



## TAX AVOIDANCE INVOLVING PROFIT FRAGMENTATION

Issued 8 June 2018

ICAEW welcomes the opportunity to respond to the *Tax avoidance involving profit fragmentation* consultation published by HM Treasury and HMRC on 10 April 2018.

This response of 8 June 2018 has been prepared on behalf of ICAEW by the Tax Faculty. Internationally recognised as a source of expertise, ICAEW Tax 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.

On 31 May 2018 we attended a meeting with HMRC in which we were able to put forward some key comments and concerns and discuss aspects of the call for evidence.

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## MAJOR POINTS

### Key point summary

1. We endorse and agree with the policy objective that UK tax and national insurance should be payable on profits arising from a trade or profession carried out by a UK resident and that a non UK resident should be taxable on profits arising from a trade or profession carried on in the UK.
2. It is unfortunate that, contrary to the Tax Consultation Framework, there was not a stage 1 consultation (setting out objectives and identifying options). If this had happened we think that this stage 2 consultation document would be far better and that generally the prospects for coherent legislative change would be far better.
3. We are very concerned about the timetable for this change. Including the consultation period of just eight weeks, the implementation date is from April 2019 and draft legislation has not been published as yet. The new timetable for introducing legislation incorporating the change to an Autumn budget appears to have been ignored, see Appendix 2. Given the interactions that there will be between this legislation and various other complex anti-avoidance legislation (see paragraph 6 below) this is a particular concern.
4. Our comments are based on the consultation document but many questions about the proposal remain. We are not entirely clear as to what the problem is since the examples in the consultation document are so extreme and seem to us to be evasion (see paragraph 11). We understand that the actual issue is not felt to be so extreme though and it would be helpful to have detailed examples of the actual problem causing concern.
5. In addition to the issue with the lack of detailed examples there is no draft legislation to review making it difficult to fully understand what is proposed. One area in particular that is not clear is the interaction with the settlement rules where trusts are involved.
6. We are concerned that this is an additional layer of legislation on top of:
  - transfer of assets abroad (ToAA);
  - controlled foreign company rules (CFC);
  - disguised remuneration;
  - close company gateway rules (see ICAEWrep 113/17 re close company gateway);
  - trading income through third parties; and
  - (as the ultimate backstop) general anti abuse rules (GAAR).
7. We appreciate that not all of the above apply in all the situations referred to in the consultation document. However, we wonder if it would be preferable to amend existing rules to achieve what is required rather than create a whole new set of rules. It seems to us that the trading income through parties legislation is particularly relevant and also a hybrid of ToAA and transfer pricing would cover much of the mischief HMRC wish to block.
8. It seems that the consultation document is suggesting that the existing rules/legislation will prevail if applicable and the new rules will be used as a backstop with the proposed notification being the keystone of these proposals as it will speed up the enquiry process. As such, the new rules will be more of an enforcement measure than a taxing measure. If that is the case why not only introduce a notification measure or rather than a new notification system just have a new hallmark under the existing Disclosure of Tax Avoidance Schemes (DOTAS) Regulations? This would avoid the need for complex legislation aimed at avoiding double taxation of the same income under the various sets of rules.
9. The current proposals will mean that most businesses will not be able to decide quickly and simply whether they are caught by the legislation and will most likely cause confusion.

10. The 80% trigger for the significantly less tax condition should be reduced significantly as we believe 80% would catch far too many innocent structures. Since the reasonableness test cannot be taken into account in deciding whether to report setting the tax condition too high will result in HMRC being flooded with notifications at a time when resource constraints would mean that this would be extremely unhelpful.

### General comments

11. Some of the examples quoted in the consultation appear to be outright evasion so adding additional legislation would make little difference to the people operating in that manner as they are already outside the rules and more robust action should be taken to deal with the offenders.
12. A right of reimbursement should be included in the provisions to allow the individual to be reimbursed for tax paid by them when the profits are held by a different entity without the reimbursement creating a further tax charge.
13. There have been problems in the past regarding ToAA not being EU compliant, are HMRC satisfied these new rules will be EU compliant? Setting the tax rate at a reasonable level (see paragraph 10) will be important in this connection. Other than this there is insufficient in the consultation document for us to comment sensibly and we will need to see the draft legislation.

## RESPONSES TO SPECIFIC QUESTIONS

### General approach

***Q1: The government would welcome any evidence and information about these and similar arrangements to assist it in designing legislation that is properly targeted and does not bear inappropriately on businesses that pay all the taxes due in the UK.***

14. The consultation document sets out a number of examples, some of which border on what we would consider to be fraudulent taxpayer behaviour or behaviour of a highly questionable nature. Bearing this in mind, we consider that a more effective way of dealing with these types of situations might be to enhance the resources of HMRC to investigate such cases. We consider that the existing legal framework provides HMRC with most of the powers required to do so. Increasing the level of resource for investigations will help catch and deter fraudulent activity.
15. The introduction of a notification test, or to avoid having to introduce a new system, an additional DOTAS hallmark would help identify cases where non fraudulent activity is involved.

***Q2: The government would welcome comments on whether any additional conditions are required to ensure that the suggested approach is effective and robust.***

16. We agree with the overall policy objectives of: (i) ensuring that taxpayers satisfy their fiscal obligations in full under the tax code; and (ii) deterring taxpayers from becoming involved in entirely artificial arrangements with no other purpose than the avoidance of their fiscal obligations. However, it is considered that the proposals do not provide a sufficiently coherent and integrated approach which will meet these policy objectives.

***Q3: Will the proposed conditions allow most businesses to decide quickly and simply whether or not they are caught by the legislation?***

17. We think that it is highly unlikely that the proposed conditions will allow most businesses to decide quickly and simply whether or not they come within the terms of the proposed provisions. Unless there are significant changes we consider that tax advisers will find

difficulty in advising their clients given the lack of clarity in the proposals and the uncertainty as to how the rules will fit into the overall statutory framework.

18. A drawback of the new proposals is that the provisions duplicate a number of existing statutory rules, and it is unclear as to how these overlaps will be dealt with. This pattern of introducing overlapping layers of legislative anti-avoidance is becoming increasingly common as the government seeks to reduce the tax gap.
19. Anti-avoidance legislation of this nature appears to be cast as a quick fix which does nothing to add to the clarity and coherence of the overall tax code. For example, HMRC already have wide ranging anti avoidance provisions under the ToAA provisions which it seems that the current proposals will mimic without necessarily including any of the ToAA statutory safeguards (it is unclear exactly how the “reasonableness” test will be framed and how close to a “motive defence” it will be). Although the ToAA rules are supposed to apply in priority to these new rules it appears that where one of the statutory defences apply under the ToAA rules and disapplies those charging provisions, the new charging rules could be ‘switched on’. Loose ends like this will only add to uncertainty rather than reduce it.

### Lower rate of tax

#### ***Q4: Will this test of a lower rate of tax be effective?***

20. We understand that the current proposal is that the trigger for bringing the new provisions into play is where the tax rate suffered on the alienated profits is 80% or less of the UK tax rate that would have been paid on the same profits. Setting the ‘trigger rate’ at this level is likely to be too high.
21. Businesses will want to be able to establish very quickly if they are potentially caught, so the trigger rate should be significantly less in order to provide sufficient margin for them to establish what the position is without having to undertake excessively detailed analysis.
22. Care will have to be taken to ensure that the behaviours of bona fide businesses are not changed, so that they avoid trading in jurisdictions where the tax rate involved might trigger what management might consider to be a potentially time consuming and unnecessary HMRC enquiry.
23. We are also concerned that setting the tax rate too high will result in unnecessary disclosures (since the reasonableness test cannot be taken into account at that stage) and drain HMRC resources unnecessarily.

#### ***Q5: Are there any alternatives which should be considered?***

24. We think that a better approach would be to put greater resource into HMRC’s investigative agencies, coupled possibly with enhanced powers to assess any potential tax leakage and administrative powers to bring tax disputes to a quicker resolution.

#### ***Q6: The government would welcome views on any genuine activities carried on in low tax territories which might require special consideration.***

25. Particular consideration should be given to the funds industry.

### Excessive profits and substance

#### ***Q7: Any comments on the excessive profits test would be welcome.***

26. We consider that the application of such a test should follow the same basic pattern as under the ToAA rules. Accordingly we consider that there should be a number of statutory safeguards and defences to ensure that the rules are applied in a uniform and fair manner.

### Power to enjoy

**Q8: Is the use of “power to enjoy” as a test the best way of addressing these schemes?**

27. The proposal appears to be basically the ToAA wording with the addition of connected person. As such, we do not see why a wholly new measure is required. See also the comments in the HMRC manuals covering IRC v Brackett [1986] STC 521 and attribution of profits to the UK. The mere fact that the proposed new rules mimic this approach suggests that there is no real justification for creating another set of anti-avoidance rules. It also suggests that it would be more effective to strengthen the existing rules and build upon the existing case law.

**Q9: Will the “power to enjoy” rules catch all likely targets?**

28. It is really unclear how these provisions will apply in practice. There is clear overlap between these proposals and the existing ToAA provisions. It would seem likely that in any notification under the new rules, will result in a tax charge under ToAA since under these rules we understand the ToAA rules are to have a priority where they apply (and we cannot see how they would not where this test is in point unless the “motive defence” is in point).

**Q10: Will they risk bringing in arrangements where no tax avoidance is involved?**

29. Depending on how the new rules are drafted there must be a risk that they will catch cases where no avoidance is involved. For example, it is possible that a structure might fall outside the operation of the ToAA rules under the statutory defences only to be targeted by the proposed rules. If this were to happen we think that such a result would bring the administration of the tax system into disrepute.

**Acting together****Q11: The government would welcome comments as to whether this connection test is appropriate.**

30. The proposals here are very unclear and it is uncertain as to what situations might be considered to be caught. There will be concern that HMRC will apply the proposed rule in an arbitrary manner. For this reason we suggest that a series of statutory safeguards are introduced. We consider that the onus of evidential proof should be placed on HMRC to establish that a connection existed based on the balance of probabilities.

**Procurer of arrangements****Q12: Will this connection rule bring in any arrangements where avoidance is not involved?**

31. Are commercial arrangements to be excluded? It is very unclear how the ‘procurer’ concept is to work in practice, and it is not possible to answer this question in greater detail from the limited detail we have in the consultation document.

**Q13: Do you have any other comments on this proposed rule?**

32. Its proposed operation, standards of proof and scope are all very unclear.

**Preventing double taxation****Q14: What potential double taxation should be taken into account in the legislation?**

33. Account should be taken of unilateral relief as well as relief via a tax treaty. This is particularly important given that the EU blacklist work may result in jurisdictions with which the UK does not currently have a tax treaty imposing minimum tax levels such that tax is suffered but this new legislation still applies.
34. Thought should also be given to providing UK tax relief in cases where a different person suffers tax on the profits in the jurisdiction outside of the UK.

35. There would also need to be provisions for dealing with interactions with the ToAA legislation and other anti-avoidance legislation so that the same profits are only taxed once. In theory the legislation would be drafted such that the same individual would not be taxed on profits under this new legislation if he or she is taxed on the profits under other anti-avoidance legislation. There should be a back stop provision which would cover: (i) any interactions not dealt with adequately in the specific provisions; and (ii) the position where a different taxpayer is taxed on the profits under the other anti-avoidance legislation should be included

***Q15: Any comments on interaction with other anti-avoidance legislation would be welcome.***

36. The potential scope for overlap with other anti-avoidance rules is huge, such as capital gains tax value shifting, close company gateway, disguised remuneration rules generally, income tax settlements, the offshore trust capital gains tax rules, general anti abuse rules (GAAR) and controlled foreign company rules (CFC).
37. We have had recent experience of working together with HMRC together with other professional bodies to identify overlaps in relation to the changes that have been made to the non-domicile tax rules. We believe that it has been the experience of all those involved that the potential overlap was much more extensive than anyone had originally envisaged. Here if anything the scope is even wider and should not be underestimated.

**Notification and payment of tax**

***Q16: The government would welcome comments on the features which should be included in the notification requirements.***

38. As mentioned above, we are concerned about new regimes, requirements and systems being introduced unnecessarily. Rather than introduce something new consideration could be given to introducing a new DOTAS hallmark.

***Q17: The government would welcome comments on these proposals for payment of tax for users of these arrangements.***

39. Rather than introduce a new regime it may be simpler and better understood if the existing advance payment notification was used.

***Q18: Are there any conditions in particular which might impose onerous reporting burdens on companies not involved in avoidance?***

40. Please see comments above.

**Alternative approach**

***Q19: Views would be welcome on whether there are alternative approaches to preventing the avoidance without affecting genuine commercial arrangements.***

41. As mentioned in the key points summary there was not a stage 1 consultation (setting out objectives and identifying options) and we are not entirely clear on the mischief HMRC is seeking to prevent as a result of these proposals.
42. We would prefer that these proposals were put back a year so there could be a stage 1 consultation and proper consideration could be given to how to address the HMRC issues.
43. Based on what we know to date, we think that the existing statutory rules should be strengthened and not superseded. New notification powers, and wider investigative powers could also be introduced as well as increasing the resources to HMRC to undertake investigations into unacceptable taxpayer behaviour.

**Other issues**

***Q20: Are there any other considerations that the government should take into account when considering the design of this legislation?***



44. See above.

### **Impact assessment**

#### ***Q21: Do you have any comments on the assessment of equality and other impacts?***

45. The Assessment of Impacts is provisional. We are not clear where the £50 million per annum comes from and are not clear that it can be supported. Given the businesses identified as being impacted by this legislation number 4,000 to 5,000 the £50 million seems particularly unlikely. Either one or both figures would seem to be incorrect.
46. We have particular concerns since we feel that if the existing legislation was applied there would be less need for changes to the current legislation than the consultation document implies..

## APPENDIX 1

### ICAEW TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM

The tax system should be:

- Statutory: tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.
- 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.
- Simple: the tax rules should aim to be simple, understandable and clear in their objectives.
- Easy to collect and to calculate: a person's tax liability should be easy to calculate and straightforward and cheap to collect.
- 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.
- 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.
- 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.
- 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.
- 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.
- 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 <https://goo.gl/x6UjJ5>).



## APPENDIX 2

### THE NEW BUDGET TIMETABLE IN PRACTICE

