Earlier warnings

Management of taxes



01 March 2015

Jon Preshaw considers the latest changes to the disclosure of tax avoidance schemes rules

Key Points

What is the issue?

HMRC are consulting on a range of proposals to amend the disclosure of tax avoidance scheme (DOTAS) rules

What does it mean for me?

The rules are being amended so that they operate alongside the accelerated payment notice (APN) regime. As a result, there are many more arrangements

where disclosure will now need to be considered and failure to comply with the rules are likely to be subject to more significant penalties

What can I take away?

It is likely that more situations will need to be considered for disclosure and the consequences of a failure to disclose will be more serious. Greater care will be needed in future to ensure that the rules are considered and complied with

Finance Bill 2015 includes a bundle of measures around the disclosure of tax avoidance schemes (DOTAS) rules for direct tax that were announced in the pre-Budget report. Other changes are expected to be made by secondary legislation later in the year. The proposed changes include minor amendments, such as increases in the existing penalties for non-compliance and modifications to ensure that employees of offshore promoters can be required to make disclosures. More fundamental changes include the introduction of a new hallmark, as well as potentially significant changes to the breadth of existing hallmarks. Fundamental changes to the disclosure regime for VAT are also under consideration but final proposals have not been formulated.

Background

The DOTAS regime was introduced in 2004 as a mechanism to provide HMRC with advance warning of tax avoidance arrangements. It has been a mark of the regime's success that, since its inception, it has captured not only its intended target, but also a wider range of situations where there is a potential tax advantage. The regime has been amended over time, with the two specific triggering 'filters' in the original regime being replaced by a larger number of 'hallmarks' in 2006; the imposition of additional reporting requirements (such as the provision of client lists) on promoters; and the extension of reporting obligations to introducers, as well as promoters.

'Promoters' includes those marketing tax avoidance schemes and anyone advising on the tax system, so the regime has always applied widely. Fundamentally, the regime is focused on the provision of information to HMRC; and the information provided by promoters enables HMRC to act quickly to challenge arrangements, either operationally or through legislation. The number of disclosures has halved every year since 2012, with the number of new disclosures under the main regime

down to 28 in the year to March 2014. The reduction in numbers is almost certainly a result of a reduction in activity, which HMRC would have wished to see at an early stage; and hence is an indication of the regime's success.

Disclosure is required where one or more of a number of hallmarks applies to the arrangements. Over time, new hallmarks have been added to expand the scope of the regime; the most recent hallmark specifically includes arrangements intended to circumvent the disguised remuneration rules at ITEPA 2003 Pt 7A. The application of all the hallmarks is not without uncertainty and there is limited precedent available to assist in the interpretation of the provisions.

The only case law dealing with the provisions (*Mercury Tax Group Ltd v HMRC* [2009] SpC 737) does little to reduce that uncertainty. As a result, it is frequently said that the operation of the DOTAS regime involves a high degree of cooperation from promoters.

FA 2014 altered the framework within which the DOTAS rules operate significantly.

Sections 219 onwards in FA 2014 introduce the accelerated payment notice (APN) rules, enabling HMRC to issue an APN where taxpayers have entered into arrangements that are discloseable under the DOTAS regime – a consequence that was not envisaged when the scheme was initially designed. Some of the proposed changes to the DOTAS regime reflect HMRC's recognition that there is a new downside for those using discloseable arrangements.

The other changes are largely targeted at expanding the scope of the regime and putting beyond doubt some of the arguments which HMRC believe might be raised by promoters seeking to establish that arrangements are not discloseable.

The changes fall into two broad categories: widening the application of the tests; and administrative changes.

Widening the application of the tests

A number of proposals are intended to ensure that the rules catch all of the arrangements about which HMRC would want to have early notice. Broadly, the proposals involve:

- the removal of ‘grandfathering’ provisions from the ‘standardised product’ hallmark;
- the imposition of additional criteria to the ‘standardised product’ hallmark;
- the re-introduction of a hallmark intended to apply where ‘financial products’ are involved;
- the widening of the ‘main purpose/benefit’ test in the ‘standardised product’;
- the widening of the proposed ‘financial product’ hallmark to ‘the main or one of the main purposes/benefits’; and
- a significant broadening of the regime as it applies to IHT. Presently, the requirement to disclose only arises where arrangements are intended to avoid entry charges in respect of relevant property trusts.

The difficulty in the regime having two purposes – as an ‘early warning’ system; and as a pre-condition for the issue of APNs – can be seen clearly in the first proposal above.

Broadly, the grandfathering provisions were intended to prevent promoters from having to disclose arrangements that HMRC were already aware of. At present, arrangements which fall into the standardised tax product hallmark, but which are the same or broadly the same as arrangements implemented before FA 2006, are exempted from disclosure.

This will change under the new proposals, so that many arrangements already well known to HMRC will need to be assessed as to whether they fall under the regime and may then need to be disclosed accordingly. This is likely to lead to an additional burden on HMRC. DOTAS numbers may be issued for arrangements widely considered unexceptional (even if those DOTAS numbers are subsequently withdrawn). Given that the consequence of receiving a DOTAS number now includes the potential receipt of an APN, clients and practitioners will be even more concerned about where they stand. They may prefer not to proceed with something that may be quite acceptable simply because of the uncertainty.

Administrative changes

A number of administrative measures are also included in the proposals, some of which are included in the draft Finance Bill and some of which will be incorporated in secondary legislation or guidance. The measures include:

- increasing the penalties for taxpayers who fail to report, or incorrectly report, a scheme registration number (SRN);
- introducing statutory protection for ‘whistleblowers’;
- changes to ensure that those associated with offshore promoters are included within the regime;
- a requirement to provide details of employees who are engaged in employment related schemes; and
- enabling HMRC to publish details of schemes and scheme promoters.

The intention to support the APN process can also be seen in the amendments to the penalty provisions. From a procedural perspective, the inclusion of an SRN on a return is the first step for HMRC in issuing an APN. The penalty provisions have therefore been amended. They will increase the downside for taxpayers if they delay the provision of information, in the hope of delaying the receipt of an APN. Currently, TMA 1970 s 98C imposes penalties on taxpayers who do not report an SRN to HMRC, and these are set at a relatively low level: £100 for the first failure; £500 for the second; and £1,000 for the third. Under the proposals, s 98C will be amended to increase these penalties significantly to £5,000, £7,500 and £10,000 respectively.

The penalties are fixed and are therefore not capable of mitigation. Although a reasonable excuse defence is available, it is hard to see the circumstances in practice in which this might apply. As a result, there is a risk that taxpayers may be subject to high penalties for minor failures (such as entering SRN details in the wrong part of their tax return).

Conclusion

Broadly, the new regime is designed to deal with the diminishing number of taxpayers entering into marketed avoidance schemes and to remove any cashflow advantage from delaying settlement of a tax liability, should it arise. However, once the requirement to disclose is triggered under a hallmark (some of which are quite wide and/or formulaic in approach) and a DOTAS number is issued, the regime can impact any taxpayer.

The new proposals will therefore increase the obligations on all practitioners that are providing tax advice and may cause concern to clients carrying out what they may genuinely believe is acceptable planning. There will also be an increased burden on HMRC. Given the consequences of the issue of a DOTAS number, it will be important that HMRC make resource available to consider the disclosures that are made, and

that they only bring arrangements within the DOTAS regime where they would reasonably expect to wish to issue an APN. These situations are likely to be a tiny proportion of the many commercial activities with tax consequences which will nevertheless need to be assessed for compliance.