Draft FB 2017 Cl 91: Errors in taxpayers' documents (penalties for users of defeated avoidance)

Management of taxes

30 March 2017

The CIOT's view is that the draft legislation goes much further than the policy intention.

In the February edition of Technical Newsdesk CIOT set out its initial views on the draft legislation in clause 91 which will amend FA 2007 Sch 24 (penalties for errors) in cases where a person has received 'disqualified' advice in relation to certain tax avoidance 'arrangements' (as defined).

Where a person receives disqualified advice in such circumstances, they will not be able to rely on that advice to demonstrate they have taken reasonable care to avoid an inaccuracy arising from their use of such arrangements. Additionally, the clause reverses the burden of proof in such circumstances so that it is to be presumed that the inaccuracy was careless unless the taxpayer satisfies HMRC (or a Tribunal on appeal) that they took reasonable care.

The draft legislation follows a consultation document 'Strengthening Tax Avoidance Sanctions and Deterrents: A discussion document' issued on 17 August 2016, which also included consultation on penalties for enablers of tax avoidance which is defeated. HMRC's response document issued on 5 December 2016 referred to modifying the existing penalty regime for users of tax avoidance, 'so that penalties are chargeable when complex tax avoidance arrangements are defeated'. HMRC state in the explanatory notes to the draft legislation that the aim of the clause is to act as a disincentive to entering into tax avoidance.

The legislation as drafted goes much further than the policy intention of acting as a disincentive to entering tax avoidance. In our view, left unchanged, it will apply to

many cases which we do not think are within the policy intention.

We have met with HMRC to discuss the proposals and following these discussions we have submitted comments to HMRC. We suggest in our submission some wording to ensure that clause 91 applies only to those arrangements within the policy intention. Our submission can be found on the CIOT website.

Tax avoidance 'arrangements' are widely defined in draft paragraph 3B(2) in terms of a 'main purpose' test, so arrangements that this definition will apply to will include any arrangements where the main (or one of the main) purposes of entering into the arrangements was the obtaining of a 'tax advantage'. Tax advantage is of course a much broader concept than tax avoidance. Accordingly, as defined, clause 91 will apply to arrangements where a taxpayer has used a statutory incentive or relief but, for whatever reason unconnected with tax avoidance, the arrangements did not work as intended.

Similarly, Condition E in draft paragraph 3B(4)(e), which extends the proposals to arrangements which concern an 'avoidance-related rule', is also very broad and will apply in what we would describe as normal commercial tax planning arrangements which are in no sense 'tax avoidance'. Commercial transactions very often have to consider the application of an avoidance-related rule which can in many instances be very uncertain.

As a potential solution to the above difficulties, we suggest in our submission that an additional clause be inserted to limit the breadth of the proposals to within the policy intention. We suggest this should introduce an objective test to determine whether the particular arrangements have failed because they are avoidance or for some other reason. If they have failed for a non-avoidance reason (and would not have been regarded as avoidance if they had been properly implemented) they should fall outside of the new penalty rules. We think the building blocks for achieving this may be along the lines of dis-applying the new rules if the tax advantage sought is one that a reasonable person would think was not within the target of the policy intention. There may also need to be a link with the intention of the person entering into the arrangements.

We have also said that HMRC need to put a good communications strategy in place to inform taxpayers about these changes. Taxpayers need to understand at the time they are considering entering into complex tax avoidance arrangements what they

will need to do to demonstrate they have taken reasonable care in the event that the arrangements are defeated. If an upfront communications policy has the effect of reducing the demand for tax avoidance schemes, then it will have also helped meet the policy objective of the legislation.

LITRG has also raised concerns about the draft clause

LITRG's response has raised concerns with the provisions and suggested some possible revisions to the draft legislation, with the aim of ensuring it is targeted more appropriately. In particular, LITRG is concerned that the provisions are drawn far too widely and that they may unintentionally catch unrepresented taxpayers, who have not engaged in the type of tax avoidance that HMRC intend to target.

LITRG is strongly opposed to and does not agree with the proposal to reverse the burden of proof. This will become particularly difficult for taxpayers to do, as the provisions also restrict the type of advice on which the taxpayer can rely to prove they took reasonable care.

LITRG is also hugely concerned that the provisions place an insurmountable burden on unrepresented taxpayers, who: may enter into arrangements without fully understanding that they are caught; may not appreciate the need to obtain specific advice, or indeed be able to afford advice; and may not be able to judge whether or not an adviser has the appropriate legal or tax expertise to advise on the arrangements.

The LITRG response is available on the LITRG website.