TAXREP 24/15 (ICAEW REPRESENTATION 49/15)

STRENGTHENING SANCTIONS FOR TAX AVOIDANCE

ICAEW welcomes the opportunity to comment on the consultation document *Strengthening sanctions for tax avoidance* published by HM Revenue & Customs on 30 January 2015.

This response of 12 March 2015 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.

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INTRODUCTION

1. We welcome the opportunity to comment on the consultation document *Strengthening sanctions for tax avoidance* published by HM Revenue & Customs on 30 January 2015

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

3. On 23 February 2015 we attended a meeting with HMRC in which we were able to discuss the proposals in the consultation document

GENERAL COMMENTS

4. We understand the public concern about aggressive tax avoidance and support the Government's efforts to tackle aggressive tax avoidance through the use of properly targeted legislation. We note the very considerable number of measures that have been put in place in recent years to clamp down on practices which the Government considers to be unacceptable. The Government's actions in this area were most recently set out in Reducing tax evasion and tax avoidance which was updated on 28 February 2015.

5. The current consultation sets out proposals for additional sanctions to target persistent tax avoiders who repeatedly use aggressive avoidance schemes in order to defer, reduce, or eliminate, tax liabilities. It is also suggested in the foreword that the time is right to consider an increase in the deterrent effect of the General Anti-Abuse Rule (GAAR) through the introduction of specific GAAR penalties. Our view is that this latter proposal is wholly premature when, as yet, not a single case has even been referred to the GAAR Panel: more time ought to be given to the new, and untested, FA 2013 and NICA 2014 GAAR regime before considering changes.

6. It is also worth remembering that the GAAR regime was only introduced after a long period of consultation. Graham Aaronson QC established a study group in late 2010 and reported its findings to Government in November 2011. At that stage the proposal was to introduce a General anti-avoidance rule. Following a period of further consultation, led by the Government, provisions were enacted in FA 2013.

7. We are concerned by the suggestion that the Government might seek to enhance such a recently introduced regime by the introduction of specific GAAR penalties. The GAAR regime has only been in existence for 18 months and the first tax returns, covering the period to 5 April 2014, would only have been lodged by the end of January 2015. Patrick Mears, the Chair of the Advisory Panel, reported in a press interview1in February 2015 that they had so far not looked at any cases and there were none in the pipeline as far as he was aware. It would, therefore, seem to be unreasonably premature to start tinkering with a new system before any cases exist or reliable statistics have become available that would enable that system's impact to be assessed on any reasonable basis.

8. We are concerned that adding a penalty regime at such an early stage when the GAAR currently remains untested is not necessary. The proposal suggests that the GAAR is considered to be ineffective, when the truth is we do not know on the evidence so far that this is the case. Indeed one measure of success of such a provision is that it does not have to be invoked because taxpayers change their behaviours. Put another way, its prime purpose is to act as a deterrent rather than be used. While we understand the need to address public concerns, we think it should be given time to bed down and an analysis made of its role in

[1] Accountancy Age 20 February 2015 see http://www.accountancyage.com/aa/interview/2395748/interview-gaar-is-ready-for-action-panel-chairman-mears-says

curbing unreasonable tax avoidance before any decisions are taken about whether its scope should be extended.

9. We respond below to the specific questions raised in the consultation document.

RESPONSES TO CONSULTATION QUESTIONS

New Measures for Serial Avoiders

Q1. What should be the starting point for identifying those who should be the subject of new legislative measures? Should it, for example, be based on the number of schemes used over a certain period or in any one period or are there other criteria that could be used?

10. Ideally any new measures should only target schemes that clearly have no commercial purpose but this would require a test which might be difficult to apply in practice. So we believe that some threshold condition relating to the number of schemes used by the taxpayer would be a more appropriate measure. We have set out some suggestions at the end of our answer to this question.

11. Most tax avoidance schemes have quite substantial 'entry costs'. Given this we are not aware that taxpayers would ever enter into multiple schemes with a view to sheltering a particular liability and intending to hedge their bets in case one or other of the schemes did not succeed.

12. Given the costs involved in using schemes, we should be interested to see the statistics, suitably anonymised, highlighting whether serial avoiders have in fact been using multiple schemes in the hope that one might work as intended. Similarly, we doubt that taxpayers experience frequent 'major life or commercial events' that lead them to seek to shelter tax liabilities as serial avoiders.

13. We therefore suggest that, to keep the deterrent simple, a serial avoider should be defined as any taxpayer who uses, more than once in a tax year or in any three (or perhaps five) tax years in succession, DOTAS-registered schemes of any kind and also only such schemes which have been found not to work. We believe that would be a fair and objective test which would allow HMRC to apply 'special measures'.

Q2. To what extent would a surcharge be a deterrent to taxpayers who repeatedly use tax avoidance schemes that are shown not to work?

14. A surcharge will act as a deterrent if the potential user of a scheme is aware of the surcharge, and has used a previous scheme that has failed with that failed scheme "counting" towards the surcharge trigger point, and the amount of the surcharge is more than insignificant. The introduction of the Accelerated Payments Notice (APN) regime in FA 2014 should address these concerns, since the economic benefit of such schemes should largely disappear with the need to pay the disputed tax up front. If the APN regime is effective and achieves its policy aim, then a surcharge should be unnecessary. We therefore believe the introduction of a surcharge to be premature.

15. Most avoidance schemes will have a Counsel's opinion to the effect that they work. That being so, if the scheme ultimately fails we would not normally expect that HMRC could levy a penalty for careless misstatement. If there was no penalty carelessness, we do not think it would be appropriate to levy a surcharge. If, however, there was any element of recklessness, then we could see that a surcharge might be appropriate.

Q3. Use of how many tax avoidance schemes, over what period, should trigger the surcharge?

16. We think the trigger should be the use of a number of schemes over a reasonable period of time, say 3 to 5 years. We also think that it should only be such schemes that have been found not to work.

Q4. What level of financial sanction would best deter the sorts of negative behaviour described here?

17. Users of tax schemes take a decision based on the balance between risks and reward. A financial sanction based on a percentage of the tax and/or NICs ostensibly saved would clearly increase the risk. Many scheme users will now be deterred by the FA 2014 APN regime, once HMRC rolls out the issue of notices on receipt of a return showing the use of a DOTAS–registered scheme, which should reduce the cash flow incentives of any such scheme. It should therefore need only a small surcharge to ensure that the risk of undertaking the scheme outweighs the potential rewards. Ultimately the precise level is a question for Government but given the introduction of the APN regime we think 5% might be about the right level.

Q5. Could subjecting a serial avoider to special measures, such as additional reporting requirements, conduct notices, or restricting access to reliefs be an effective and proportionate approach to encouraging less risky behaviour?

18. We are not convinced that it would be effective. We do not think it would be proportionate if HMRC is already collecting the tax and/or NICs via the APN regime. Enhanced monitoring of serial avoiders would surely be expected and should be happening now, whether or not there is a special regime? We are not at the moment convinced that it would be appropriate to restrict access to what would otherwise be legitimate reliefs while a serial avoider is in special measures.

Q6. What sort of special measures would best positively influence the behaviour of serial avoiders?

19. We remain to be convinced whether any special measures would have the desired effect in view of the impact of the enhanced DOTAS requirements and new APN regime. We have not yet seen any measurement of the impact of the APN rules on serial avoiders. They are, after all, the taxpayers most heavily affected by the new regime. It remains to be seen whether having to pay over alleged arrears of tax in respect of numerous schemes is successful in putting a stop to the serial use of schemes. We do not believe any special measures will be necessary once the cash flow difficulties caused by the receipt of multiple APNs have taken their toll on the attitude of past users.

Q7. What threshold conditions should trigger entry into special measures?

20. Of the threshold conditions set out we think the only one that would be appropriate would be the use of schemes sold by monitored promoters, as that is a situation where the taxpayer can reasonably be expected to know that his investment is regarded as tax avoidance.

Q8. What consequences should follow from failure to comply with special measures?

21. It would be appropriate to charge a penalty in cases where there has been a failure to comply with special measures, but only if the taxpayer has been careless, reckless or worse.

Q9. In particular, would the prospect of publicly naming serial avoiders be an effective and proportionate approach to encouraging behaviour change?

22. We can see that public shaming could be a deterrent and we imagine that many of the celebrities that found themselves in the public domain just over two years ago as a result of their use of tax avoidance schemes would now think very carefully about whether they are willing to risk the reputational consequences of entering into such schemes But any naming

regime needs to have very strong safeguards to ensure it does not fall foul of the Human Rights Act.

Q10. Should special measures be imposed for a set period of time or lifted only when the avoider has demonstrated objectively a change in behaviour?

23. We are not sure how it would be possible to demonstrate that an avoider has "objectively" changed their behaviour so imposing special measures for a set period of time would appear to be the only practical course of action.

Q11. What safeguards do you think would be necessary and proportionate to ensure the fair application of each of the proposed measures?

24. The key safeguard will be to ensure that any measures are properly targeted so that it will be possible to assess whether special measures are appropriate in the particular circumstances.. There will also need to be appropriate rights of appeal before such measures can be introduced.

Q12. The Government would welcome views on whether and how such a threshold condition might work, and in particular what proportion and/or how many adverse decisions should trigger the threshold condition.

25. We have some difficulty in understanding how such a threshold would work in any practical way, since there is a multitude of schemes, many of which are variations on a theme, but subtle differences can mean separate litigation in each case. It is not clear how, given the small number of cases decided by the tribunals and higher courts, more than one or two of a single promoter's schemes might be the subject of an adverse judicial decision. We do not think it would be appropriate to trigger the mooted threshold if a promoter has sold essentially the same scheme a number of times. But in order to take a view as to whether a promoter has consistently marketed schemes which overwhelmingly do not work would require many years and certainly a number of judgments from the Tribunals.

Penalties for the GAAR

26. See our opening remarks about the recent nature of the GAAR, the need to allow the new regime to bed down, and for there to be experience as to how it is working in practice, before any changes should be considered to the regime. There is no evidence that the GAAR is not working – indeed, DOTAS notifications appear to have virtually ceased, so it may well have succeeded in tipping the balance solidly against widespread avoidance.

Q13. To what extent would a GAAR penalty act as an effective deterrent?

27. We said above that is premature to start tinkering with the GAAR before any cases exist or reliable statistics have become available to enable that system's impact to be assessed on any reasonable basis. While the GAAR currently remains untested, the number of DOTAS disclosures appears to have reduced considerably, and we do not think that a case has been made for the inclusion of a penalty regime within the GAAR. The position could be reviewed again when there is more evidence available about the effectiveness of the GAAR.

Q14. Do you think an alternative sanction such as a surcharge might act as a more appropriate deterrent? What form might such a sanction take?

28. No.

Q15. Do you agree that it would not be appropriate to charge a penalty when a taxpayer has correctly included a GAAR adjustment on their return?

29. The question suggests a misunderstanding of how the GAAR works. In the circumstances posited, the taxpayer will not have obtained a tax advantage, there will have been no understatement of liability, and so the GAAR will not be in point. It is certainly the case that no penalty would be appropriate in such circumstances.

Q16. Should a GAAR-specific penalty apply when the GAAR applies, without exception?

30. We are not convinced that a GAAR specific penalty is appropriate but if such a penalty were to be introduced then it should only apply in cases where, for instance, the transaction is identical to one of the examples in the GAAR guidance .

Q17. Do you agree that submission of the taxpayer's return ought to be the trigger point for a specific GAAR penalty to become chargeable?

31. No. The earliest time that a penalty can realistically be imposed is when the GAAR Advisory Committee expresses its opinion that HMRC are entitled to counter the transaction. Arguably it should be delayed to a later date if the taxpayer has appealed the notice and, in such cases, it could be deferred until the court has ruled that the taxpayer has acted improperly

Q18. Are there any other points at which you think a GAAR penalty or other sanction could become chargeable?

32. See our answer to the previous question.

Q19. Should a GAAR-specific penalty be tax-geared? If so, what do you consider would be an appropriate rate of penalty?

33. Yes, any penalty should be tax geared. Carelessness discovered by HMRC normally means a penalty of15-30%, less any mitigation, with a floor of 15%. Serial users of tax avoidance schemes are not usually careless (if the implementation is wrong, then the GAAR is not in point and ordinary penalty considerations apply). So it would seem reasonable to impose a maximum penalty of say 10%. That should be enough to tip the balance against doing the scheme when the taxpayer has already had an APN and paid the tax.

Q20. If you consider that a fixed penalty would be more appropriate, why do you think this is? How much would you consider to be an appropriate fixed penalty?

34. We do not consider that a fixed penalty would be appropriate.

Q21. Should the normal penalty mitigation rules apply? Should it be possible to levy higher penalties according to taxpayer behaviour?

35. See our comments above.

Q22. Should it be possible to charge a GAAR penalty in addition to a penalty under Schedule 24 to the Finance Act 2007?

36. No. If the taxpayer has made a careless or deliberate misstatement on a return, the penalties charged deal with the back duty. There is unlikely to have been voluntary disclosure, so the minimum penalty will be 15% of the potential lost revenue. In contrast, a GAAR adjustment is unlikely to result from carelessness, as most promoters and users of complex schemes will usually have taken Counsel's opinion before proceeding. A GAAR adjustment is neither careless nor deliberate, but a result of a difference of interpretation. It would not be appropriate to charge both a GAAR penalty and a carelessness penalty.

Q22 Do you agree that existing rights of appeal would be appropriate for a GAAR penalty?

37. Yes.

Taxes Impact Assessment

Q24. Do you think either of these measures would impact disproportionately on those with protected characteristics (as defined under the Equality Act 2010)?

38. No response.

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).