regardless of the turnover of its client.

21. However, we do not believe that individual small businesses should be required to make their own disclosures, as many small businesses acting without an adviser would be unaware of their requirement to make a disclosure and less likely to engage in an activity that required disclosure. A turnover limit for self-disclosure would therefore seem to remain appropriate.

Q6: To what extent should a revised indirect tax disclosure regime place reporting obligations on VAT non-taxable persons?

22. Similar to small businesses, as above, we do not believe that individual non-taxable persons should be required to make their own disclosures, as such businesses acting without an adviser would be unaware of their requirement to make a disclosure and less likely to engage in an activity that required disclosure. If they use an adviser, then the promoter of the scheme should be required to notify its use, regardless of whether or not the user is a taxable person.

Q7: How should users of VAT avoidance schemes who are not registered for VAT, and who receive a scheme reference number from the promoter, be required to notify HMRC when they use such schemes?

23. Ideally, there should be no requirement for such users to notify HMRC, assuming that HMRC has received notification from the promoter. However, we accept that it may be necessary for an unregistered user to notify in certain circumstances, in which case this should be by letter when first using the scheme. In any event, we believe that such notifications should be subject to the same turnover limit as per question 5 above.

Q8: Should the indirect tax disclosure regime adopt the DOTAS definition of tax advantage for VAT or should it retain the current definition, suitably adapted to cover non-taxable persons?

24. We believe that the indirect tax disclosure regime should retain the current definition from the VADR regime with the addition of the DOTAS condition regarding the avoidance of any obligation to deduct or account for tax.

Q9: Do you believe that penalties for failure to comply with obligations under the indirect tax disclosure scheme should be the same as those applied under DOTAS? If not, please explain your reasons and explain what penalty structure would be more appropriate.

25. If the list of disclosable schemes becomes redundant, then so will the 15% penalty applicable to those schemes, leaving only a flat £5,000 penalty for hallmark schemes. We believe that any penalty should be more aligned to the potential tax saving. Therefore, the DOTAS rules appear to be more appropriate.

Q10: Which DOTAS hallmarks do you believe are suitable for an indirect tax disclosure regime? Would these hallmarks require any modification to work effectively for VAT arrangements, and if so how should they be modified?

26. We believe that the confidentiality, premium fee and standardised tax products hallmarks are as appropriate for VAT as they are for direct taxes.

Q11: Which of the current VADR hallmarks should be retained in a reformed regime? What further hallmarks or features of schemes should be added?

27. We believe that it would be appropriate to retain the following hallmarks for the current VADR regime:

- Prepayments between connected persons
- Funding by loans, share subscriptions or subscriptions in securities
- Off-shore loops
- Property transactions between connected persons
- Issue of face-value vouchers

Other indirect taxes and duties

Q12: Do you see any reason why gambling duties and IPT should not be brought within the scope of VADR, revised as proposed in this consultation?

28. We are unable to comment on this question.

Q13: Do you agree that indirect taxes should be included within the scope of the proposed revised VADR? What further changes would be required to include these regimes? 21

29. We are unable to comment on this question.

Q14: Which hallmarks do you believe are suitable for VAT and for IPT and gambling duties? Would these hallmarks require any modification to work effectively for arrangements in these taxes, and if so how should they be modified?

30. We are unable to comment on this question.

Q15: Would these 'generic' hallmarks also be suitable for other indirect taxes? If not, what changes do you believe would be needed to make them effective?

31. We are unable to comment on this question.

Q16: What further hallmarks are required to ensure avoidance risks specific to these taxes properly addressed?

32. We are unable to comment on this question.

Q17: Do you agree that the DOTAS definition of tax advantage is appropriate for indirect taxes other than VAT? If so, does it need to be modified for any of the taxes?

33. We are unable to comment on this question.

DOTAS and inheritance tax

Q18: Do the revised Conditions 1 (tax advantage a main purpose) and 2 (contrived or abnormal arrangements) target the hallmark appropriately and ensure that ordinary tax planning arrangements are not caught, whilst ensuring that IHT avoidance is disclosed?

34. The proposed filters are still extremely wide, and this will necessarily result in a lot of unnecessary disclosure being made. In order to avoid this, it is proposed to make it easier for advisers to identify cases where disclosure is needed through the use of high level examples in the DOTAS guidance. We are generally opposed to this trend as it places too great an emphasis on guidance instead of a principles based legislative approach which is sufficiently clear in itself to permit correct decisions to be made. In addition we think that there should be an extended list of excepted arrangements in order to help practitioners identify the cases that HMRC really want to be disclosed.

35. Regarding the detail of the current proposed wording:

For the purposes of IHT planning, Condition 1 is always likely to be in point no matter how benign the arrangements are so is not a filter in real terms. This is due to the nature of the tax itself rather than an indication of undesirable taxpayer behaviour. For example, executing a Will to ensure a taxpayer's nil rate band is utilised would meet Condition 1.

We believe that Condition 2(a) should be removed. Contrived or abnormal should only be relevant if linked with *the* tax advantage. In this regard, Condition 2(b) links contrived and abnormal with *a* tax advantage and we feel this should be changed to refer to *the* tax advantage (with a corresponding change in Condition 1). This would be consistent with the "Financial Products" hallmark.

While Condition 2(a) remains, it is easy to put forward scenarios where a statutory relief is available so providing a tax advantage as defined in s318 FA 2004, where the arrangement is contrived or abnormal, but where no link exists between the contrivance or abnormality and the tax advantage.

Presumably HMRC do not wish to receive such disclosures? Put another way, a transaction can be abnormal for many non-tax related reasons but be completely benign from a tax perspective. Condition 2(a) as drafted would make this disclosable when we actually think that the contrivance or abnormality with which HMRC is concerned with is that which produces a tax advantage.

36. The use of the word "contrived", while we understand how it has come to be included, is not appropriate in the context of IHT. "Contrived" can be construed to mean artificial or forced. This is an appropriate measure for hallmarks dealing with other taxes where a commercial reality normally underlies the transactions. However, in the case of IHT, it is not an appropriate measure; all transactions involving IHT are potentially contrived in the above sense.

37. The consultation document speaks of Gifts, Settlements and Reliefs at para 4.11 and gives brief examples of what would not be caught by Conditions 1 and 2. But there is no rationale given for *why* these examples are not considered to be contrived or abnormal. A gift to a trust must certainly be considered to be a contrived transaction in one sense of the word but HMRC obviously disagrees. Why? Against what is HMRC measuring the concept of contrived?

38. If this wording (i.e. "contrived or abnormal") is to be adopted then ideally it should be given some legislative colour. Failing this, it is imperative that comprehensive guidance is issued explaining how the term is to be construed along with details and examples of what HMRC consider to be an acceptable level of contrivance.

39. Returning to our opening point, we would just conclude by saying that it is now more important than ever that great care is given to the drafting of hallmarks. In light of the various other provisions which now turn on DOTAS (APN's, POTAS etc) there are potentially severe consequences for advisors arising from both incorrect disclosure and incorrect non-disclosure.

It is therefore imperative that the legislation is clear and targeted. Clearly drafted legislation will ensure a level playing field for all advisors and a consistency of application. Guidance can never be a substitute for good law.

Q19: Does the Schedule now cover the types of arrangements which could meet Conditions 1 and 2 but which should not be disclosed? Should other types of arrangements be included?

40. As a general point, the listing of excepted arrangements implies that other "non-listed" arrangements must, by definition, be within the hallmark. If carefully targeted law was adopted instead, then this "listing" of excepted arrangements would not be necessary.

41. The introduction to the section entitled Excepted Arrangements at 4.14 of the consultation document states that the excepted arrangements might otherwise be disclosable had they not been specifically excluded.

42. The first excepted arrangement is a loan trust. Whether the trustees invest in an insurance product or not cannot be relevant so the implication is that HMRC consider loans to trusts generally to be caught by Condition 2.

If we are correct in this regard, it is not clear why settling a trust (see 4.11 of the consultation document) is outside Condition 2 but lending to a trust is caught. Similar implications can be drawn from the remaining 3 arrangements; why are these arrangements more contrived or abnormal than settling a trust? They all involve basically the same concept: how equitable/beneficial interests to property are divided and arranged and it is not possible to detect any theme or objective measure at work which is useful in distinguishing one from the rest.

43. Evaluating the impact (in practice) of these draft Regulations is very difficult without knowing how HMRC construe or measure the concept of contrived or abnormal; the legislation itself is too widely drawn and subjective.

If a list of excepted arrangements is deemed necessary then, rather than giving specific excepted arrangements, perhaps a solution is to expand the list to be a white list of arrangements.

44. Turning specifically to the consultation question in light of the above, we consider that the list of excepted arrangements is inadequate; it is unclear why prominence should be given to investment based planning ideas, as distinct to making it clear that more commonly used planning arrangements are also excepted arrangements. For example it would be helpful to have confirmation that reorganising a group of closely held trading companies in order to benefit more fully from business property relief was also an excepted arrangement. Another example would be the use of a non-UK incorporated company by an individual who was not domiciled for UK inheritance tax purposes in order to change the situs of underlying UK property.

Q20: Do you agree that the revised approach of describing the type of excepted arrangements is preferable to one where the circumstances are more precisely defined? Are the descriptions sufficiently precise to ensure that the appropriate arrangements are included?

45. The reference to these various insurance related products is of itself fairly general. This suggests that it would be fairly straightforward to set out and describe in similar terms other commonly used planning techniques, rather than have to rely on DOTAS guidance which can be changed at short notice, and does not have the force of law. A wide ranging list of excepted arrangements would enable members to adopt a more focussed approach in identifying cases where disclosure is required, and would prevent HMRC receiving a large number of unwanted disclosures.

46. We would also reiterate that if carefully targeted law was adopted instead, then this "listing" of excepted arrangements would not be necessary.

Assessment of impacts

Q21: What impact is the proposed change likely to have on your business?

47. The impact on the business of members of the proposed inheritance tax DOTAS changes is potentially serious. Members will want to be compliant, but in the absence of targeted law or a comprehensive list of excepted arrangements they will necessarily spend more time than is really required to identify the type of cases that HMRC want to be disclosed to them. This expenditure of time represents a real business cost and an unnecessary administrative burden.

48. The effect will be particularly pronounced if there is any delay in issuing DOTAS guidance as has been the case following the recent introduction of the Financial Products Hallmark. This has led to confusion and uncertainty as to what is disclosable and in what circumstances. In particular, if reliance has to be based on guidance it should not be high level, but rather detailed and clear with as many examples as possible.

Q22: Are there any specific impacts on small and micro businesses that are not covered above? If so please provide details of the anticipated one-off and on-going costs and burdens.

49. See response to Q23.

Q23: Please tell us if you are think there any other impacts not covered

50. The potential impact of this legislation, as currently drafted, on smaller advisors is concerning. Unlike larger firms, they will not have the resources to deal with such a wide ranging hallmark nor the experience of working with the regime in practice.

51. We are concerned that the current wording could catch mainstream benign advice undertaken by small firms such as Will drafting and basic IHT/estate planning. With uncertain application this could lead to numerous unnecessary disclosures by concerned practitioners or, more

worryingly, inadvertent compliance failures. The penalties involved for non-disclosure could be punitive in this context.

In a worst case scenario, smaller advisors may consider pulling back from basic Will/estate work due to the risks involved.

52. If HMRC is to implement such a wide ranging hallmark it is imperative that the changes are communicated to these advisors especially in light of the financial penalties involved.

It is entirely possible, if not likely, that it will not occur to many small advisors that their activities could be with the scope of the Disclosure of Tax Avoidance Schemes legislation.

APPENDIX 1

ICAEW 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.

These are explained in more detail in our discussion document published in October 1999 as TAXGUIDE 4/99 (see via http://www.icaew.com/en/about-icaew/what-we-do/technical-releases/tax).