A harsher environment

Management of taxes



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Helen Adams and *Rebecca Hartley* consider HM Revenue & Customs' ongoing steps in tackling tax avoidance and the forthcoming Serial Tax Avoidance legislation

Key Points

What is the issue?

HMRC continues to tackle tax avoidance in many ways including court challenges, accelerated payment notices, follower notices and penalties. More measures are included in the current Finance Act 2016 and a recent consultation.

What does it mean to me?

Clients who participated in avoidance arrangements in previous years who are yet to finalise their position will need advice on how the Serial Tax Avoidance legislation may affect them so that can make an informed choice on what to do before 5 April 2017.

What can I take away?

HMRC will continue using all its powers to encourage taxpayers to withdraw from arrangements and deter future participation so taxpayers will need bespoke advice to understand what to expect next and what action to take at every stage.

HMRC and the Treasury continue to take action against tax avoidance arrangements (TAAs) as political and public opinion hardens against aggressive TAAs. HMRC is taking a tougher stance on tackling TAAs which it perceives do not achieve their original tax-saving aims whilst also taking action to penalise some taxpayers who used failed arrangements as well as deterring taxpayers from entering into new TAAs. Two years after legislation introduced accelerated payment notices and follower notices, how is HMRC continuing to tackle avoidance and what might affect taxpayers in future?

How HMRC tackles tax avoidance

HMRC stepped up its efforts in tackling tax avoidance after the 2008/09 financial crisis. The principal methods are:

- Publishing Spotlights on gov.uk describing TAAs which HMRC perceives do not achieve their tax-saving aims with the intention of deterring use of these arrangements. However, only a minority of TAAs appear in the 32 published Spotlights. HMRC will challenge TAAs regardless of whether they feature in Spotlights;
- Investigating TAA-related entries on tax returns using information and discovery powers, self-assessment enquiries and Code of Practice 8 investigations. HMRC occasionally uses suspected serious fraud investigations (COP9) or criminal investigations if it believes fraud occurred during the TAA's implementation;
- Offering settlement opportunities encouraging taxpayers to exit on pre-determined terms before a fixed deadline;
- Issuing Accelerated Payment Notices (APNs) and Follower Notices (FNs);
- Sending 'nudge letters' to scheme participants. These tactically use phrases informed by behavioural psychology to 'nudge' clients into voluntarily withdrawing from TAAs. Such letters may, for example, point out the extent of

HMRC's successful challenges of TAAs or draw the reader's attention to what the government could spend the tax on if they paid it;

- Taking cases to the tax tribunals and higher courts to challenge TAAs. HMRC wins over 75% of such cases, although its Litigation and Settlement Strategy means that HMRC tends to only take cases that it perceives it has more than 50% chance of winning. HMRC regularly publishes news stories on gov.uk and frequently publicises its successes in the national press to encourage taxpayers to voluntarily withdraw from arrangements and to deter future participation;
- Imposing penalties for errors under FA 2007 Sch 24 on some users of TAAs which failed following implementation issues;
- Changing tax legislation. HMRC introduced the general anti-abuse rule (GAAR) and the Promoters of Tax Avoidance Scheme legislation. According to its 2015/16 Annual Report and Accounts, HMRC began issuing conduct notices to promoters requiring 'them to change their behaviour or, among other things, face closer scrutiny from HMRC'. Few formal notices have been issued 'as promoters have been responding positively and changing their behaviour in advance of formal action'. Finance Act 2016 includes measures targeted at enablers of offshore non-compliance, Serial Tax Avoidance and the GAAR penalty. In August 2016 HMRC consulted on:
    - penalties for enablers of defeated tax avoidance; and
    - making it more difficult for TAAs' users to avoid being charged penalties for errors after a TAA is defeated through making 'reasonable care' a higher standard for taxpayers to achieve.

Accelerated Payment Notices and Follower Notices

Finance Act 2014, Part 4 empowers HMRC to issue APNs to taxpayers who participated in TAAs which are subject to an enquiry or ongoing appeal if certain conditions are met. APNs enable HMRC to collect tax which would otherwise not be paid pending resolution of an enquiry or appeal. APNs were covered in more detail in Anton Lane's article, 'What lies beneath' in the September 2016 issue of *Tax Adviser* .

Its 2015/16 Annual Report and Accounts confirmed that HMRC issued 36,000 APNs in 2015/16, bringing the total to 46,000 since the start of the regime in 2014. By the

end of this year HMRC expects to issue a further 24,000 notices to individuals and businesses involved in TAAs currently under dispute. The APNs issued in 2015/16 charged £3.1 billion in tax, bringing the total tax charged by APNs to £4.8 billion. HMRC received £2.1 billion worth of payments as a consequence of APNs. The amounts payable within 90 days of the APN are often significant, so some taxpayers need to agree time to pay arrangements with HMRC in order to prevent additional penalties being imposed.

Taxpayers may make representations to HMRC against APNs if they consider that the amount of tax is incorrect or the conditions for the APN's issue are not met. HMRC decided 8,500 of the 15,000 representations made by 5 April 2016, confirming 89% of the APNs mostly without change. Taxpayers also challenged APNs and partner payment notices via Judicial Review with limited success, resulting in APN refunds because the TAA was not notifiable under DOTAS, although some decisions are under appeal.

HMRC also issued 282 FNs with respect to more than £200 million tax. FNs are still very much in their infancy as they can only be issued following final court decisions on similar TAAs. More FNs are expected in the next few years as more cases finish their transit through the courts. Penalties for not complying with a FN are up to 50% of the tax 'advantage'. HMRC issued £1.4 million of FN penalties in 2015/16. FNs are designed to resolve all similar avoidance cases after a final, relevant ruling is issued as they compel taxpayers to amend their returns to remove the defeated TAA. Consequently, HMRC is expected to issue FNs whenever possible in future in order to efficiently bring all affected taxpayer's cases to a close simultaneously, although it will also continue using enquiry closure notices in some cases. Whilst taxpayers may make representations to HMRC against FNs and lodge appeals against FN penalties it is unclear whether any have been made to date.

Penalties for errors

HMRC can charge taxpayers penalties for submitting incorrect returns, such as those containing entries reducing tax liabilities as a consequence of using TAAs which are subsequently defeated in the Courts or from which taxpayers voluntarily withdraw (e.g. via contract settlements). Principally, penalties of up to 100% of the tax are imposed via FA 2007, Sch 24 or its predecessor TMA 1970, s95 if a taxpayer was careless/negligent or deliberately submitted incorrect returns. So far three cases

have been heard by the First-tier Tribunal (FTT) regarding such penalties.

In *BP Litman & A Newall v Commissioners for HMRC* [2014] UKFTT 089 (TC03229), the taxpayers relied on the promoter for tax advice and for the entries to be included on their tax returns. However, whilst it was reasonable for them not to understand the technical aspects of the TAA or the order in which steps were meant to happen, the FTT concluded that the taxpayers were negligent so penalties were charged because they did not check that the TAA's steps had happened before submitting their tax returns. It was within their ability to identify that a loan (one of the steps) had not been advanced.

In contrast, the director in *Herefordshire Property Company Ltd v Commissioners for HMRC* [2015] UKFTT 79 (TC04286) persuaded the FTT that he took reasonable care when submitting the company's return, despite participating in the same scheme as Litman, so no penalties were due. He showed that he had no reason to doubt his advisers' abilities as the promoter's previous scheme had not failed by the time this scheme was being implemented and put on the tax return. He explained the thought process he used at various points in order to satisfy himself that the scheme was properly implemented prior to submitting the return and drew parallels between it and how he made decisions for the company's normal business activities. A further comparison of these two cases is available in 'A Penalty Puzzle' (Tax Adviser, May 2015).

In the most recent case, *Anthony Bayliss v Commissioners for HMRC* [2016] UKFTT 500 (TC05251), Mr Bayliss participated in a Contracts for Differences (CFD) TAA. HMRC imposed penalties as it considered he fraudulently filed incorrect returns. The FTT decided that the taxpayer had 'an honest belief that his tax return was correct' so he did not fraudulently file an incorrect return. He acted reasonably diligently, consulted advisers who he believed had the necessary expertise and relied on their assurances that the TAA was legal. Whilst he did not retain copies of all documents, obtain independent financial advice or do checks on the chronology of documents, this and the uncommercial loan terms and CFD transaction were insufficient to demonstrate negligence. All steps of the TAA occurred so there were no implementation issues and HMRC failed to link the negligence to the 'error' in the tax return so no penalty was due.

Serial tax avoidance

The current Finance Act includes the Serial Tax Avoidance (STA) legislation. The STA regime applies if a taxpayer participates in one or more TAAs which are ‘defeated’ after 5 April 2017. HMRC will issue a warning notice to the taxpayer within 90 days of a ‘relevant defeat’, which broadly occurs when:

- A GAAR counteraction notice becomes final;
- A follower notice is complied with or becomes final; or
- DOTAS (or the VAT equivalent) arrangements are counteracted e.g. via an assessment or contract settlement (such as one reached via a settlement opportunity).

A five year ‘warning period’ starts from the day after the warning notice is issued, although it is extended if the taxpayer suffers another relevant defeat. Information notices must be submitted to HMRC annually by the taxpayer during the warning period. These annual information notices (AIN) give HMRC details of TAAs the taxpayer used during the year. Late submission of an AIN and submission of an incorrect AIN will both result in the warning period being extended to finish five years after this failure. Special rules will apply for corporate groups, associated persons and partnerships.

The STA legislation imposes consequences if a taxpayer uses three TAAs during a warning period which HMRC subsequently defeats:

1. The imposition of STA penalties;
2. Restriction of tax reliefs; and
3. Publishing of taxpayers’ details.

Finance Act 2016, Schedule 18, Para 55 broadly defines ‘use’ as occurring on submission of a tax return or claim containing entries relating to the TAA.

STA Penalties

The STA penalty will start at 20% of the value of the ‘counteracted advantage’ (i.e. the tax which was meant to be saved by undertaking the TAA) if this is the only TAA used in the warning period and defeated. The penalty increases to 40% and 60% for the second and third (or more) defeats, respectively. No penalty will be charged if the taxpayer has a reasonable excuse. However, ‘reasonable excuse’ will not include relying on an adviser if the advice was addressed to or was given to another person or if it takes no account of the taxpayer’s circumstances.

Restriction of tax reliefs

HMRC will issue a Restriction of Relief Notice (RRN) if a person is given three warning notices in the same warning period and the notices relate to the misuse of a relief of a particular type, unless the person has a reasonable excuse. After an RRN is issued the person cannot claim the relief for three years. This period will increase if a Restricted Period Extension Notice (RPEN) is issued following another 'relevant defeat' in the restricted period. It is possible to appeal against RRNs and RPENs if the grounds for their issue are not met. HMRC will have discretion to mitigate the restriction of reliefs 'if it would otherwise have an unduly serious impact' on the taxpayer's or a third party's tax affairs (para 23).

Publishing of taxpayers' details

This will operate in a similar way to the publishing deliberate defaulters' details (FA 2009, s94). Whilst HMRC must notify the person about the proposed publishing and give an opportunity for them to make representations, there is no formal right of appeal. The information published will include the taxpayer's name, address, the amount of the tax and the STA penalty.

STA is partially retrospective

The legislation confirms that taxpayers who participated in TAAs prior to Royal Assent and from which they are yet to withdraw will escape the regime if, before 6 April 2017, they:

- Reach an agreement with HMRC to exit the TAA; or
- Notify HMRC of their firm intention to withdraw from the TAA and settle with HMRC; or
- Fully disclose to HMRC the matters to which the 'relevant counteraction' relates.

It is expected that HMRC will issue guidance as to how taxpayers can notify their intention to withdraw and what HMRC expects in terms of a full disclosure. Taxpayers who don't take one of these steps before 6 April 2017 will be issued with a warning notice if the TAA is defeated after 5 April 2017.

Summary

Overall, HMRC continues using many methods to tackle TAAs with the aim of encouraging taxpayers to withdraw from TAAs as well as deterring future participation. Once HMRC’s guidance on the STA is released, taxpayers will need advice on how STA will affect them so that they can consider their position and take appropriate steps.