Tax avoidance involving profit fragmentation

International Tax | OMB | Personal tax

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The ATT and CIOT have responded to a consultation on proposals to tackle avoidance schemes where profits of trades or professions are moved outside the charge to UK tax.

HMRC launched a consultation titled *Tax avoidance involving profit fragmentation* on 10 April 2018. This proposed that new legislation be introduced from April 2019 to tackle arrangements entered into by individuals, partnerships or companies that aim to place profits properly attributable to the UK outside the charge to UK tax.

The consultation identifies the following as being common features of such arrangements:

- UK profits being moved to offshore structures in low tax jurisdictions.
- The use of offshore entities that are supposedly performing or providing services, but have little or no substance.
- A business being carried on by an individual resident in the UK, with core services such as office space, IT and support staff located in the UK.
- Profit allocated offshore which is excessive having regard to the services carried out there.
- In order to tackle such arrangements, the consultation proposed a dual approach combining:
- Legislation which requires profits alienated under such arrangements to be added to UK profits for tax purposes.
- A requirement for taxpayers to notify schemes and make advance payment of any tax.

Whilst the ATT supports the aim of the consultation, it is concerned that the proposed approach is overly complex, and could potentially apply much more widely

if not carefully implemented.

In particular, the ATT notes that the proposals in the consultation appear to be very similar to the Diverted Profits Tax (DPT), but extended to individuals and SMEs. The difficulties currently faced by large international groups and their advisers in interpreting and applying the DPT rules will be even more pronounced for smaller companies and individuals, especially given that their in-house tax technical expertise and budget for external advice will be much lower than that of large groups.

In addition, one of the proposed conditions in the consultation (the excess profits condition) will effectively require a transfer pricing exercise to be undertaken, a complex and highly specialised exercise which may be completely unfamiliar to individuals and SMEs.

The ATT therefore believes that HMRC should consider alternative methods to achieve its aim. One possibility could be the introduction of a new hallmark into the Disclosure of Tax Avoidance Scheme (DOTAS) rules. This would deliver the desired notification mechanism and allow HMRC to seek advanced payment of disputed tax balances, without the need to build a new and complicated reporting and payment system.

If the proposals in the consultation are to be taken ahead, the ATT stresses that their scope needs to be very clearly defined, with adequate safeguards built in throughout. This should include:

- Incorporating a clear *motive test* which specifically states that the new rules will only apply where the main purpose, or one of the main purposes, of the arrangements is to ensure that there is a reduction in the overall UK tax liability.
- Notification only being required where it is believed that tax is due (the consultation currently proposes a wider test for notification).
- Clear guidance as to when, and under what circumstances, HMRC will be able to issue a charging notice to taxpayers under the new rules.
- Allowing taxpayers to appeal early on, and not only at the end of the charging process.
- The introduction of time limits for HMRC to issue charging notices and undertake a review.

The ATT response can be found on the ATT website.

Volunteers from the CIOT's Management of Taxes sub-committee attended a meeting with HMRC in May where we had a wide-ranging and very useful discussion on the proposals in this consultation document. It was apparent from our discussions that the major challenge in devising legislation would be in targeting it properly so that it does not adversely affect businesses which are not engaged in the sorts of arrangements that HMRC are seeking to tackle, including compliance costs which could be very large. Following the meeting, it was decided that the CIOT would not submit a written response as well.